ICELANDAIR GROUP

Annual Report 2013

Key Figures

USD thousand	2013	2012	2011	2010	2009
Operating results					
Total income	1,022,957	898,866	790,653	717,904	655,147
EBITDAR	189,870	165,772	144,788	173,361	142,210
EBITDA	143,710	109,646	84,935	102,594	66,354
EBIT	73,011	50,787	38,622	51,011	12,096
EBT continuing operations	71,048	57,448	28,548	53,638	−36,452
Net profit / loss	56,418	44,275	36,310	37,162	−86,990
Balance sheet					
Total assets	832,875	762,895	729,739	687,104	726,786
Total equity	346,082	295,932	263,385	231,672	119,127
Interest bearing debt	122,017	150,906	196,868	200,685	351,843
Net interest bearing debt	−77,476	18,112	90,179	94,698	336,272
Cash flow					
Net cash from operating activities	230,874	166,743	117,341	127,838	71,623
Net cash used in investing activities	−113,223	-76,476	-106,175	−44,959	−63,613
Net cash used in financing activities	−45,232	-51,453	-27,602	−400	−26,778
Cash and cash equivalents end of year	191,538	117,060	79,405	95,334	15,571
Key Ratios					
Earnings per share in US Cent per share	1.13	0.89	0.73	2.50	−8.92
Intrinsic value	8.52	7.29	6.49	5.71	14.98
Equity ratio	42%	39%	36%	34%	16%
Current ratio	0.94	0.94	0.91	1.16	0.58
Capex USD thousand	114,240	95,874	125,008	40,905	48,303
Tranport revenue as % of total revenues	69%	67%	64%	61%	59%
EBITDAR ratio	18.6%	18.4%	18.3%	24.1%	21.7%
EBITDA ratio	14.0%	12.2%	10.7%	14.3%	10.1%

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About the Annual Report
In Icelandair Group's annual report for 2013 we offer you a glimpse into the breathtaking nature Iceland has to offer, as caputured by the photograper Marinó Thorlacius.
Come and be inspired by Iceland. ■

Design: Íslenska
Photos by Marinó Thorlacius
Printing: Oddi ehf.

01 **ÞORLÁKSHÖFN | 63.8534°N, 21.3632°W**
A rainy day is a magical backdrop for surfing at sunbreak.

Iceland.
An island in the middle of the Atlantic Ocean.
Rich of breathtaking nature, society and culture.
Icelandair Group is a part of this society.
Every day we contribute to that society by creating value.
Our business, our passion is the tourism industry.

Our Vision

To unlock Iceland's potential as a year-round destination, to strengthen Iceland's position as a connecting hub and to maintain our focus on flexibility and experience

Letter from the Chairman of the Board of Directors

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

Throughout our history we have welcomed increased competition and found ways to leverage our flexibility and experience to find new and profitable opportunities for expansion. Our unwavering dedication to excellence has stood the test of time and will continue to do so and support our commitment to connecting Iceland with the world.

Fellow shareholders

Last year, 2013, was yet another favorable year for Icelandair Group. We continued to expand our profitable operations, both through our Route Network and through our drive to establish Iceland as a year-round destination. From 2009 we have remained focused on our core strengths and leveraged our geographical position between Europe and North-America to extend both our Route Network and our domestic footprint. We have continued to enlarge our international fleet and at the same time we have streamlined our operations, which has resulted in a 56% growth in revenue and a 117% increase in EBITDA since 2009. The keyword has been profitable organic growth and that keyword will continue to drive our expansion in 2014 and onwards.

Icelandair Group is an operating company engaging in diverse flight and tourist services. Through our subsidiaries, we hold a strong position across the value chain in international aviation and leasing, in domestic air travel, in the hotel market and in other areas of tourist services. Our interests are interlinked with the success of Iceland as a tourist destination and we take pride in our sustained campaign to promote Iceland abroad as a year-round destination.

In 2013 Icelandair Group's EBITDA amounted to USD 143.7 million and net profit before taxes amounted to USD 71.0 million, up by 24% between years. The financial position of Icelandair Group has gone from strength to strength with the Company's equity ratio at 42% and net interest-bearing debt reduced by USD 95.6 million over the year to a year-end negative figure of USD 77.5 million.

Our shareholder base has continued to expand and the number of shareholders was 1,833 at year end, including Iceland's largest pension funds. The number of shareholders increased by 26% in 2013. The Company's share price more than doubled in 2013 and its market capitalisation increased from ISK 41.0 billion to ISK 91.0 billion over the course of the year.

The strong operating results paved the way for a third consecutive year of dividend payments. The Board of Directors has proposed a dividend payment of USD 18.6 million to shareholders in 2014. Since the Board of Directors approved the dividend policy of Icelandair Group the Company has returned USD 36.7 million to its shareholders since 2011.

As before, the Board of Directors remains grateful to shareholders for their support; we value their commitment to the Company.

Commitment to connect Iceland

Our business efforts are firmly founded in the Icelandair Group vision statement and backed by our strong cash position. Our vision is to unlock Iceland's potential as a year-round destination, to strengthen Iceland's position as a connecting hub and to maintain our focus on flexibility and experience, the qualities that have taken us where we are now.

Our international Route Network is the heart of our operations and has proven its value time and again since 1987, facilitating connections between Europe and North-America through our hub at Keflavik Airport. We have systematically increased both the depth and breadth of the Route Network, which now connects 13 cities in North-America with 25 cities in Europe. The increased frequency has enabled us to strengthen our market position on both sides of the Atlantic.

It is worth noting that in 2014 Icelandair will have more than 80 weekly flights to North America from Iceland. This is a significant figure in comparison with all the other major Scandinavian hubs. The right mix of number of destinations and increased frequency has allowed the

Company to strengthen its foothold in the VIA market between Europe and North America, which we will serve with 21 aircraft in 2014. Our cargo business has been successfully restructured and its operations are now profitable. The number of charter flights carrying freight was systematically reduced, as two chartered aircraft were returned, bringing the current cargo fleet down to three aircraft. The key emphasis is now on carrying freight to and from Iceland both on our own freighters and in the holds of Icelandair's passenger aircraft.

By expanding the Route Network we have unleashed the potential of year-round tourism in Iceland. The numbers speak for themselves, as the number of tourists to Iceland has grown by around 70% since 2009. The growth has benefitted all domestic tourist services and given our companies opportunities for profitable growth.

This growth has not gone unnoticed, as 16 airlines included Iceland among their destinations last summer and we expect the competition to continue to intensify, most dramatically over the peak summer season. However, we have remained true to our dedication to reducing the seasonal fluctuations in our operations by expanding our operations relatively more over the low season. Our increase in Available Seat Kilometers (ASK) over the summer season in 2013 registered at 14% whereas the shoulder season and the low season saw an increase of around 18% in ASK.

Dedication to Iceland lies at the heart of our business model, and this dedication has been instrumental in making tourism the driving force of the Icelandic economy as its largest export sector. We take pride in actively building up Iceland as a world-class destination. Supporting tourism growth in Iceland is good business – and continuing to create sustainable shareholder value remains at the centre of our organic expansion strategy.

Opportunities ahead

Recent reports from IATA suggest that airline operators are generally anticipating improved profitability in 2014. With average fares and costs expected to remain stable over the year, demand is expected to grow gradually in both the passenger and freight markets. Icelandair Group has plans for continued expansion in 2014 with the number of the Company's passengers on international flights in 2014 projected at 2.6 million, as compared to 2.3 million in 2013. With the addition of three aircraft to our fleet we will serve our markets with 21 Boeing 757s and the Company is well positioned for profitable growth in our three core markets formed by the TO-FROM-VIA segments.

The introduction of a new fleet, with the first deliveries of Boeing 737 MAX aircraft scheduled in 2018, will create further opportunities for the Company. A mixed fleet of Boeing 757s and Boeing 737 MAX aircraft suits our Route Network, reaching both Europe and North America. The new aircraft will be a great addition to the fleet and increase both flexibility and capacity for growth through added frequency and new destinations.

Continued development of Keflavik Airport is vital to support Icelandair Group's ambitious future goals. Investment in aviation and tourism infrastructure needs to become a higher priority going forward, as tourism is rapidly becoming the most important pillar of the Icelandic economy, if it has not already achieved that status. Further investment is a requisite for sustainable growth, and Icelandair Group has increasingly focused its efforts on securing the expansion of its infrastructure.

Onwards, higher

These are exciting times. Our shareholders supported the Company in the challenging period in the aftermath of the international banking crisis and have continued to do so through our profitable expansion since 2009. With its strong balance sheet and sound cash flow Icelandair Group is well positioned to capitalise on growth opportunities, both in the Route Network and tourist services in general.

We believe that re-evaluating our strategy on a regular basis is a sign of strength. In 2013 the Group underwent an extensive strategic review process focused on positioning Icelandair Group so as to enable the Company to take the best possible advantage of future opportunities. We commissioned the Boston Consulting Group to assist us in the process to obtain an outside perspective of the way we conduct our business and how we can best prepare ourselves for future challenges. As a result of this process we have sharpened our future vision and lined up a series of business initiatives that will further strengthen our foundation for future growth.

Throughout our history we have welcomed increased competition and found ways to leverage our flexibility and experience to find new and profitable opportunities for expansion. Our unwavering dedication to excellence has stood the test of time and will continue to do so and support our commitment to connecting Iceland with the world.

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. ■

Letter from the President and CEO

BJÖRGÓLFUR JÓHANNSSON
PRESIDENT AND CEO
OF ICELANDAIR GROUP HF.

Our focus is fixed on the clear objective of delivering sustainable shareholder value throughout the business cycle. We are proud of our Company's success and it is our firm intention to do even better next year for the benefit of all of our stakeholders.

Fellow shareholders

Following the celebration of its 75th Anniversary in 2012, Icelandair Group continued its profitable operations in 2013 and returned a good financial result. The year was yet another year of continued organic growth. We continued to streamline our operations while at the same time investing in our infrastructure as a platform for continued growth. While we anticipate continued and increasing competitive pressure, we are confident that our Company, with its unique business model, is well placed to continue onward and upward in the challenging terrain that lies ahead.

Our focus is fixed on the clear objective of delivering sustainable shareholder value throughout the business cycle. We are proud of our Company's success and it is our firm intention to do even better next year for the benefit of all of our stakeholders. In all our endeavors we attempt to identify the optimum 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 with the aim of providing continually improved services at a proportionally reduced cost for the satisfaction of our customers and in the interests of our shareholders.

We have gone to great lengths in constantly re-evaluating the way we do business to sustain a steady process of improving our operations. Even though we currently have the wind in our back, and even though we can take pleasure in looking over our shoulder at the success we have achieved, it is a sign of our strength that our sights remain firmly on the mission ahead. The rapid growth of recent years has tested the Company's infrastructure, but it has also made that infrastructure stronger than ever before. A number of factors contributed to Icelandair Group's success in 2013: external conditions were largely favourable, tourism in Iceland increased and passenger numbers grew, but, most importantly, our strong team of employees possessed the ingenuity, dedication and stamina to take full advantage of an improved environment which in many ways was of their own making.

Strong financial result

The Company's performance in 2013 was strong and considerably better than projected in the Company's budget at the beginning of the year. Profit before taxes amounted to USD 71.0 million, up by USD 13.6 million between years and net profit amounted to USD 56.4 million up by USD 12.1 million since last year. Like recent years, last year was characterized by profitable organic growth, in line with our long-term strategy. Capacity in our Route Network was increased by 16% from last year, and the number of passengers increased by 12%.

Total income increased by 14% between years, just topping USD 1 billion in 2013, and EBITDA amounted to USD 143.7 million, up from USD 109.6 million last year. The favorable financial results of recent years have significantly strengthened the Company's balance sheet. Equity stands at USD 346.1 million, total assets amount to USD 832.9 million and the Company's equity ratio at year-end 2013 was 42%. Net interest-bearing debt was negative by USD 77.5 million and the Company had USD 199.5 million available in cash and marketable securities at the end of the year.

Sound strategy is key to success

The Company's largest market in international flight services is the market between Europe and North-America, which has been the principal driving force of our growth in recent years. The tourist market to Iceland has also shown significant growth, and the demand for domestic tourist services has increased rapidly. Concurrently with this expansion, the individual companies forming

Icelandair Group have found opportunities for profitable growth. Although Icelandair Group has grown in size in the last four years, we still see ample opportunities for further profitable growth on the horizon.

The aggregate EBITDA of Icelandair Group currently stands at USD 507.2 million since 2009, which is a testament to the strength of the underlying operations of the Company. However, there are various challenges ahead that we need to address. The principal challenge is the increasing competition, but in addition our contracts with some of our classes of employees have expired, which creates some uncertainty. Nevertheless, the Company's business model has proven sound, our finances are solid and our cash position is strong. Icelandair Group is therefore well positioned to take on the future. While we continue to assess new possibilities, we remain focused on our core business and on prudent and sustainable growth in our operations. The Company's budget for 2014 projects EBITDA at USD 145-150 million.

Delivering on promises made to shareholders

I am pleased that the Board of Directors is proposing a USD 18.6 million dividend payment to our shareholders in accordance with Icelandair Group's dividend policy, which was approved in 2011. Even though the Company will continue to use its resources to expand its operations, we believe it is a sign of strength to have the ability at the same time to pay dividends to our shareholders.

In my address to shareholders in 2012, I indicated that Icelandair Group would take a leading role in developing and strengthening the tourism infrastructure in Iceland. At Icelandair Group we take seriously our responsibility to contribute to the development of Icelandic tourism. As the largest company in aviation and tourist services in Iceland we have never hesitated to take decisive steps of our own and to propose our ideas and promote our aspirations for Iceland as an attractive and sustainable tourist destination.

Last fall a consortium of Icelandic companies commissioned the Boston Consulting Group to develop a long term strategy proposal for Iceland as a tourist destination. The work was initiated, led and funded by a consortium of Icelandic companies including Icelandair Group, and in my opinion the result of the work was the most in-depth and forward looking analysis published to date of tourism infrastructure in Iceland.

The seasonal fluctuations in Icelandic tourism remain the single most pressing issue facing Icelandair Group. The Icelandic winter is an underutilised resource that needs to be leveraged further to increase the efficiency and profitability of Icelandair Group and enhance the viability of Icelandic tourism as a major contributor to the Icelandic economy. We have taken decisive steps towards reducing the inherent seasonal fluctuations and will continue those efforts in 2014.

Moving forward

We are always moving forward in our quest to find future opportunities for Icelandair Group. Our international Route Network is rapidly gaining the critical size required for optimal operating efficiencies, with 38 destinations planned in 2014. The key to the successful expansion of the Route Network has been systematically to increase both its breadth and depth – to find the right mix between increasing frequency to our historical locations and at the same time to extend our frontier by adding new and exciting possibilities into the Network. In so doing we have created significant demand for our tourist-related services in Iceland that continue to expand in line with the growth of the Route Network. As part of our efforts in this regard we recently announced a new hotel project in Reykjavík city centre that will help to revitalize a crucial part of the city and expand our portfolio of first-class hotels.

If our endeavours are successful, the next decade will see tourism become the backbone of the Icelandic economy. A combined effort from the government, airlines, tourist companies and the general public is needed to secure our standing in the competitive tourist services industry. Although our business environment is inherently seasonal we have systematically addressed the seasonality by increasing the supply in our Route Network in the winter, spring and autumn in excess of the high-season increase – to the benefit of Iceland as a year-round tourist destination.

There are many opportunities for Icelandair Group to grow. A recent 10-year analysis of Icelandic tourism shows that although we have come a long way there are many opportunities that can be seized. With our dedicated and experienced employees at the forefront I believe that Icelandair Group will be the undisputed leader in driving Icelandic tourism into the next decade of growth. ■

02 **GRÓTTA | 64.1649°N, 22.0206°W**
This vantage point for northern lights welcomed a part of 2013's ~ 800,000 visitors.
In 1952, they were only 4,823.

We are Icelandair Group

Icelandair Group operates in the international airline and tourism sectors, with Iceland as the focal point of its international Route Network. We believe that our current portfolio of companies in the aviation and tourist services sectors is both stable and mutually reinforcing, but it remains critical for the Group to retain a high level of flexibility to adapt to unforeseen changes in the market environment.

Icelandair Route Network is the main drive in all of our operations

Icelandair Group's business concept is built on Icelandair's Route Network and on marketing Iceland as a year-round destination. In 2013 the Company employed an average of 2,850 full-time employees, generated total revenues of USD 1 billion and carried approximately 2.3 million passengers on its routes.

Icelandair Group is the parent company of nine subsidiaries covering the two business segments of route network and tourism services.

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

In addition to the passenger flights operated by Icelandair, Icelandair Group has extensive interests in most other parts of Icelandic tourism and aviation, including hotel chains, travel agencies, domestic airlines and cargo, support services and ground handling and technical services, in addition to its ACMI and lease operations.

The Route Network is our cornerstone

We fly to 38 destinations in our international Route Network, 13 in the USA and Canada and 25 in Europe. Our Route Network is based on a 24-hour rotation schedule with morning and afternoon connections through the hub in Iceland.

In our international network we operate a single-type fleet of Boeing 757 aircraft, which is well suited to our operations.

Our strategy is clear

Our strategy is regularly tested in order to enable Icelandair Group to take advantage of any hidden opportunities that may exist and any new opportunities that may arise. To this end we strive to develop tools that will enable us to create more value than our competitors for the benefit of all of our stakeholders.

Our strategy is regularly tested in order to enable Icelandair Group to take advantage of any hidden opportunities that may exist and any new opportunities that may arise.

The Group's long-term strategy remains firmly centred on five key points:

- Focusing on the Route Network and tourism services
- Reducing seasonality in the Group's operations
- Focusing on organic growth and business development
- Achieving greater synergies between Group companies
- Improving efficiency with special emphasis on continuous cost control

Our building blocks of sustainable shareholder value

Icelandair Group's strategy can be graphically illustrated in the shape of tapering building blocks, rising in hierarchical order to show our approach to the Company's strategic development from the ground up.

At the base is the day-to-day focus of our employees on current operations and new business initiatives and at the top is our vision for Icelandair Group.

Our building blocks of sustainable shareholder value

Vision	What we aspire to become
Operating pillars	The source of our strength
Values	How we conduct our business
Goals	How we evaluate our efforts
Strategic Initiatives	Our day-to-day focus

The top three building blocks represent our long-term aspirations and corporate conduct. They are the core of our competitive advantage and they determine how we structure our operations to leverage our strengths. In essence, they determine our strategic direction and serve as the lens through which we evaluate new projects and strategic initiatives.

The bottom two building blocks represent our short-term focus on profitable operation. They are revised annually and updated to capitalise on emerging short-term and long-term trends. The strategic initiatives are the engine that drives the long-term strategic trajectory of the Group and the goals provide us with important check points along the way to monitor our progress.

Vision statement

Our vision statement encapulates our aspirations and is a powerful tool to rally all our stakeholders around a set of common goals. It reflects our ambitions and quantifies our goal for the future.

- **Reducing the seasonality of tourism to improve utilisation of assets**
- **Destination and schedule growth focused on strengthening the Iceland hub**

To unlock Iceland's potential as a year-round destination, to strengthen Iceland's position as a connecting hub and to maintain our focus on flexibility and experience

- **Fully leveraging flexibility across subsidiaries to deliver maximum value for the Group**
- **The experience of our employees and over 75 years of operating experience set us apart from the competition.**

The vision belongs to Icelandair Group as a whole, and all of our employees contribute to its realisation. Through our goals and strategic initiatives we translate our aspirations into actions that can be measured and managed throughout the business cycle.

The essence of our vision encompasses the focal points of our business concept of leveraging our strengths; to us, these points are much more than mere words on paper.

Year-round destination

Icelandair Group has been at the forefront of devising a long-term strategy for Iceland as world-class destination, and through our investments in Icelandic tourism we have played a leading role in a sustained campaign of development and promotion that benefits not only our own operations but the entire Icelandic travel industry and the Icelandic economy.

Strengthen Iceland as a connecting hub

Steadily expanding Icelandair's Route Network, which has grown by 14 destinations since 2009, is the Group's key to enhancing Iceland's position as an international connecting hub.

Focus on flexibility and experience

Our continued leveraging of the experience of our unique talent pool remains our primary source of strength as our employees have proven time and again.

Through our goals and strategic initiatives we translate our aspirations into actions that can be measured and managed throughout the business cycle.

Operating pillars of Icelandair Group

Our vision can be depicted as a structure resting on three pillars: the growth of Icelandic tourism, the growth of VIA traffic and a combination of flexibility and experience.

Sustainable value creation for our shareholders and other stakeholders lies at the heart of our organisation. The best way for us to succeed in this effort is to maintain our traditional dedication and commitment to connecting Iceland with the world by drawing on the strength of our operating pillars.

Within Icelandair Group there are several supporting businesses that provide enabling positions and capabilities for the Group to expand its profitable operations.

Values

Our core values are grounded in the philosophy that guides our internal conduct as well as our external relations with our customers, partners, shareholders and other 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

What we do, what we say, and how we behave determines how our customers see us.

Our behaviour is the practical manifestation of our brand and is reflected in our values.

Goals and strategic initiatives

What Icelandair Group needs to do in order to survive in its competitive landscape is dictated by financial objectives which are universal and apply in all business operations, but these objectives do not in themselves suggest business strategies, nor do they provide strategic direction. Through continuous strategic development, Icelandair Group seeks to preserve its strong market position and continue to grow its profitable operations.

We evaluate our effort by comparison with clear-cut short-term and longer-term financial and operational goals that we translate into our EBITDA projection, which is published annually.

Through continuous strategic development, Icelandair Group seeks to preserve its strong market position and continue to grow its profitable operations.

A few of Icelandair Group's ongoing strategic initiatives

■ Increase the breadth and depth of the Route Network	■ Develop a city center hotel that enhances its surroundings	■ Expand the Group's digital footprint
■ Corporate Governance	■ Strengthen ground services infrastructure	■ Initiate work on tourism strategy for Iceland
■ Expand the cargo cooling chain	■ Develop higher paying customers segments	■ Increase ancillary revenue

Behind the numbers lies a set of strategic initiatives undertaken by all our businesses – both individually and across the Group.

We believe that one of our principal strengths lies in our employees. Our operations require a wide range of knowledge and specialised skills in aviation, hospitality, international marketing, finance and management to name but a few. For this reason we are committed to making Icelandair Group an attractive workplace for our employees. Our success is reflected in the fact that on average our employees have been with the Company for 11 years.

Every day we strive to meet the needs of our customers in business and tourism. Icelandair Group is proud of its role in the Icelandic community and continues to seek new opportunities to strengthen its business.

That is our job around the clock, all year round, all over the world. ■


03
NES I 65.6168°N, 24.2006°W
It speaks volumes of this country's hospitability and otherworldly scenery that 80% of foreign visitors want to come back.

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 Centre for Corporate Governance at the University of Iceland selected Icelandair Group for their "Exemplary in Corporate Governance" recognition in 2012. Icelandair Group was 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 in relations to corporate governance.

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 with regard 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 subsequently 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 prevent the Company's management from 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 management's performance-related bonuses, including stock options. The Committee conducts evaluations of management remuneration and monitors 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 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, having 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 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 Eignarhaldsfélagið Bifreiðar, Bergey ehf., Bifreiðainnflutningur ehf., Bílaútleigan ehf., Okkar bílaleiga ehf., and TK bílar ehf. He is a board member of Toyota á Íslandi ehf, Króksslóð ehf, TMH Iceland ehf, AB 257 ehf, Blue Lagoon International ehf., Eldvörp ehf., Hótel Bláa lónið ehf., Bláa Lónið Heilsuvörur ehf., UK fjárfestingar ehf, Johan Rönning hf., 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 Chairman of the Board of Directors of Marel hf. and JÖR ehf. Ásthildur is a member of the Board of Directors of Marorka ehf., and the Research Centre for Business Ethics at the University of Iceland and the Court of Arbitration of the Icelandic Chamber of Commerce. 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. Herdís has years of experience in the private equity sector. Previously, she was a member of the investment team at Thule Investments. Herdís is Chairman of the Board of Icelandic Group, a Vice- Chairman of the Board of Promens, a member of the Board of Copeinca ASA, Icelandic Group Investments ehf., and Invent Farma ehf. She joined the Board on 14 December 2010.

KATRÍN OLGA JÓHANNESDÓTTIR, BOARD MEMBER

Katrín Olga Jóhannesdóttir 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 Ölgerðin hf., Reykjavik University, the Iceland Chamber of Commerce, and Njála ehf., having previously served on the boards of the Central Bank of Iceland., 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 on 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 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. Björgólfur is the chairman of the Confederation of Icelandic Employers. 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 Icelandair Group

Magnea Þórey Hjálmarsdóttir, Managing Director of Icelandair Hotels

Birkir Hólm Guðnason, CEO 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 the 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 authorisation 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. This year, the Board of Directors met 18 times with full participation at nearly all meetings. All the Members of the Board of Directors, except Ásthildur Otharsdóttir are independent of the Company. Sigurður Helgason, Ásthildur Otharsdóttir, Katrín Olga Jóhannesdóttir and Úlfar Steindórsson were independent of the Company's major shareholders in 2013. ■

Shareholder Information

Icelandair Group is committed to providing stakeholders with informative, accurate and timely news and information about the Company. In 2013 the Company's shares increased in value by 121% and earnings were 1.13 US cents per share. The market capitalisation of the Company was ISK 91.0 billion.

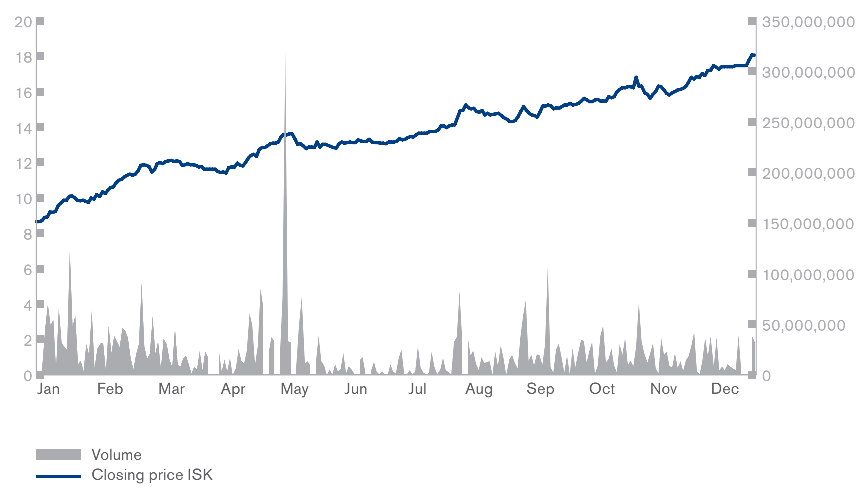
Share capital

Icelandair Group's share capital as at 31 December 2013 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 dividends as declared from time to time. The Company held own shares in the nominal amount of ISK 25 million at year-end 2013 (2012: ISK 25 million). The Group's 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 8.22 to ISK 18.20, an increase of 121%. The highest closing price in 2013 was ISK 18.20 per share, the lowest closing price was ISK 8.22 per share and the average closing price over the year was ISK 13.52 per share.

Closing price ISK and traded volume | 2013 per month



All amounts in ISK	2013	2012	2011	2010	2009
Market capitalisation million	91,000	41,100	25,150	15,750	3,650
Share price at year-end	18.20	8.22	5.03	3.15	3.65
Highest closing price	18.20	8.24	5.18	3.90	13.41
Lowest closing price	8.22	4.83	5.70	2.80	1.80
No. of issued shares million	5,000	5,000	5,000	5,000	1,000
No. of outstanding shares million	4,975	4,975	4,975	4,975	975
Average no. of outstanding shares million	4,975	4,975	4,975	1,486	975

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 for the Company's shares on NASDAQ OMX Iceland. Shares in Icelandair Group were traded 4.639 times in 2013 for a total market value of ISK 73.8 billion (up from ISK 26.3 billion in 2012). Icelandair Group's market capitalisation at the end of 2013 had reached ISK 91.0 billion.

Key ratios

Icelandair Group reported net shareholder earnings of USD 56.4 million in 2013. Earnings amounted to 1.13 US cents per share. The Company's total equity at year-end was USD 346.1 million. The P/E ratio at the same time was 13.9 and the P/B ratio was 2.1.

	2013	2012	2011	2010	2009
Earnings per share in US cent	1.1	0.9	0.7	2.5	−8.9
Intrinsic value of share capital	8.5	7.3	6.5	5.7	15.0
P/B ratio	2.1	1.1	0.8	0.6	0.2
P/E ratio	13.9	7.2	5.6	1.0	−0.3
Number of shareholders	1,833	1,458	1,269	871	834

Shareholders

At the end of 2013 the number of shareholders was 1,833, as compared to 1,458 at the beginning of the year.

Number of shares	Shareholders	%	Shares	%
1–10,000	1,148	62.6%	26,646,067	0.5%
10,001–1,000,000	532	29.0%	185,348,276	3.7%
1000,001 - 10,000,000	104	5.7%	323,347,066	6.5%
10,000,001 - 100,000,000	38	2.1%	1,190,343,704	23.8%
100,000,001 +	11	0.6%	3,274,314,887	65.5%
Total	**1,833**	**100.0%**	**5,000,000,000**	**100.0%**

FINANCIAL CALENDAR

Q1 2014 – 30 April 2014

Q2 2014 – 31 July 2014

Q3 2014 – 30 October 2014

Q4 2014 – 05 February 2015

Shareholder Information, continued:

20 Largest shareholders 31 December 2013:

Name	Shares	%
Lífeyrissjóður verslunarmanna	718,136,116	14.36
Stefnir – ÍS 15	495,974,903	9.92
Lífeyrissj.starfsm.rík. A-deild	370,500,000	7.41
Framtakssjóður Íslands	350,539,559	7.01
Stefnir – ÍS 5	308,008,235	6.16
Gildi – lífeyrissjóður	245,041,885	4.90
Íslandssjóðir hf.	180,029,877	3.60
Lífeyrissj.starfsm.rík. B-deild	171,000,000	3.42
Stafir lífeyrissjóður	158,078,548	3.16
Íslandsbanki hf.	149,995,994	3.00
Sameinaði lífeyrissjóðurinn	127,009,770	2.54
Landsbréf – Úrvalsbréf	99,574,487	1.99
Stapi lífeyrissjóður	99,477,000	1.99
Söfnunarsjóður lífeyrisréttinda	79,733,881	1.59
Auður Capital safnreikningur	76,053,838	1.52
A.C.S. safnreikningur	70,245,752	1.40
Straumur fjárfestingabanki hf.	62,529,376	1.25
Lífeyrissjóður starfsm. sveitarf.	50,798,640	1.02
Akkur SI	38,870,937	0.78
Festa –lífeyrissjóður	35,133,333	0.70
Other	1,113,267,869	22.27
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. The Board of Directors of Icelandair Group proposes that dividends for the year 2013 totalling ISK 2,150 million, or USD 18.6 million, should be paid out to shareholders, an amount representing 30% of the comprehensive income for the year. Based on Icelandair Group's share price as at 31 December 2013, ISK 18.20, the dividends correspond to 2.4% of the market capitalisation.

Investor relations

It is the objective of Icelandair Group to ensure that timely and correct information about the Company is made available to all stakeholders 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 information, share price information, dividend policy and the financial calendar. ■

DID YOU KNOW THAT ...

- Icelandair Group is composed of nine subsidiaries engaging in airline and tourist service and working every day to meet their customers' needs
- An average of over 2,800 employees work for Icelandair Group
- Icelandair Group has over 1,800 shareholders, including all the largest pension funds in Iceland
- The Company runs 17 hotels across Iceland, 5 year-round hotels and 12 summer hotels
- The Company estimates that it will transport over 2.6 million passengers on international flights in 2014
- Three of the Company's aircraft operate exclusively in freight carriage – in addition to the cargo transported in the holds of the Company's international passenger aircraft
- There will be 38 destinations in the Route Network in 2014
- The average length of service of Icelandair Group employees is 11 years
- The Company estimates that it will fly over 9,000 flights in 2014
- Air Iceland flies to four destinations in Greenland
- The number of nights spent at the Company's hotels will be about 310 thousand in 2014
- The Company hires about 1,100 summer employees in Iceland every year

04 **PATREKSFJÖRÐUR | 65.5818°N, 24.0864°W**
Most visitors who come to Iceland are looking for water to relax in.

Quarterly Overview

Q1

Icelandair Group organic growth continued in Q1

Icelandair Group's performance in Q1 exceeded management expectations, and management projections of continued growth materialised. Capacity on international flights increased by just short of 25% in the first three months of the year, and the increase in passenger numbers over the same period was 18%. The greatest increase was in the number of passengers on the North Atlantic market, about 40%. The number of passengers in the tourist market to Iceland also increased significantly from last year, with a positive impact for all tourist services in Iceland.

Icelandair Group and Boeing finalise orders for 737 MAX aircraft

Icelandair Group and Boeing finalised a firm order in February for sixteen 737 MAX 8 and 737 MAX 9 aircraft, as well as a contract on purchase rights for eight additional 737 MAXs. The first aircraft is scheduled for delivery in the first half of 2018. The value of all sixteen aircraft is USD 1.6 billion at Boeing list prices, but the actual purchase price is confidential. The new aircraft will further strengthen the Company and increase its flexibility and capacity for growth. The Boeing 737 MAX is a new, improved version of the present Boeing 737s with a greater range. Fuel savings compared to the Company's present fleet of Boeing 757s is expected to be over 20% per seat.

Toronto new year-round destination

In early February it was announced that as of March 2013 Toronto would become a year-round destination in the Company's international Route Network. The city has been a destination from spring to fall. Toronto is the fifth city in North America to which the Company has year-round flights; the others are Boston, New York, Seattle and Denver.

	Measurement	Company	2013	2012	Change from LY
Revenues	USD million	Icelandair Group	173.0	157.7	15.3
EBITDAR	USD million	Icelandair Group	4.1	11.1	–7.0
EBITDA	USD million	Icelandair Group	–8.3	–3.0	–5.3
Net loss	USD million	Icelandair Group	–18.3	–13.2	–5.1
Assets	USD million	Icelandair Group	834.9	780.3	54.6
Equity ratio	%	Icelandair Group	32.0	30.9	1.1 ppt
Net interest bearing debt	USD million	Icelandair Group	–24.7	25.6	–50.3
Passengers	thousand	Icelandair	358	305	18%
Load factor	%	Icelandair	74.2	75.3	–1.1 ppt
Passengers Air Iceland	thousand	Air Iceland	70	78	–10%
Load factor	%	Air Iceland	70.7	68.7	2.1 ppt
Freight tonn kilometers	thousand	Icelandair Cargo	23	22	2%
Room utilisation	%	Icelandair Hotels	62.9	61.8	1.1 ppt

Q2

Good second quarter results
Icelandair Group's second quarter results were good and improved between years. Profit after taxes amounted to USD 18.5 million, up by USD 4.2 million from last year. The Group's international flight operations continued to perform well. Capacity on international flights was increased by 17% between years, bringing passenger numbers over the quarter to 609 thousand. The greatest increase in capacity was on the North Atlantic routes, where the increase in passenger numbers was also greatest, at 22%.

Partnership with WestJet
In April Icelandair and the Canadian airline WestJet announced a new partnership between the two companies, which, among other things, includes sales and ticket issues on each other's routes. WestJet is the second largest airline in Canada, offering flights to 80 destinations in Canada, the United States, Central America and the Caribbean. The new partnership will strengthen Icelandair's foothold in Canada and improve the company's service in North America.

Over 150 people on Icelandair Special Children Travel Fund trip
At the end of April, 24 children and their families, 150 people in all, were awarded a travel grant from Icelandair's Special Children (Vildarbörn) Fund. The aim of the Special Children Fund is to give chronically ill children, their parents and siblings an opportunity to go on a dream trip that would otherwise be impossible for them. A total of 398 families have benefitted from the support of the Fund since its foundation. This was the 20th allocation from the Fund and 2013 was its 10th year of operation.

	Measurement	Company	2013	2012	Change from LY
Revenues	USD million	Icelandair Group	265.6	234.4	31.2
EBITDAR	USD million	Icelandair Group	54.6	42.9	11.7
EBITDA	USD million	Icelandair Group	42.9	28.8	14.1
Net profit	USD million	Icelandair Group	18.5	14.3	4.2
Assets	USD million	Icelandair Group	901.3	821.7	79.6
Equity ratio	%	Icelandair Group	31.6	30.9	0.8 ppt
Net interest bearing debt	USD million	Icelandair Group	–85.0	–22.0	–63.0
Passengers	thousand	Icelandair	609	547	11%
Load factor	%	Icelandair	79.6	82.1	–2.6 ppt
Passengers	thousand	Air Iceland	79	88	–11%
Load factor	%	Air Iceland	70.5	68.0	2.6 ppt
Freight tonn kilometers	thousand	Icelandair Cargo	24	23	6%
Room utilisation	%	Icelandair Hotels	71.3	72.0	–0.6 ppt

Quarterly Overview, continued:

Q3

912 thousand passengers carried

Results in the third quarter were good, with profit after taxes at USD 65.3 million, as compared to USD 51.4 million last year. The flight schedule in the third quarter was the most extensive in the Company's history. 912 thousand passengers were carried in total on international and domestic flights. The greatest increase was in the North Atlantic market, at 16%, with passengers in that market accounting for 52% of the total passenger number. The tourist market to Iceland also increased significantly, by over 7%.

Operation of a flight simulator in Iceland

An agreement was signed in August between the American company Opinicus on the operation of a flight simulator for Boeing 757 aircraft in Iceland. Use of the simulator is scheduled to begin in the final quarter of 2014. Flight simulators are used to train new pilots and for regular training of active pilots, who are required to undergo re-training sessions every six months. Icelandair has always conducted its pilot training abroad, as no flight simulators have been available in Iceland. The simulator is of the type "B757 Level D" and is a precise replica of the cockpit of 757 aircraft of the kind used by Icelandair in its operations.

Downtown Reykjavik Hotel announced

At the beginning of August was announced that Icelandair Hotels, a subsidiary of Icelandair Group, will open a new hotel in the Reykjavik City centre in the summer of 2015. The name of the hotel will be Icelandair Hotel Reykjavik Kultura. The new hotel will have 142 rooms and facilities for both indoor and outdoor restaurants. The main advantages of the hotel will be its central location and proximity to Reykjavik's concert hall Harpa and other downtown attractions.

	Measurement	Company	2013	2012	Change from LY
Revenues	USD million	Icelandair Group	371.7	317.4	54.3
EBITDAR	USD million	Icelandair Group	114.3	92.7	21.7
EBITDA	USD million	Icelandair Group	102.2	77.9	24.3
Net profit	USD million	Icelandair Group	65.3	51.4	14.0
Assets	USD million	Icelandair Group	877.5	794.7	82.8
Equity ratio	%	Icelandair Group	40.1	38.6	1.6 ppt
Net interest bearing debt	USD million	Icelandair Group	–89.9	–9.5	–80.3
Passengers	thousand	Icelandair	822	746	10%
Load factor	%	Icelandair	83.7	84.0	–0.3 ppt
Passengers	thousand	Air Iceland	90	102	–11%
Load factor	%	Air Iceland	73.1	69.0	4.1 ppt
Freight tonn kilometers	thousand	Icelandair Cargo	23	21	10%
Room utilisation	%	Icelandair Hotels	84.3	85.5	–1.2 ppt

Q4

Income increased by 12% between years

Icelandair Group performed well in the fourth quarter. Income increased by 12% between years and EBITDA reached USD 6.8 million. The increase in income was mostly a result of the expanded capacity on the Company's international flights, which grew by 13% during the quarter; the number of passengers increased by 11% over the same period. Tourist-related services also increased significantly over the quarter. One of Icelandair Group's principal aims is to increase the number of passengers to Iceland outside the high season in order to reduce the seasonal fluctuations in the Company's operations.

Oldest passenger ever to have flown with the Company

In November Lára Jónsdóttir, who celebrated her 100th birthday in the summer of 2013, flew with the Company to Orlando in the United States. Lára is not one to let age bother her, and she travels regularly to countries outside Iceland. She is believed to be the oldest passenger ever to have flown with Icelandair Group.

Regular scheduled flights begin to Newark

At the end of October, regular scheduled flights began to New York Newark. As one of the world's aviation pioneers, Icelandair Group has served the New York market for over 65 years with flights to and from John F. Kennedy International (JFK). With the addition of seasonal services from Newark, Icelandair Group will serve two gateways to the New York metropolitan area. ■

	Measurement	Company	2013	2012	Change from LY
Revenues	USD million	Icelandair Group	212.7	189.4	23.2
EBITDAR	USD million	Icelandair Group	16.8	19.1	–2.3
EBITDA	USD million	Icelandair Group	6.8	5.9	0.9
Net loss	USD million	Icelandair Group	–9.1	–8.2	–0.9
Assets	USD million	Icelandair Group	832.9	762.9	70.0
Equity ratio	%	Icelandair Group	41.6	38.8	2.8 ppt
Net interest bearing debt	USD million	Icelandair Group	–77.5	18.1	–95.6
Passengers	thousand	Icelandair	469	422	11%
Load factor	%	Icelandair	76.3	76.7	–0.4 ppt
Passengers	thousand	Air Iceland	68	77	–12%
Load factor	%	Air Iceland	69.4	72.1	–2.7 ppt
Freight tonn kilometers	thousand	Icelandair Cargo	25	23	6%
Room utilisation	%	Icelandair Hotels	57.6	58.5	–0.8 ppt

05 **NESJAVALLAVEGUR | 64.1112°N, 21.2900°W**

When summer descends upon the island in the north, about 70 per cent of its visitors take to national treasures such as Þingvellir National Park, Gullfoss and Geysir.

Performance in 2013

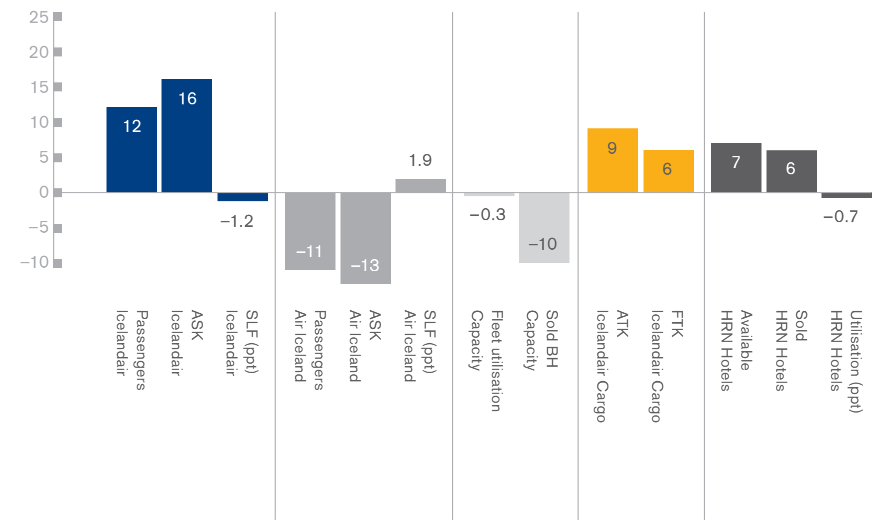
Icelandair Group's 2013 results were good and considerably better than projected in the Company's budget at the beginning of the year. Profit before taxes amounted to USD 71.0 million, up by USD 13.6 million between years. Like recent years, 2013 was characterised by profitable organic growth, which is in line with Icelandair Group's long term strategy.

TRANSPORT FIGURES

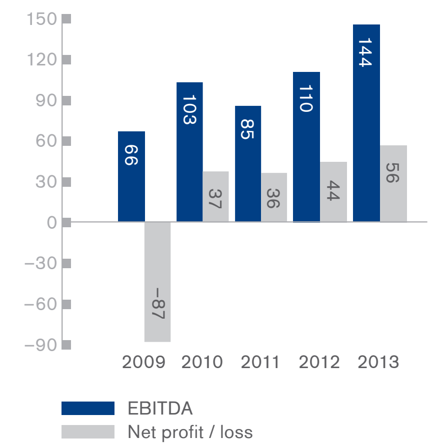
Capacity on international flights was increased by 16% from 2012. Passengers numbered 2.3 million, up by 237 thousand, or 12%, from the preceding year. The passenger load factor was 79.3%, down by 1.2 percentage points. Passengers on regional and Greenland flights were 307 thousand, down by 11% between years. The number of sold hours in charter projects decreased by 10% from 2012. Air freight on scheduled flights increased by 6% over the year. Available nights in Icelandair Hotels were 315 thousand in all, up by 7% between years. The utilisation of hotel rooms was 70.7%, as compared to 71.4% in 2012.

	2013	2012	% Change
INTERNATIONAL FLIGHTS			
Number of passengers (Thousand)	2,258	2,020	12%
Load factor (%)	79.3	80.5	−1.2 ppt
Available seat kilometers (Million)	8,320	7,178	16%
REGIONAL AND GREENLAND FLIGHTS			
Number of passengers (Thousand)	307	345	−11%
Load factor (%)	71.1	69.2	1.9 ppt
Available seat kilometers (Million)	155	178	−13%
CHARTER FLIGHTS			
Fleet utilisation (%)	91.0	91.3	−0.3 ppt
Sold Block Hours (Number)	28,089	31,104	−10%
CARGO			
Available tonne kilometers (Thousand)	201,796	184,748	9%
Freight tonne kilometers (Thousand)	94,769	89,391	6%
HOTELS			
Available hotel room nights (Number)	314,603	294,234	7%
Sold hotel room nights (Number)	222,320	210,114	6%
Utilisation of hotel rooms (%)	70.7	71.4	−0.7 ppt

Traffic figures | YOY change in %



EBITDA and net profit /loss USD million | 2009–2013



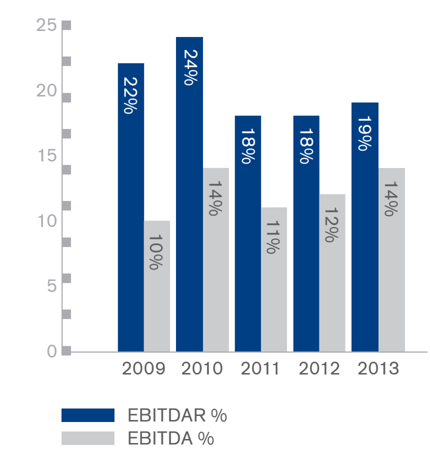
EARNINGS

Good results in 2013

The year was characterised, like recent years, by profitable organic growth. Income increased by 14% from the preceding year. Net profit at year-end 2013 stood at USD 56.4 million, up by USD 12.1 million between years. EBITDA was USD 143.7 million, up by USD 34.0 million compared to 2012.

USD thousand	2013	2012	% Change
EBITDAR	189,870	165,772	24,098
EBITDA	143,710	109,646	34,064
EBIT	73,011	50,787	22,224
EBT	71,048	57,448	13,600
Profit for the year	56,418	44,275	12,143
EBITDAR %	18.6	18.4	0.1 ppt
EBITDA %	14.0	12.2	1.9 ppt

EBITDAR % and EBITDA % | 2009–2013

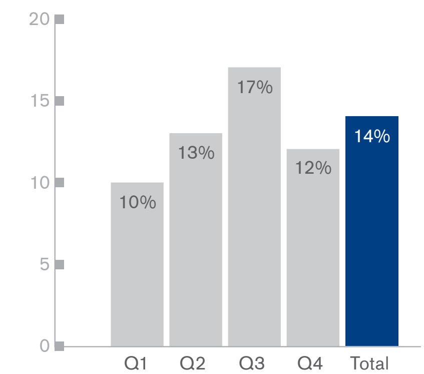


INCOME

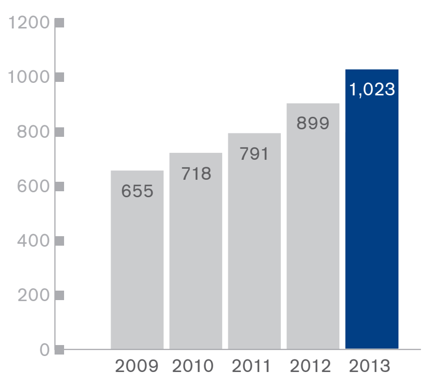
USD thousand	2013	2012	Change	Change in %	% of rev. '12
Transport revenue	702,882	604,499	98,383	16%	69%
Passengers	659,992	564,886	95,106	17%	65%
Cargo and mail	42,890	39,613	3,277	8%	4%
Aircraft and aircrew lease	117,969	120,815	−2,845	−2%	12%
Other operating revenue	202,106	173,552	28,554	16%	20%
Total	**1,022,957**	**898,866**	**124,091**	**14%**	**100%**

Performance in 2013, continued:

Total income
Change per quarter | 2013 vs. 2012



Total income in USD million | 2009–2013



Organic growth continues

Transport revenue totalled USD 1,022.9 million, up by 14% from 2012. Transport revenue counts for 69% of Icelandair Group's total income. Of this figure, passenger revenues amounted to USD 660.0 million, increasing by 17%. Passenger revenue increased on all of the Company's three markets: the home market from Iceland, the tourist market to Iceland and the market between Europe and North-America.

Decrease in aircraft and aircrew lease revenue

Aircraft and aircrew lease revenue amounted to USD 118.0 million in 2013, as compared to USD 120.8 million in 2012, down by 2% due to less demand for charter services.

Other revenue up due to increased scope of business

Other revenue totalled USD 202.1 million in 2013, up by USD 28.6 million from the preceding year, mostly as a result of increased revenue from tourism services and an expanded scope of operation, including increased sales of merchandise in aircraft, in hotels and at airports.

EXPENSES

Operating expenses amounted to USD 879.2 million in 2013, as compared to USD 789.2 million in 2012, an increase of 11% between years.

USD thousand	2013	2012	Change	% Change	% of exp. '13
Salaries and other personnel expenses	239,432	203,815	35,617	17%	27%
Aircraft fuel	242,630	220,059	22,571	10%	28%
Aircraft and aircrew lease	34,570	46,740	–12,170	–26%	4%
Aircraft maintenance expenses	81,475	78,197	3,278	4%	9%
Aircraft handling, landing and communication	74,316	66,467	7,849	12%	8%
Other operating expenses	206,824	173,942	32,882	19%	24%
Total	**879,247**	**789,220**	**90,027**	**11%**	**100%**

Staff cost increased by 17%

Salaries and other personnel expenses amounted to USD 239.4 million, increasing by USD 35.6 million from 2012. The reason is primarily the increased scope of operation and the contractual salary increases between years. The average number of full-time employees was 2,850 in 2013, as compared to 2,532 in 2012.

Average fuel price lower in 2013 than in 2012

Fuel cost totalled USD 242.6 million in 2013, up by USD 22.6 million, which represents a 10% year-on-year increase. The difference is explained by the increase in production between years. The world average price in 2013 was USD 989/ton, as compared to USD 1,027/ton in 2012.

Other expenses increased by 9%

Aircraft and aircrew lease decreased by USD 12.2 million between years, or 26%, mainly due to a smaller number of leased aircraft than in the preceding year. Aircraft maintenance expenses amounted to a total of USD 81.5 million, increasing by 4%. Aircraft handling, landing and communication expenses amounted to USD 74.3 million, increasing by 12% between years as a result of the increase in capacity. Other expenses amounted to USD 206.8 million, up by USD 32.9 million, or 19%, 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 items relating to increased sales, such as booking fees, credit card fees and agents' costs, advertising expense etc.

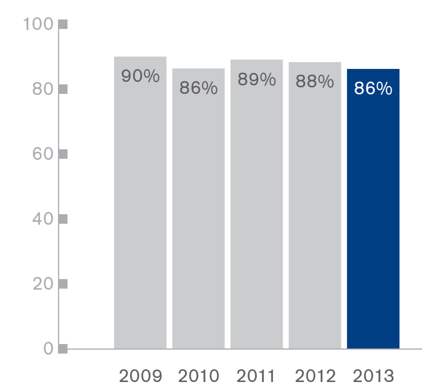
Depreciation and amortisation amounted to USD 70.7 million

Total depreciation of operating assets amounted to USD 68.0 million in 2013, as compared to USD 57.7 million in 2012. Amortisation of intangible assets totalled USD 2.7 million, increasing by USD 1.6 million from 2012. No impairments were made in 2013.

Net finance cost USD 1.9 million

Finance income totalled USD 6.8 million in 2013, as compared to USD 17.6 million in 2012. The biggest contributing factor was the net currency exchange gain, which amounted to USD 4.1 million in 2013, as compared to USD 14.2 million in 2012. Interest income totalled USD 2.7 million, as compared to USD 3.4 million in the preceding year. Interest cost decreased by USD 1.8 million, or 18%, from 2012 and amounted to USD 8.7 million. ■

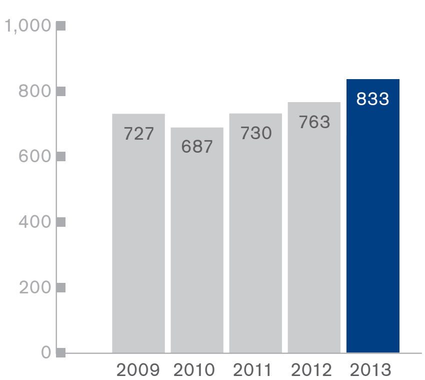
Total expenses before depreciation as % of total income | 2009–2013



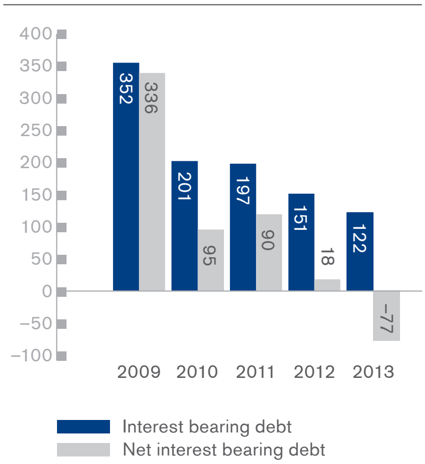
Financial Position

Icelandair Group's financial position remains strong. Assets amounted to USD 832.9 million at year-end, increasing from the beginning of the year by USD 70.0 million. The equity ratio was 42%, as compared to 39% at the end of preceding year. Cash and cash equivalents and marketable securities totalled USD 199.5 million, 50% higher than in 2012. Total capital expenditures in 2013 amounted to USD 114.2 million.

Total assets USD million | 2009–2013



Interest bearing and net interest bearing debt USD million | 2009–2013



ASSETS

Balance sheet total up to USD 832.9 million

At the end of the financial year 2013 total assets amounted to USD 832.9 million, increasing by USD 70.0 million, or 9%, from the beginning of the year. Non-current assets amounted to USD 497.0 million at year-end, as compared to USD 473.9 million at the beginning of the year. Current assets increased by USD 46.9 million during the year.

Operating assets USD 299.2 million

Operating assets increased by USD 16.2 million in the course of the year. The increase is largely a result of the acquisition of four Boeing 757 200 aircraft; of which two were previously under long-term lease. Intangible assets and goodwill totalled USD 179.7 million, mainly comprising goodwill in the amount of USD 139.2 million. Other non-current assets amounted to USD 18.1 million at year-end, as compared to 14.2 million at the end of 2012. Of this figure, non-current receivables and deposits increased by USD 6.6 million between years.

Cash and marketable securities up by 50%

Current assets totalled USD 335.9 million at the end of 2013, USD 46.9 million above the preceding year. Trade and other receivables decreased by USD 20.8 billion from the beginning of the year and totalled USD 114.3 million at year-end 2013. Cash and cash equivalents and marketable securities increased by USD 66.7 million, or 50%, in the course of the year 2013, amounting to USD 199.5 million at 31.12 2013.

LIABILITIES

Non-current liabilities down by USD 30.9 million

Non-current liabilities amounted to USD 130.2 million at year-end 2013. Of that figure, loans and borrowings amounted to USD 78.5 million, down from USD 119.4 million at the beginning of the year. Current liabilities were USD 356.6 million at year-end 2013 Of that figure, loans and borrowings totalled USD 43.5 million, trade and other payables USD 159.5 million and deferred income USD 153.5 million.

Net interest-bearing debt negative at year-end

Interest-bearing debt totalled USD 122.0 million at year-end 2013. Repayment of long-term liabilities amounted to USD 33.5 million. Net interest-bearing debt was negative at year-end 2013 in the amount of USD 77.5 million, which represents a reduction by USD 95.6 million from year-end 2012.

Calculation of net interest-bearing debt:

USD thousand	31.12.13	31.12.12	Change
Loans and borrowings non-current	78,489	119,358	–40,869
Loans and borrowings current	43,528	31,548	11,980
Marketable securities	7,955	15,734	-7,779
Cash and cash equivalents	191,538	117,060	74,478
Net interest bearing debt	**–77,476**	**18,112**	**–95,588**

EQUITY

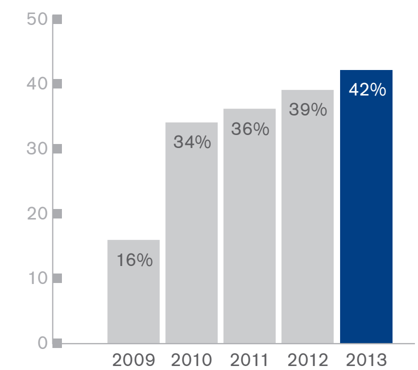
Equity ratio 42% at year-end

Icelandair Group's total equity amounted to USD 346.1 million at 31 December 2013, increasing from USD 295.9 million from the beginning of the year. The largest part of the increase is due to the positive comprehensive income of USD 61.9 million. Dividend payments in 2013 amounted to USD 11.8 million, which equals 0.24 US cents per share. The equity ratio was 42% compared to 39% in 2012. Share capital at year-end amounted to ISK 5,000 million in nominal value. The Company held own shares in the nominal amount of ISK 25 million at year-end 2013 unchanged from 2012.

USD thousand	2013	2012	2011	2010	2009
Result*	69,910	38,854	32,093	17,488	-35,677
Profit / loss	56,418	44,275	36,310	37,162	-86,990
Equity	346,082	295,932	263,385	231,672	119,127
Equity ratio	42%	39%	36%	34%	16%

* Comprehensive income

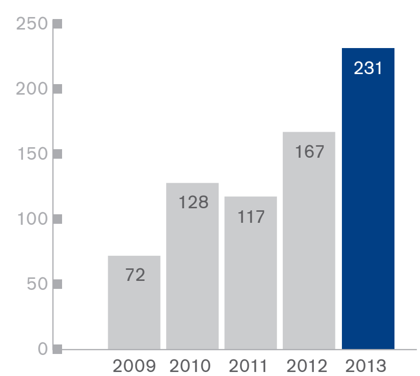
Equity ratio | 2009–2013



CASH FLOW AND INVESTMENTS

USD thousand	2013	2012	Change
Working capital from operations	162,385	141,490	20,895
Net cash from operating activities	230,874	166,743	64,131
Net cash used in investing activities	-113,223	-76,476	-36,747
Net cash used in financing activities	-45,232	-51,453	6,221
Change in cash and cash equivalents	72,419	38,814	33,605
Cash and cash equivalents at 31 December	**191,538**	**117,060**	**74,478**

Cash flow from operating activities
USD million | 2009–2013



Cash and cash equivalents up by USD 74.5 million, or 64%

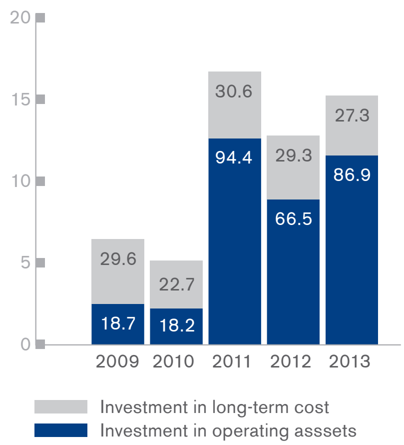
Working capital from operations amounted to USD 162.4 million in 2013, increasing by 20.9 million from 2012. Net cash from operating activities totalled USD 230.9 in 2013, as compared to USD 166.7 million in 2012. Net cash used in financing activities amounted to USD 45.2 million. Of that figure, repayments of long-term borrowings amounted to USD 33.5 million and dividend payments USD 11.8 million. Cash and cash equivalents at year-end amounted to USD 191.5 million, as compared to USD 117.1 million in 2012.

Total capital expenditure USD 114.2 million

Investments in operating assets amounted to USD 86.9 million. Of this figure, investment in aircraft and aircraft components totalled USD 58.4 million, and investments in engine overhauls on own aircraft USD 18.5 million over the period. Investments in long-term expenses amounted to USD 23.8 billion, largely stemming from overhauls of leased engines. Investment in intangible assets amounted to USD 3.5 million. Expensed long-term cost in the profit/loss statement, excluding cash flow effects, amounted to USD 24.9 million in 2013.

Financial Position, continued:

Total investment
USD million | 2009–2013



Fleet

At year-end 2013 Icelandair Group's fleet comprised 37 aircraft. Of these aircraft, 26 were owned by the Company and 11 were leased. The table below provides an overview of the Company's fleet of aircraft:

Type	Ice-landair	Cargo	Loft-leidir	Air Iceland	Group fleet 31.12.13	Group fleet 31.12.12	Of which owned	Of which leased	Ch. from 31.12.12
B757 200	16	3	4		23	23	18	5	0
B757 300	1				1	1	1		0
B767 300			3		3	5		3	-2
B737 700			1		1	0		1	1
B737 800			2		2	1		2	1
Fokker F-50				5	5	6	5		-1
Dash 8-200				2	2	2	2		0
A-320					0	1			-1
Total	**17**	**3**	**10**	**7**	**37**	**39**	**26**	**11**	**–2**

In February 2013 the Company signed a contract with Boeing confirming an order of sixteen 737 MAX8 and 737 MAX9 aircraft, with an option to buy an additional eight aircraft. The commitment resulting from the confirmed orders, according to Boeing's list prices, amounts to USD 1.6 billion. The actual purchase price has not been disclosed.

Delivery of the first aircraft is scheduled for early 2018. 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. For comparison, Icelandair's Boeing 757-200 aircraft used in the Company's international route network seats 183 passengers.

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

Boeing 757 aircraft will continue in use, 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 enables them to fly to destinations in 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

Continued profitable organic growth

The outlook for Icelandair Group is favourable. However, the Company will face challenges in the form of increased competition and negotiations of wage bargaining contracts with several segments of its staff. Continued profitable organic growth is planned, and the Company's flight schedule is projected at 18% in excess of the 2013 schedule. Increased flight frequencies to current destinations in Europe will account for 7% of the growth, and current destinations in North America for just over 6%. Increases resulting from three new destinations, two in Canada and one in Europe, will account for just over 4%. The Company's Route Network is based on three markets: the home market in Iceland, the tourist market with Iceland as a destination, and the international market between Europe and North America. Of the three, the last is the largest and drives the Company's growth. The number of the Company's passengers on international flights in 2014 is projected at 2.6 million, as compared to 2.3 million in 2013. Over the high season, 21 Boeing aircraft will be used in the Route Network, representing an increase in the size of the fleet by 3 aircraft. Bookings of international flights in the first three months of the year are off to a slower start than anticipated. However, the bookings for the peak season is in line with plans.

The Route Network is the main engine that drives Icelandair Group's operations. Increased capacity and growing numbers of passengers in the Route Network have a positive impact on other business of the Group, whether hotel operations, services to tourists in Iceland or freight carriage between countries; these companies are expected to grow over the year.

Freight operations profitable

The outlook for the Company's freight operations is favourable. The principal focus is on scheduled air cargo services from Iceland to Europe and North America. Two aircraft are engaged in these operations, and in addition passenger aircraft holds are used to carry freight. Also, one aircraft will be engaged in cargo charter flights in Europe.

Setting the scene for future hotels

The Company's hotel operations have shown significant growth in recent years with the addition of Icelandair Hotel Reykjavik Marina in central Reykjavik and Icelandair Hotel Akureyri in North Iceland. Further growth is not anticipated in 2014, but a new hotel is scheduled to open in the spring of 2015, Icelandair Hotel Reykjavik Kultura in downtown Reykjavik, with 142 rooms. Price competition is fierce in the hotel market in Reykjavik and other locations that compete with Reykjavik as destinations. Similar utilisation in Reykjavik, is expected as in 2013. Bookings of rooms in other parts of Iceland for the summer are good, and the annual utilisation rate is expected to increase between years.

EBITDA forecast for 2014 at USD 145-150 million

EBITDA for 2013 amounted to USD 143.7 million, the best result in the Company's history. The forecast for 2014 assumes that EBITDA will remain at a similar level, about USD 145–150 million, but that the EBITDA ratio will fall between years and be in the range of 13.0%–13.5%, as compared to 14.0% in 2013. This forecast assumes that the exchange rate of the EUR against the USD will be on average 1.35 in January–June and 1.30 in July–December. The projection of fuel cost assumes a average price of USD 1,000/ton. Increased competition, rising fuel costs and general cost increases are the reasons for the decline in EBITDA ratio between years. EBITDA in the first quarter is projected as negative and short of the figure for the first quarter of last year. The reason is cost relating to the increased scope of operations over the peak period accrues to a large extent during this quarter. This includes the cost of advertising and market initiatives, the introduction cost of aircraft and booking expenses. As before, the majority of the Company's profit will be generated in the second half of the year. ■

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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 CEO, endeavours 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 annual 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 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.

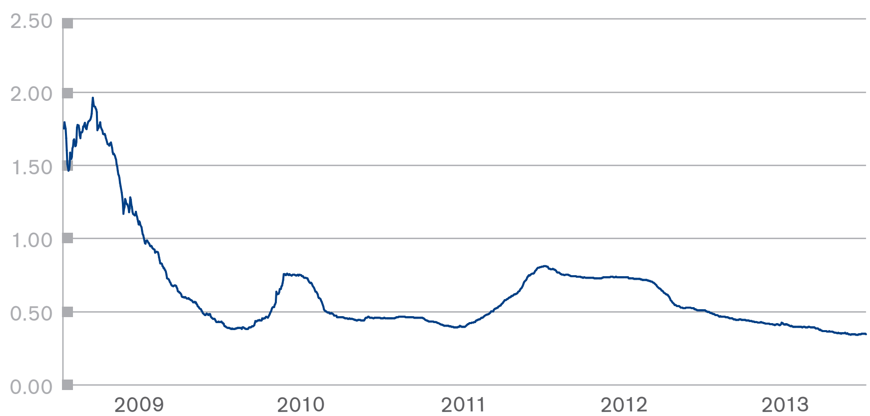
Interest rate risk

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 hedged against roughly 50% of its 2014

Six month USD libor | 2009–2013



Jet fuel price per tonne | 2009–2013

EUR/USD exchange rate | 2009–2013

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.

Risk Management, continued:

At group and subsidiary levels, management monitors and assesses the risk exposure, which has historically posed uncertainty, even in normal operating conditions.

exposure through the EU allocations of emissions quotas and procurement. In November 2012 the EU decided to offer airlines flying to and from European destinations an exemption from the Scheme with respect to international flights. Icelandair accepted this offer and its commitment was therefore reduced to covering internal European flights. However, the exemption is limited to 2012 and its extension for the financial year 2013 is uncertain.

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 the 3-month operating costs.

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 risk exposure, which has historically posed uncertainty, even in normal operating conditions. A part of the company 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 which, as such, can be regarded as valuable intangible assets which require attention. Icelandair's credibility and reputation are 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 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 introduced 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 its individual companies.

Enterprise risk management

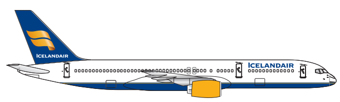
Risk management needs access to a secure and steady flow of information about all enterprise-related risks at the Group level and thus requires centralized mapping and detailed registration of risk items and their estimated inherent financial values and potential consequences. The Group's Risk Management 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 distinguishes between industry-related risks and those which expose the subsidiaries on an individual company level.

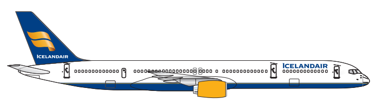
06 **EFRI TUNGA ÖRLYGSHÖFN | 65.5777°N, 24.1541°W**
The long days of summer are alluring to about 50 per cent of annual visitors.

Icelandair

Number of aircraft by aircraft type 31.12.2013
Icelandair

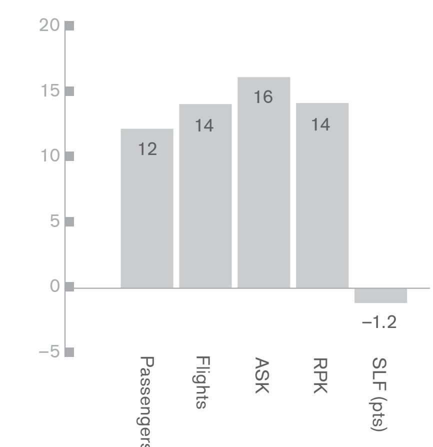


17 Boeing 757-200

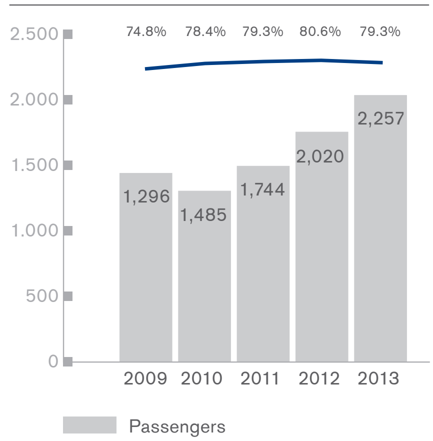


1 Boeing 757-300

Traffic data Icelandair | YOY change in %



Number of passengers (thousands) and load factor | 2009–2013



Operation

Icelandair business strategy is based on Iceland's advantageous geographic position between northern Europe and North America.

The heart of the operation is a "24-hour" hub at Keflavik International Airport. In the morning, Icelandair's aircraft take off for all the destinations in the East. They reach Europe around midday and start the return flight early in the afternoon. The fleet is typically back in Keflavik at around 3-4 p.m. The North America operation begins toward late afternoon and the fleet arrives in the U.S. and Canada in the early evening and returns to Keflavik early in the morning of the next day, just in time to leave for Europe.

Icelandair recently announced planned capacity increases for 2014, with two new routes to North America and one new route to Europe and additional frequency on two North American and eight European routes. This will expand the company's international flight schedule by 18%, on top of a 16% growth in available seat kilometres (ASK) in 2013, and take Icelandair's international passenger numbers to 2.6 million in 2014. From its base at Keflavik International Airport, Icelandair will fly this year to 25 destinations in Europe and 13 in North America.

Almost two thirds of Icelandair's seat capacity is on flights to Europe, with the remaining capacity deployed on North American routes. The United States is the company's largest single destination country, while its European network focuses mainly on Scandinavia and Northern Europe, with the United Kingdom as the company's number two country.

Icelandair offers daily frequency or more on 10 out of 35 routes. It has 5 routes with a frequency of double daily flights or more during the peak season: Copenhagen, New York, London Heathrow, Paris CDG and Boston. There are also five routes with either one or two flights per day: Frankfurt, Seattle, Oslo, Amsterdam, Stockholm and Helsinki.

Icelandair had 1,600 employees during the peak season last summer. Of these, 300 were new employees, mostly cabin crew for the company's fleet of 18 Boeing 757's. Passenger numbers grew by 12% in 2013 to 2.3 million and the load factor was 79.3%. Overall punctuality was above the company's 85% target.

In line with the growth of its fleet, Icelandair decided early in 2013 to launch the operation of a flight simulator for Boeing 757 training in Iceland, in Q4 2014.

Icelandair Technical Services provides maintenance and technical services for the Icelandair aircraft fleet and is an integral component of Icelandair. Most of the work is performed at the Service Centre at Keflavik Airport. In order to deal with seasonality Icelandair does most of its heavy maintenance work in the winter while utilising the fleet to the fullest possible extent in the summer. The company also leases out aircraft with the help of its sister company and charter specialist, Loftleidir-Icelandic.

In addition to aircraft flown on its scheduled network, Icelandair operates aircraft for Loftleidir-Icelandic and Icelandair Cargo. 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.

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

The Route Network

Since 1937 Icelandair Group and its predecessors have connected Iceland with the world. The Company's Route Network links Europe and America with a stopover in Iceland. In the morning a aircraft takes off from Keflavik Airport and flies to Europe. It returns later in the day and continues westward across the ocean to North America and returns to Iceland the next morning. And so it continues, around the clock, all year long.

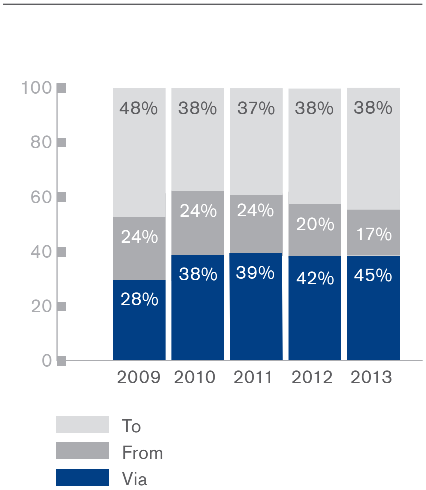
Markets

Operating on three different and independent passenger markets (the North Atlantic market, "VIA", "FROM" Iceland market and "TO" Iceland market) gives the company a variety of options in route network 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 focused 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. The company's success has been ascribed to its business concept of operating as a blend of a legacy carrier and low-cost carrier.

Icelandair's strategy is to use its efficiency and flexibility to be the leading airline for travel to and from Iceland, as well as a unique and exciting alternative for air travel across the North Atlantic. The company's mission is to operate a first-rate airline and maintain a reliable quality service through the experience and knowledge gained from 77 years of operation.

Passenger mix (%) | 2009–2013



International marketing and sales activities are organized through the company's offices in its key markets: North America, Scandinavia, Continental Europe, the United Kingdom and Iceland. In addition, the company has sales agents in large markets outside the core network, such as Asia. Great efforts are made to promote Iceland as a tourist destination and branding Icelandair as a refreshing Icelandic travel experience.

Icelandair sponsors and hosts a number of events and activities to promote Iceland and Icelandair, including Iceland Airwaves, Food and Fun and the participation of Icelandic national teams in numerous sports events. The annual Icelandair Mid-Atlantic Tradeshow in February has been a key event in bringing together over 700 travel industry professionals, buyers and suppliers from Icelandair's main markets in North America and Europe.

The company's business activities have seen substantial growth since 2008, and the number of scheduled flights and passengers has doubled from 2009 to 2014.

Icelandair's Route Network operates an all-Boeing 757 fleet, the majority with 183 seats. Three 757s will be added to the fleet in 2014. The company's aircraft have three classes: a business class, economy comfort and regular economy. The fleet is equipped with personal in-flight entertainment systems and has started to offer on-board WiFi connections on its routes across the North Atlantic.

Outlook

Much of Icelandair's recent growth has stemmed from its transfer traffic strategy, and the proportion of "VIA" passengers has grown from 28% in 2009 to 49% in 2013. Icelandair has increased its US-to-Europe available seat kilometres (ASK) at rates between approximately 15% and 30% each year since 2010, as compared to a total market growth in the low single digits.

The carrier will be expanding its seat capacity by 18% in 2014. Of the increase, 4% will result from the new destinations, 7% from increased European flights and 6% from increased flights to North America. Three new destinations have been introduced: Edmonton, which will be a year-round destination, and Vancouver and Geneva, with two flights a week over the summer.

On the North Atlantic market Icelandair competes mainly with three transatlantic alliances that represent more than 80% of the market. But geography is key to Icelandair's strategy. Iceland is right underneath the busiest routes from Europe to North America. Flights from Iceland to Europe are between 3 and 4 hours long, and flights to North America take between 5 hours (Halifax, Boston) and about 8 hours (Denver, Seattle, Orlando), which enables Icelandair to use narrow-body Boeing 757 aircraft for its entire Route Network.

A turning point in the company's recent history was in 2009, following the economic crisis which hit Iceland hard, when Icelandair reduced its dependence on the home market, increased its transatlantic marketing and operations and redesigned its aircraft rotation.

Another milestone is anticipated in 2018, when Icelandair will take delivery of its first Boeing 737 MAX aircraft. ■

Loftleidir-Icelandic

Operation

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 (Aircraft and Maintenance) projects and consulting services. The company has expanded its horizon beyond the aircraft types traditionally operated under the Icelandair AOC (Air Operator's Certificate) with the recent introduction of the first B737-800 and B737-700 aircraft into its fleet.

Markets

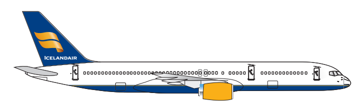
Loftleidir-Icelandic works on a global scale, as the company currently operates AM (Aircraft and Maintenance), ACMI (Aircraft, Crew, Maintenance and Insurance) and full charter contracts in Asia and the South Pacific as well as North and South America.

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.

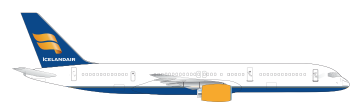
Outlook

The overall outlook on the aircraft leasing market is improving after a few challenging years. The demand for aircraft, especially B737 NGs (next generation), is strong. However, availability is limited. Loftleidir-Icelandic intends to capitalize on the improved market conditions and secure new customers and projects. The emphasis will continue to be on the AM product with continued efforts on the VIP and ACMI market. By adding further NGs to its fleet Loftleidir will continue to open up new segments of the AM market with opportunities for growth. ■

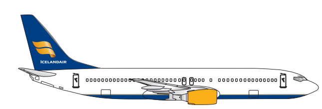
Number of aircraft by aircraft type 31.12.2013
Loftleidir



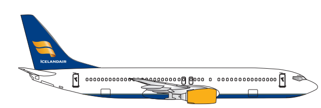
4 Boeing 757-200



3 Boeing 767-300

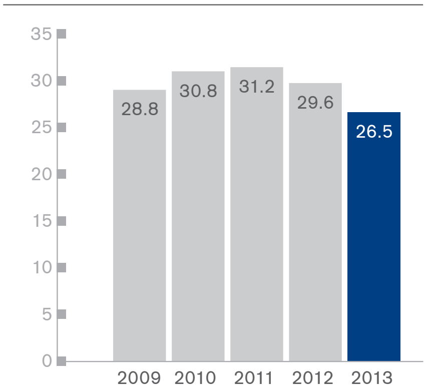


1 Boeing 737-700



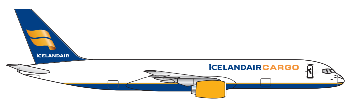
2 Boeing 737-800

Numbers of sold block hours (thousands) | 2009–2013



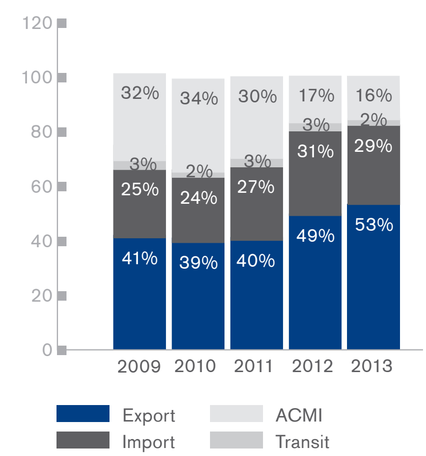
Icelandair Cargo

Number of aircraft by aircraft type 31.12.2013
Icelandair Cargo



3 Boeing 757-200

Revenue split | 2009–2013



Operation

Icelandair Cargo specialises in air freight services to and from Iceland. The company's operations are based on a strong route network comprising Icelandair's passenger routes and scheduled air cargo flights from both sides of the Atlantic. The company is the largest player in the air freight market in Iceland. Icelandair Cargo has also operated aircraft in ACMI (Aircraft, Crew, Maintenance and Insurance) projects for courier companies. In recent years, however, the weight of these services in the company's operation has been reduced, and currently the company operates a single aircraft in ACMI services in Europe. Due to the economic difficulties in Europe, the decision was made to downscale these operations and in the past two years two aircraft have been withdrawn from these services and returned to their owners. Icelandair Cargo does not have its own AOC (Air Operator's Certificate), but operates under the licence held by Icelandair. The company leases crews from Icelandair and buys maintenance services from Icelandair Technical Services, an Icelandair subsidiary.

Markets

Icelandair Cargo's market area is based on Icelandair's Route Network. The company has operated cargo aircraft since the turn of the century, and at present there are two B757-200 cargo aircraft on flights to destinations in Europe and the United States. Icelandair's Route Network is also used in locations where the company offers its services; this year there will be 38 destinations on offer. In addition, the company co-operates with a number of air carriers on continued flights to more distant markets, such as Asia. Extensive collaboration with overland haulage companies in Europe and North America enables the company to offer services to and from all the principal cities in these areas. The company has office in New York, which are responsible for business in North America and office in Liege in Belgium, which are responsible for markets in Central Europe. In addition, the company has agencies in all of Iceland's principal market areas in Europe, America and Asia. Fresh fish is the mainstay of Icelandic exports and these exports have increased significantly in recent years. Imports to Iceland have grown slowly following the changes that occurred after the economic collapse in 2008. Live lobster is the principal product that the company carries between America and Europe.

Outlook

Icelandair Cargo's future prospects are favourable. Fresh fish has formed the core of Icelandic exports at Icelandair Cargo, and exports of fresh fish have increased significantly in recent years. In particular, the growth has been extensive on routes to North America, with freight to the American market doubling over the past two years. Imports to Iceland have been at a minimum since the economic collapse, and the past years have been characterised by slow growth. Significant changes in this situation are unlikely in 2014, but there are hopes that imports will improve in 2015. Icelandair Cargo's charter operations (ACMI) are contracted until mid-year 2015, but no decisions have been made regarding the continuation of those operations. ■

Air Iceland

Operation

Air Iceland is a dynamic company of about 230 employees operating in Iceland and Greenland, with firm roots that go back to the dawn of Icelandic aviation. It was formed in 1997 by a merger of two companies, Icelandair Domestic and Norlandair, with the goal of creating a flexible but influential airline servicing the North Atlantic countries.

With headquarters based in Iceland's capital city, Reykjavík, the airline offers flights to six destinations within Iceland, covering the three major towns outside Reykjavík and, through a general sales agent agreement with Norlandair, three destinations in north-eastern Iceland. In addition, Air Iceland offers flights to four destinations in Greenland and to the Faroe Islands. Year-round flights are operated to Nuuk on the west coast of Greenland and to Kulusuk on the east coast, and during the summer and dog sledding season Air Iceland offers flights to Ilulissat on the west coast and Narsarsuaq in the south. Air Iceland also offers flights to Constable Point in co-operation with Norlandair. Flights to the Faroe Islands are offered year-round in co-operation with Atlantic Airways. Furthermore, Air Iceland offers day-tours within Iceland as well as day-tours to Kulusuk in Greenland.

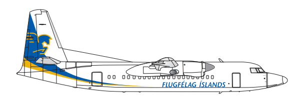
Markets

Air Iceland has the aim of providing its customers with the best possible service where simplicity and efficiency are key factors. With Air Iceland's exclusively branded card (Flugkort) corporate customers, which represent about 20% of the total number of the company's customers, enjoy various benefits, such as an extra luggage allowance, flexibility regarding name changes on tickets and modifications of travel schedules, to name just a few advantages, but with the main benefit being the discount offered based on each customer's annual turnover. As the majority of Air Iceland's customers travel at their own expense it is essential to be able to offer a variety of fares to match the different levels of purchasing power. By offering the option of buying the bulk of tickets at a discounted rate for different age groups (Flugfrelsi for adults, SMU for youths and Flugkappar for the youngest generation) and with regular offers to members of its Internet club, Air Iceland has made it more affordable for customers to travel more frequently. Due to the weak Icelandic economy and the heavy taxes on domestic flights, resulting in fewer passengers travelling with Air Iceland, the international arriving tourist market has grown in importance. With foreign tourist travels on domestic flights in Iceland increasing by 22% between years, this segment has become increasingly important, even though it still accounts for only 10% of the company's total passenger numbers on an annual basis.

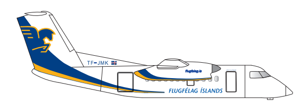
Outlook

As a result of the 2008 economic collapse and the increasingly heavy taxation of domestic airline services, Air Iceland's operating environment has been challenging in recent years. However, it is anticipated that the decline in the number of passengers has finally come to an end. With investment growing slowly and the economy recovering gradually in Iceland, Air Iceland is optimistic for 2014 and the following years. Opportunities on the fast-growing tourist market will be further exploited by fully utilising the recently connected global distribution system, Amadeus. Despite a more difficult operating environment, Air Iceland plans to grow and increase its profitability by offering the best available services in the Icelandic 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 both Iceland and the North Atlantic region. ■

Number of aircraft by aircraft type 31.12.2013
Air Iceland

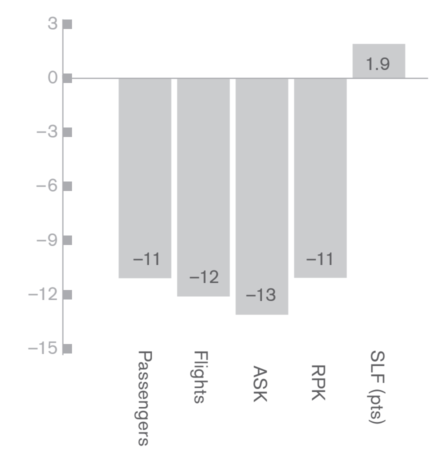


5 Fokker Friendship

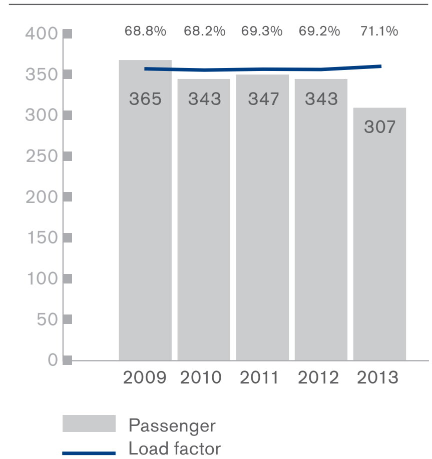


2 Dash 8-200

Traffic data Air Iceland | YOY change in %

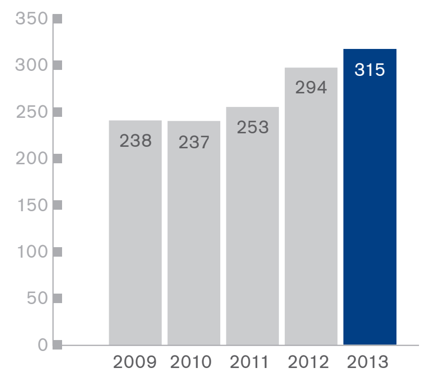


Number of passengers (thousands) and load factor | 2009–2013

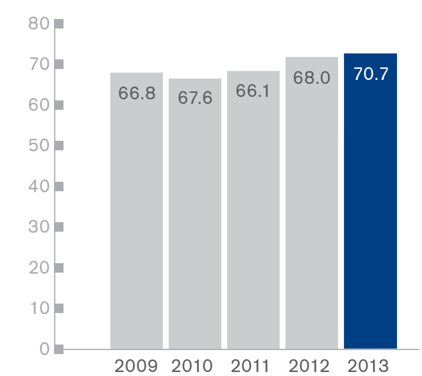


Icelandair Hotels

Available hotel room nights (thousands) | 2009–2013



Occupancy (%) | 2009–2013



Operation

Icelandair Hotels is Iceland's leading hotel chain, operated with the clear objective of creating an authentic Icelandic experience, leveraging the unique qualities and natural surroundings of our country as a tourist destination, and bearing in mind that a "Hotel stay and service is the most tangible part of the traveller's service experience in a destination."

It is the strategic goal of Icelandair Hotels to support value creation for its owners and sister companies through added brand recognition and a positive perception of Iceland as a destination, as the Group collectively aims for a long term build-up of "higher spending" segments visiting Iceland year-round.

2013 was a good year for Icelandair Hotels, with increased occupancy and higher revenue per average room. The company's structure was reinforced and further defined, and this work will be continued in 2014, when the emphasis will be on luxury markets and the MICE market (Meetings, Incentives, Conferences and Exhibitions).

Icelandair Hotel Herad and Hilton Reykjavik Nordica went through extensive renovations, and a new Edda Hotel was opened in Höfn. The new hotel was well received and further improvements of the property will be completed in 2014.

Markets

The main markets of the hotels are defined in line with Icelandair's Route Network and marketing efforts at any time. Continuing increases in the frequency of flights on existing routes and new N-American gateways provide significant opportunities for the further growth of our hotels.

Outlook

In 2014 the main projects of Icelandair Hotels will be the preparation and design of the new Icelandair Hotel Reykjavik Kultura, which is scheduled to open in Reykjavik city centre in the spring of 2015. The completion of the enlargement of the successful Icelandair Hotel Reykjavik Marina is also confirmed for early 2015.

The enhancement of winter stays continues to be a main emphasis of the hotels, as well as the focus on further strengthening the company's countryside hotels. Icelandair Hotels are optimistic for 2014 and aim at long term build-up of "higher spending" segments visiting Iceland year-round. ■

Icelandair Ground Services

Operation

Icelandair Ground Services (IGS) provides comprehensive airport ground handling services for airlines and passengers at Keflavík International Airport. The company has four independent business units and each is operated as an independent profit centre. The aircraft ground handling unit is the largest of the four units and is responsible for providing passenger services in the terminal and servicing aircraft. Flight catering is the second largest unit and is responsible for supplying in-flight meals and providing bar services. The bar and restaurant unit in the passenger terminal offers bar and meal services to passengers at four different locations in the terminal. The IGS cargo warehouse is responsible for providing airlines and their customers with warehouse handling and cargo storage. IGS possesses a wide range of ground handling equipment and is well positioned to provide universal ground handling services to all types of aircraft. A major asset in the operation is the fact that the company enjoys the services of a very highly dedicated and well trained staff in all areas of its operations. This has been the key to a very successful operation in a year when the companys resources have been stretched by the rapid growth of the market and the operations.

Markets

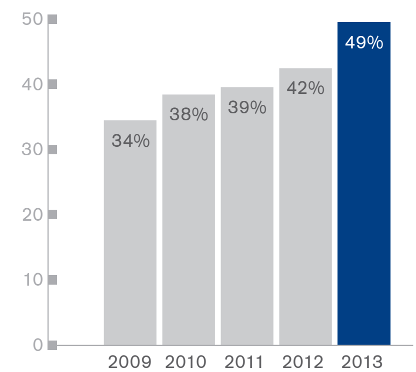
IGS's customers are the airlines and passengers travelling through Keflavik International Airport. This is a competitive market, as two other aircraft ground handling companies are operated at the airport and IGS is also in competition with other bar and restaurant services in the terminal. IGS's main income derives from aircraft ground handling services and the production of in-flight meals for airlines in the flight catering unit. Current and prospective customers are the airlines that include or will be including Keflavik Airport in their route network and the passengers transported by these airlines. Icelandair is by far IGS's largest customer. The company is also under contract with other airlines for ground handling services. General Aviation (i.e. flight activities other than commercial air transportation) is another market sector serviced by the company. On the in-flight meals side we have Icelandair as our biggest customer by far. Other airlines, such as Delta Airlines, Primera Air and Air Greenland, have also contracted with IGS for in-flight meals and services.

IGS saw rapid growth in all areas of its operation in 2013. This rapid growth was mostly driven by the expansion of the Icelandair Route Network. Opportunities for further market growth go hand in hand with the general growth in the number of flights and passengers passing through the airport and the ability of IGS to grow with the market and meet its customers' demands for first class services at competitive prices.

Outlook

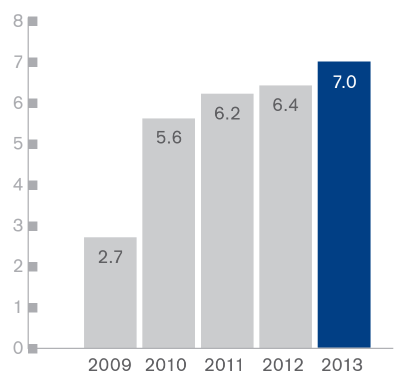
The general outlook for 2014 is good. The company's main challenge will be to meet the demands of customers in a rapidly growing market in a cost-efficient and professional manner. This entails investment in facility improvements, new ground handling equipment and additional manpower. The forecast growth in the number of flights and passengers passing through the terminal in the year will contribute to further improving our utilisation of manpower, equipment and facilities. IGS is anticipating and planning for a busy and an exciting year ahead with a healthy outcome at year end. ■

Passengers using self service, internet & phone check-in at Keflavik Airport
2009–2013



Fjárvakur – Icelandair Shared Services

Number of tickets processed in millions | 2009–2013



Operation

Fjárvakur – Icelandair Shared Services provides "one stop" financial services to its customers. The company was established in 2002 as a finance support department for Icelandair Group companies with the shared services concept as a cornerstone, but it soon diversified and began offering services to companies outside the Icelandair Group.

The company has three business units and each is operated as an independent profit centre. Financial Services provides services such as general accounting, debt collection, payments of supplier invoices, management information and reporting including systems for customers in Iceland. Human Resource Services provides payroll and HR services for customers in Iceland. Revenue Accounting Services provides services such as sales accounting, other airline accounting, revenue uplift, ticket refunds and sales audits for airlines, both in Iceland and abroad.

Markets

The company offers its financial, payroll and HR services to companies in Iceland that have an annual turnover of more than 5 million USD and/or 50 employees or more. The main customers for revenue accounting are airlines in Northern Europe with less than 3 million passengers per year.

The company saw growth in all areas of its operation in 2013. The expansion of the Icelandair Route Network contributed significantly to this growth but the company also attracted a number of new customers in 2013.

Outlook

The outlook for 2014 is good with indications of continued growth. Business outside Icelandair Group is expected to represent 40% of the company's total turnover in 2014, which is similar to the proportion in 2013. ■

Vita

Operation

Vita is an outgoing tour operator for leisure tourism and a specialised business travel agent. The team at Vita consists of approximately 14 full-time employees, all experienced and well educated in the industry. Vita served 10,000 clients in 2013, mainly on charter flights operated by Icelandair.

Markets

Vita's outgoing holiday markets consist of year-round sun destinations, City Breaks, Ski Holidays, Golf Trips, Sport Events, Cruises and Special Interest Groups. Vita is a IATA-licensed travel agent serving companies and individuals in Iceland with packages and flights all over the world.

Outlook

Due to the economic conditions and restricted purchasing power in Iceland, outgoing tourism is difficult at present. There are some indications that the bottom has been reached, as the number of bookings has increased from same time last year. Vita is anticipating growth in 2014. Capacity will be similar to 2013, but Vita is positioned to respond to increased demand at short notice and has the ability to increase capacity, both in charters and on scheduled flights, in line with market demand at no additional cost. ■

Iceland Travel

Operation

Iceland Travel is the largest tourism service provider in Iceland, offering a wide range of high-quality services for travellers from all over the world, including categories such as Leisure, MICE (Meetings, Incentives, Conferences and Events) and Cruise Services. Using a multi-channel sales approach, with the focus on enhancing the development and marketing of Iceland as a destination, the team at Iceland Travel consists of more than 100 full-time employees, with extensive experience of their core markets and well educated in the industry as a whole.

Markets

Iceland Travel's core market consists in services to business-to-business tour operators and travel agencies, mainly in North America and Europe. The focus on direct sales to customers is mainly through web solutions and tour desks. The company's leisure clients are mainly senior travellers seeking relaxation (55+) and affluent adventure-seeking tourists. Iceland Travel has weighted its customer base in the direction of more affluent clients by focusing attention on MICE and Luxury services. Iceland Travel's growth has exceeded the growth rate of incoming tourists to Iceland in 2013.

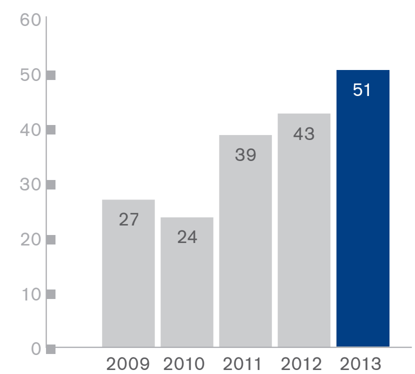
Iceland Travel is a member of a number of domestic and international associations, including the Icelandic Travel Industry Association, Meet in Reykjavik, the United States Tour Operators Association (USTOA), the Japan Association of Travel Agents (JATA), and many more. Iceland Travel is a registered trademark in the USA.

Outlook

The environment in Iceland has been favourable for incoming tourism in recent years. The growth of the Icelandair Route Network, along with increased efforts to sell Iceland as a year-round destination, have provided opportunities for growth.

The outlook for 2014 is promising, and further growth is anticipated. By using a multi-channel sales approach, Iceland Travel is able to optimize its marketing efforts in favour of different markets, including Leisure, MICE and Cruise and/or business-to-business and direct to customer sales. Increased attention has been focussed on higher-end passengers through MICE and Luxury sales and direct sales to customers through online solutions. ■

Number of tourists with flights to Iceland through IT (thousands) | 2009–2013



07 **ÆÐARFUGL, LÁTRAR | 65.5281°N, 24.4624°W**
Látrabjarg is the western-most point of Europe.
Birds live there. Millions of them.

Icelandair Group and the Community

Icelandair Group supports a wide variety of community activities all year round. The main focus is on support for Icelandic sports, Icelandic music, the Icelandic tourist industry and the Special Children Foundation.

The National Olympic and Sports Association Of Iceland

The National Olympic and Sports Association of Iceland (ISI) is the umbrella organisation of the entire sports movement in Iceland and the supreme authority in all amateur sports activities and associated volunteer work in Iceland under the Sports Act. ISI 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 ISI and is one of the four companies forming the ISI 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 and coaches 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. 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. In 2012 Icelandair Group established a fund called Forskot along with the Golf Union of Iceland, and three other Icelandic companies. The objective of the fund is to support Icelandic professional and amateur golfers who aim to play golf at a world-class level.

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.

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.

Iceland Airwaves

Icelandair is the founder and main sponsor of Iceland Airwaves (or "Icelandair waves" as some of us like to spell it), 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 Quarashi, Sigur Ros, Apparat Organ Quartet, Trabant, Of Monsters and Men, Asgeir Trausti and others, have made their way to the international music scene. For more details see the festival website www.icelandairwaves.com.

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.

Reykjavik Airbridge

Icelandair supports Icelandic musical talent beyond Iceland Airwaves. Through co-operation with the city of Reykjavik, Icelandair has set up 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 exclusively with Icelandic ingredients. 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.

Special Children Travel Fund

The main objective of the Special Children Travel Fund is to help children suffering from long-term illness or other difficult circumstances to see something of the world. The fund is supported both directly by Icelandair and through the generous gifts of our customers. We estimate that each year the Icelandair Travel Fund will enable 20 children and their families, from all over the world, to go on their "dream journey". Vigdis Finnbogadottir, former President of Iceland, is the protector of the fund. For more details see www.vildarborn.is ■

Environment

Icelandair Group recognizes its responsibility for protecting the environment and ensuring a sustainable future. The Company seeks to minimise the impact of its operations on the planet's climate and the global environment, and is committed to designing and implementing innovative solutions and initiatives to achieve its goals.

Icelandair Group is going green

Icelandair Group aims to obtain ISO-14001 Environmental Management System certification for all Icelandair Group companies by 2016. We have already received ISO-14001 certification for Icelandair Hotel Natura and Marina.

Icelandair Group is dedicated to its mission of implementing programmes of continuing environmental education for its staff and informing its customers of 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 the use of green energy and minimize waste in all operations by adopting sustainable solutions.

Environmental policy

Icelandair Group's Environmental Policy describes our approaches to protect and preserve the environment. All employees are responsible for ensuring compliance with Company policy. Management at all Company subsidiaries and entities 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 Icelandair Group companies by 2016.
- Regularly communicate environmental awareness matters to employees, customers, suppliers and the public.
- Protect the environment by adopting sustainable business practices, technologies and procedures that maximize the use of green energy, minimize 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 in complying with environmental rules and regulations in our operations to minimize our impact on the environment.
- Require every employee to comply with this environmental statement and with procedures relating to environmental sustainability.
- Encourage employees to point out environmentally friendly methods to enhance our daily operations.

Environmental awareness

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

Protecting the atmosphere and maximizing 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 impact of our business on Earth's climate, Icelandair Group considers climate preservation an important mission. To attain its goals Icelandair Group has established numerous programs to maximize fuel efficiency and has 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 recognizes the importance of conserving fuel and minimizing 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 operations 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 2013 was 3.86 litres per 100 RPK (revenue passenger kilometre) while in 2013 Icelandair moved 2,000 tonnes more freight kg, up by 19% from 2012, as compared to 3.81 litres per 100 RPK in 2012, 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 (as laid down in ICAO Annex 16, Vol. I). Additionally, Icelandair strives to keep noise at minimum using noise abatement procedures.

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 concerning aircraft engine emissions (as laid down in ICAO Annex 16, Vol. II).

Minimizing waste and managing utilities

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

The Waste Management Program 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. The Company's goals are to reduce waste, reuse and recycle materials, conserve energy and reduce pollution and greenhouse gas emissions. Accordingly, our offices follow a "print-by-need" policy and they 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 suppliers that have adopted the best environmental practices. Our suppliers will be audited with regard to environmental awareness and the level of environmental control they have implemented in their operations in order to support our environmental policy. We will communicate environmental matters to our suppliers as necessary for the duration of our business relationships.

Benefits of commuting

Icelandair Group will implement an environmentally sound commuting policy. Using public transportation, carpooling, biking, or telecommuting can save energy and reduce greenhouse gas emissions from 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. ■

08 **ARNARSTAPI | 64.7707°N, 23.6190°W**
Even in a lonely house under a lonely mountain, you will find hospitality and welcoming people. Iceland's nature, people and diverse activities are what draws visitors to the country.

Employees

The steady growth of Icelandair Group in recent years has continually borne out the integral part that our employees play in our success. Their quality, dedication and team spirit have repeatedly been put to the test and they have come through every time with flying colours. They possess a broad range of skills and knowledge, as required by the diverse nature of our operations, which benefits the Group as a whole. We need to provide our employees with attractive and challenging opportunities so that we can remain successful and continue to grow.

Recent years have seen a significant growth in the number of our employees. This rapid growth, combined with the disruptions to our services caused by natural disasters, has tested our mettle. Our employees have responded with admirable resilience and energy, showing initiative and flexibility and great team spirit, thereby underlining their commitment to the Company. This commitment cuts both ways.

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

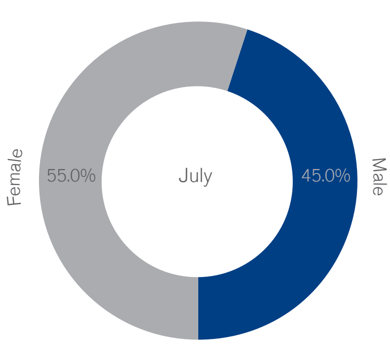
Recruitment

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.

As one of Iceland's largest private employers and the de facto flagship carrier of Iceland, 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 a wide range of jobs to highly trained professionals at competitive salaries in an international working environment.

Because of the seasonality of our business we need to take on around 1,100 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. As they acquire knowledge of the business they gain faith in their work, loyalty to the Company and pride in its success.

Male / female ratio Icelandair Group
July 2013

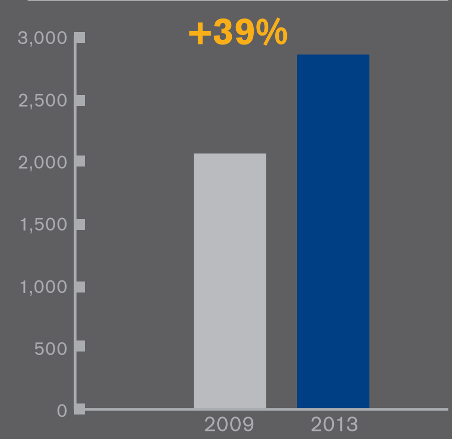


Icelandair Group employees, full time equivalents (FTEs) by company

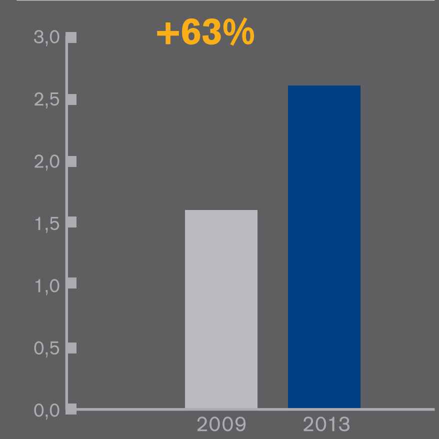
	2013	2012	2011	2010	2009
Icelandair	1,387	1,236	1,179	981	1,028
IGS	469	425	386	354	343
Icelandair Cargo	49	47	44	37	49
Loftleidir	11	11	11	11	10
Air Iceland	230	224	224	225	231
Icelandair Hotels	468	384	313	234	218
Iceland Travel	94	64	64	76	64
Vita	19	21	–	–	–
Fjárvakur – Icelandair Shared Services	109	107	95	105	95
Icelandair Group	13	13	13	14	15
Total	**2,850**	**2,532**	**2,350**	**2,028**	**2,053**

Our growth from 2009 in numbers

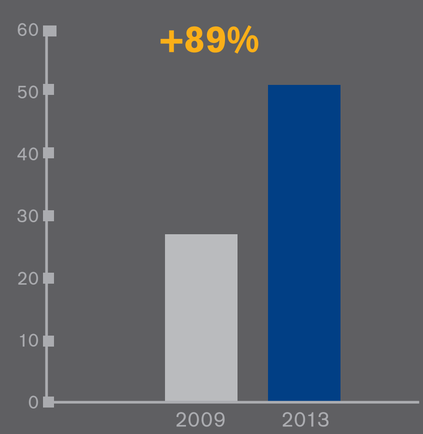
Employees
2009–2013



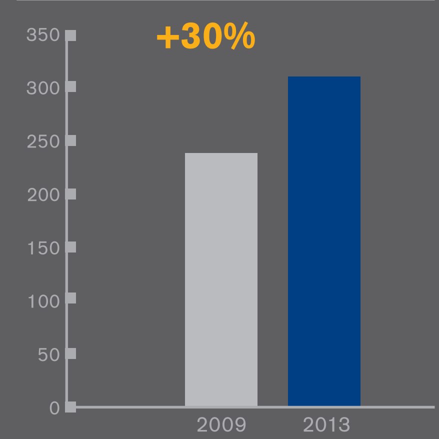
Passengers in millions
2009–2013



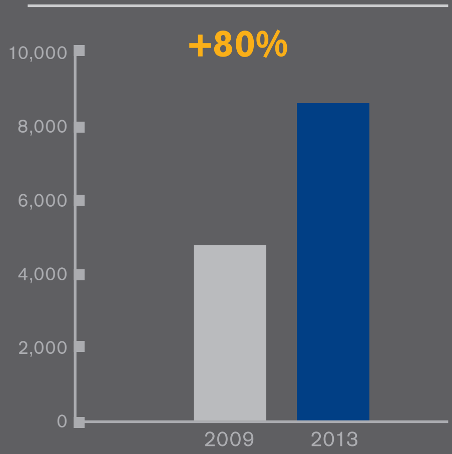
Iceland Travel flight passengers in thousands
2009–2013



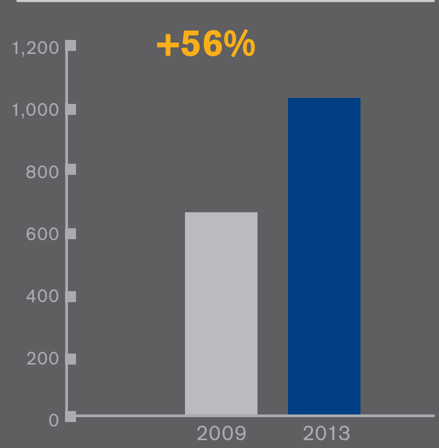
Available Hotel Room Nights in thousands
2009–2013



Available Seat Kilometers (ASK) in millions
2009–2013



Total income in USD millions
2009–2013



Employees, continued:

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

	Jan. 2013	Jul. 2013
Icelandair	1,188	1,603
IGS	351	640
Icelandair Cargo	45	54
Loftleidir	11	11
Air Iceland	222	261
Icelandair Hotels	380	694
Iceland Travel	76	109
Vita	21	18
Fjárvakur - Icelandair Shared Services	110	115
Icelandair Group	13	13
Total	**2,417**	**3,518**

Professional development

We emphasise the professional development of our employees because we want to make the best use of their talents. 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.

Employees, by job tenure

31.12.2013	
Icelandair	15.0
IGS	7.6
Icelandair Cargo	14.0
Loftleiðir	13.5
Air Iceland	14.2
Icelandair Hotels	3.3
Iceland Travel	6.3
Fjárvakur – Icelandair Shared Services	10.9
Icelandair Group	13.8
Average employment in years	**10.6**

Communications

We keep our employees informed with timely and accurate reports on Company affairs. This is especially important, because our operations are 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 among employees.

In MyWork we have created a way to store the reservoir of experience and knowledge within our employees 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.

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 exchanges of this kind we are able to build trust between employees and management, which in turn is the basis for achieving maximum results. All of this serves to keep our employees committed and maintain a team spirit within the Company.

Human resource strategy

Icelandair Group seeks to attract qualified personnel who can help the Company meet the challenges of the future while upholding the standards that have served us so well in the past. In order to attract ambitious and qualified people we strive to maintain a superior workplace which is challenging and demanding, but at the same time welcoming and satisfying, so that we are always able select the best person for every job.

Our Human Resource strategy emphasises equality and non-discrimination and welcomes diversity in our workforce. All employees are required to 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 are given equal opportunities to further their career. Above all, we will make sure that all our employees feel they are part of a team. ■

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.

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 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. Björgólfur is the chairman of the Confederation of Icelandic Employers. 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 ICELANDAIR 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, where he previously worked as Director of Sales and Marketing at. Before that, he was 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 he 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.

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 an independent subsidiary of Icelandair Group since January 2012.

MAGNÚS KR. INGASON
MANAGING DIRECTOR, FJÁRVAKUR – ICELANDAIR SHARED SERVICES
Magnús joined Icelandair Group in 1998. He has been Managing Director of Fjárvakur - Icelandair Shared Services since its incorporation at year-end 2002. 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 chartered accountant in 1999.

09 **SKÓGAFOSS | 63.5310°N, 19.5118°W**
Waterfalls hold much allure for those who visit Iceland. After all, falling water can be almost hypnotizing.

PHOTO: SIGGI ANTON

The Boston Consulting Group Report on the Future of Tourism in Iceland

In September 2013, the Boston Consulting Group (BCG) published its independent report on the future of Icelandic tourism. The project was a private initiative launched by a broad set of companies with a strong stake in Iceland's future success as an attractive, growing and sustainable tourist destination. These include Icelandair Group, Blue Lagoon, Holdur / Europcar, and Isavia. The report was intended to bring to the table new ideas, new evidence, and new analysis in the active and ongoing debate on this important subject in Iceland.

The report was presented by BCG in at a conference with over 1,000 participants in Harpa, Iceland's Concert Hall, with opening statements from the the Prime Minister of Iceland and the Minister of Industry and Commerce.

The following pages comprise a brief overview of the report.

The Boston Consulting Group Report, continued

Tourism is a vital part sector of the Icelandic economy. In 2013, it is likely to become the country's largest export sector, overtaking fisheries for the first time ever in Iceland's history. Iceland has been remarkably successful over the past ten years in attracting new visitors, who consistently leave the country with a smiles on their faces, inspired by Iceland's distinctive natural surroundings, unique culture, and warm-hearted welcome.

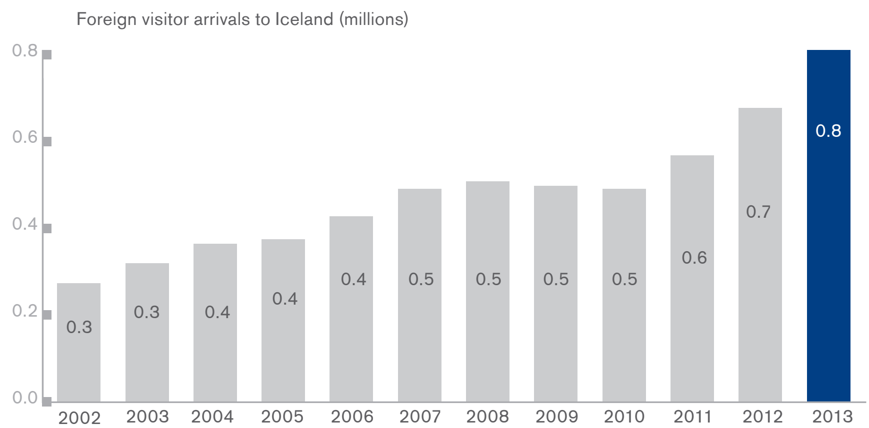
The next ten years could see Iceland move to a new phase of development, with visitors generating substantial new revenues to fund new products, environmental conservation programmes, and infrastructure – creating more and better jobs, increased tax income, and economic growth as a result. However, achieving this goal will require a concerted effort from a host of individuals and organisations across Iceland's tourism sector.

Over the past ten years, the successful growth of tourism has done much to aid the Icelandic economy, while at the same time giving the country a far greater degree of international exposure. Looking to the next ten years, the future still looks bright for Icelandic tourism. There's much to do, but much work remains to be done to make it move from vision to reality.

Iceland has been remarkably successful over the past ten years in attracting new visitors, who consistently leave the country with a smiles on their faces, inspired by Iceland's distinctive natural surroundings, unique culture, and warm-hearted welcome.

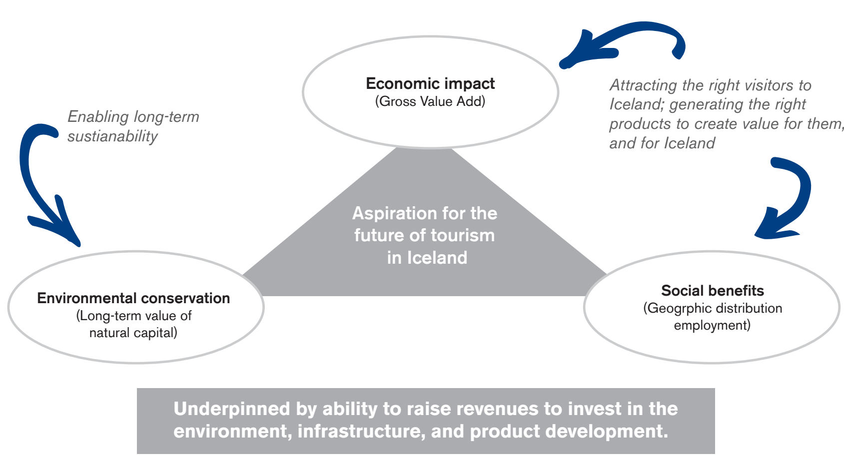
The full report, presentations and videos are available at: www.icelandictourism.is

Iceland has succeeded in more than doubling foreign visitors over ten years



Over the past 10 years, Iceland has more than doubled the number of visitors that arrive through its four international airports, the Smyril Line sea route, and cruises. From around 249,000 in 2002, international visitor numbers through Keflavik, capturing the vast bulk of arrivals, exceeded 781,000 last year.

Iceland's aspiration for tourism should take into accont three key goals

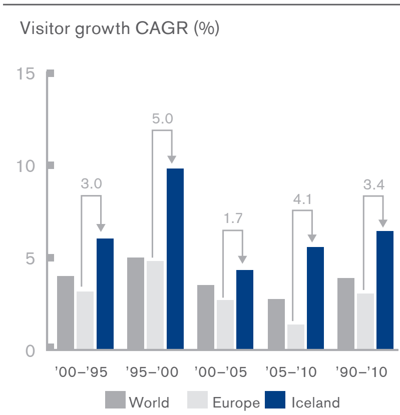


While increasing tourism will bring significant benefits, it will also create significant challenges for the country: Conserving nature, engaging visitors to spend more during their stay, reducing the seasonality of tourism, and spreading visitors further around the country.

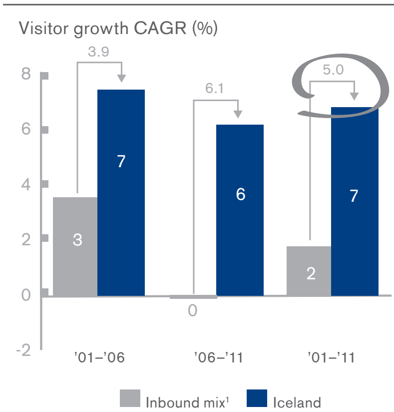
Balancing the opportunities of growth with the need to address its challenges, we believe that the future vision for Icelandic tourism should be to "maximise tourism's contribution to the whole of Iceland with managed and sustainable growth of visitors inspired by Iceland's distinctive nature, unique culture and warm-hearted welcome."

The Boston Consulting Group Report, continued

Iceland outgrowing European and World tourism by 2-5p.p. since 1990



Compared to growth of Iceland's inbound pools, outperforming by 5p.p.

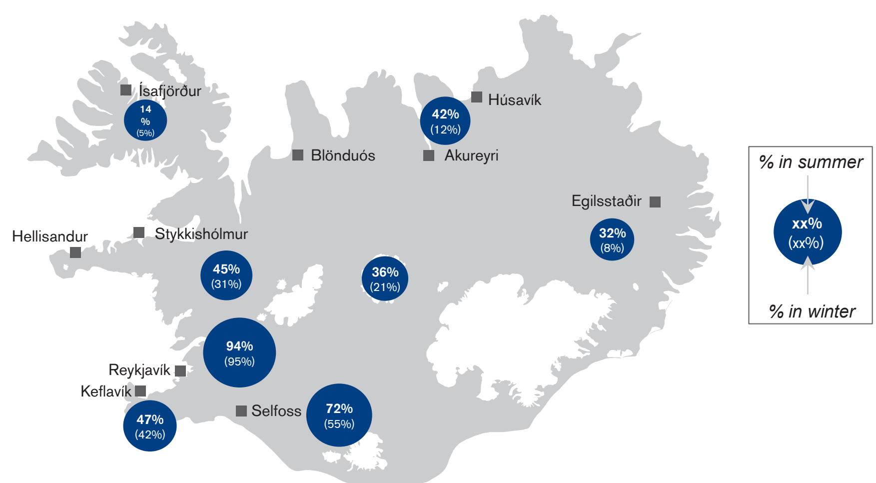


Icelandic tourism has grown significantly faster than world tourism over two decades

The BCG analysis shows the extent to which Iceland has outpaced European and world tourism growth over an extended period of time. It is not only that Iceland attracts visitors from particularly high-growth countries. The upper chart on the left shows that, even considering Iceland's inbound market mix, i.e. the set of countries that send visitors to Iceland today, Iceland has grown as much as five percentage points faster per year than the total growth of outbound tourists from those countries. In business terminology, Iceland is winning market share from competing destinations.

Most visitors only experience southern and western regions of Iceland

Icelandic tourism is strongly focused around Reykjavik and the South-West. Recent visitor surveys show that, while around 95% of visitors to Iceland spend time in Reykjavik, less than half visit the North, and only around a third make it to the East. This is largely driven by the presence of Keflavik International Airport in the region and the concentration of accessible, high-quality attractions in the "Golden Circle" of the South-West, the home to world-famous Geysir, Gullfoss and Þingvellir National Park.

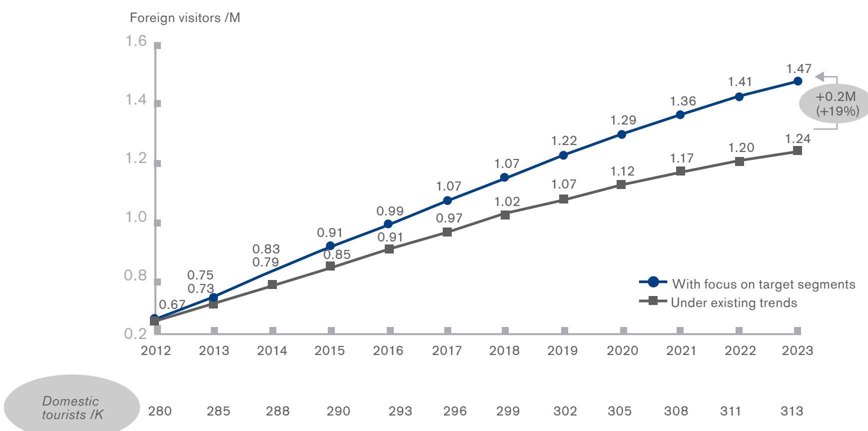


Source: Icelandic Tourist Board: "Visitor Surveys Summer & Winter 2011/2012"

Projections of tourism visitor numbers over the next ten years

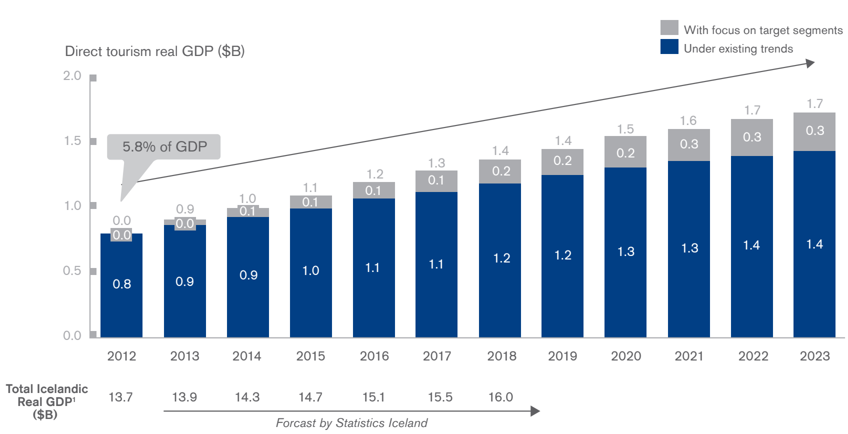
BCG estimates that foreign visitor arrivals will grow from 0.67 million in 2012 to around 1.2 million in 2023 under existing trends. If, however, Iceland effectively attracts the target visitor segments described in this report, and puts in place the measures BCG recommends, then we believe this would rise to approximately 1.5 million in ten years.

This visitor projection is based on three key drivers of future growth: (1) Growth in future travel by categories in each of Iceland's inbound markets (adjusted for expected demographic trends); (2) Iceland's track record of superior performance at attracting travellers from these inbound markets, based on recent trends and expectations on how this might develop in future; and, finally, (3) the improved penetration of our target visitor segments that we would expect if Iceland pursues the strategy described in this report.



Forecast growth of tourism's direct contribution to Icelandic GDP

BCG estimates that tourism's direct contribution to Iceland's GDP will rise from $0.8Bn in 2012 to $1.7Bn (ISK 215Bn) by 2023. This implies an annual growth rate in the direct tourism economy (i.e., airlines, hotels, tour operators, restaurant spend, etc.) of around 7% per year. This compares with the current forecast growth rate of Icelandic GDP of 2.6% per year by Statistics Iceland. Clearly, this implies a substantial increase in tourism's share of Iceland's GDP, making it one of the key potential growth engines of the Icelandic economy in the years ahead.



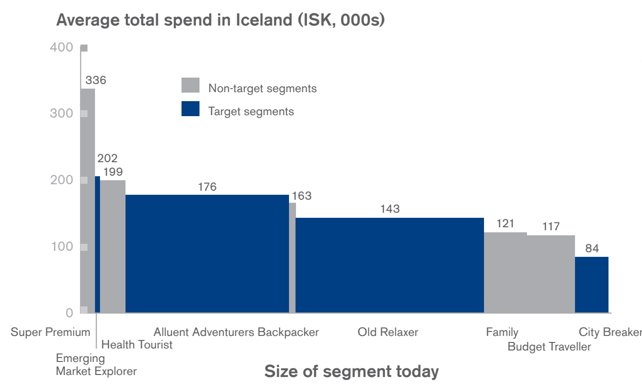
Source: *Icelandic tourism board, Isavia, EIU, Euromonitor, UNWTO; Statistics Iceland; Oanda; HVS; Icelandic Road Administration; BCG analysis.*
Note: *2012 prices, 2012 USD: ISK exchange rate applied, Domestic tourists' incremental spend on tourism and cruise passengers' spend in Iceland also included in calculation*

BCG estimates that foreign visitor arrivals will grow from 0.67 million in 2012 to around 1.2 million in 2023 under existing trends. If, however, Iceland effectively attracts the target visitor segments described in this report, and puts in place the measures we recommend, then we believe this would rise to approximately 1.5 million in ten years.

The Boston Consulting Group Report, continued

Affluent Adventurers and Older Relaxers highest value to Iceland today

Two target segments (Older Relaxers and Affluent Adventurers) are also the most important groups to Iceland today in terms of their spend. The other targets, City Breakers and Emerging Market Explorers, are much smaller, but have other attractive features (i.e. tendency to visit during winter, high spend per day and very high expected future growth).



Indexed total spend by segment	
Affluent Adventurrers	100
Older Relaxers	93
Budget Travellers	20
Families	18
Health Tourists	17
Super Premium	15
City Breaker	10
Backpacker	3
Emerging Market Explorer	3

Note: Cruise & MICE segments not covered by survey

Note. *Calculations weighted to adjust for seasonal bias. 2011 / 2012 average exchange rate used to convert from Krona. Groups not MECE. Index: Affluent Adventurer total spend = 100*
Source: *MMR–International Visitors in Iceland, 2011 / 2012. BCG analysis*

The story of Iceland's tourism sector is much like that of its underground geothermal energy. Dormant for many years, with considerable untapped potential, it is now all fired up and ready to go. Encouraged by effective marketing, increased international news coverage, a devalued currency, and an expansion in air routes, it has shown how quickly it can develop.

Iceland is blessed with a wide range of natural resources: From its bountiful oceans to its abundant sources of energy. These assets have proved a reliable source of economic wellbeing for the Icelandic people for many decades, if not centuries. Today, a relatively new resource is ripe for development: That is the international appeal of Iceland's extraordinary nature, unique culture, and authentically warm-hearted people.

This substantial increase in economic activity will stimulate a considerable increase in new job creation across multiple sectors in Iceland: Direct tourism-related occupations (hotel and airport staff, tour guides, etc.); construction; and other "overhead" roles such as marketing, administration, administration, logistics, etc.

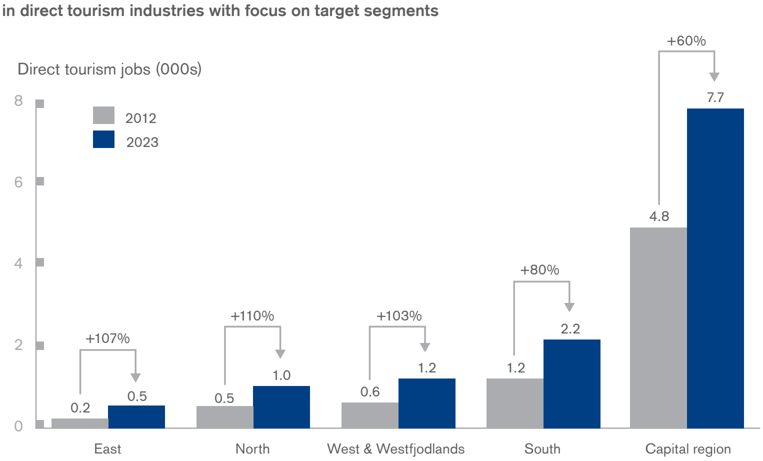
The story of Iceland's tourism sector is much like that of its underground geothermal energy. Dormant for many years, with considerable untapped potential, it is now all fired up and ready to go.

BCG's projections of the impact of tourism growth on employment show more than 5,000 new direct tourism-linked jobs being created over the ten years to 2023, up from around 7,400 today. In short, the growth in tourism will create more jobs, but it will also create better, higher-paying jobs.

It will also create more jobs outside of the Capital region and the South. The number of tourism employees will rise by around 60% in the Capital region and 80% the South, but by around 110% in the North and East and 100% in the West, and Westfjords.

All regions predicted to benefit from increased tourism employment, with highest growth in the North & East

Employment in direct tourism industries with focus on target segments



~1.4k of of 5.2k new direct jobs created in East, North and West

Gaustave Flaubert said "Travel makes one modest. You see what a tiny place you occupy in the world." There is nowhere like Iceland to turn a brash tourist into a humble supplicant to the wonders of nature. Tourism is one of Iceland's gifts to the world. Let's make it even better. ■

Transforming tourism will bring major gains to all of Iceland

+4.2M	**Additional foreign visitor overnight stays annually**
150%	**Increase in visitor nights in regions outside the south**
215B ISK	**Annual direct tourism GDP contribution in 2023** (+105B ISK increase from 2013)
7%	**Grooth in tourism's direct GDP contribution p.a. since 2013** Double the rate report
+5.5K	**Additional tourism jobs created over 10 years** ~ double the number of tourism jobs outside the south today
+16B ISK	**Incemental direct tax contribution from tourism since 2013** Equivalent to ~120K IAK per Icelandic household per year

10 **KRÍSUVÍKURVEGUR | 64.0170°N, 21.9514°W**
Many who visit mention the grand colour palette of the country. At Krísuvíkurvegur, the country has donned its best dress, ready to greet visitors.

Endorsement and Statement by the Board of Directors and the CEO

Operations in the year 2013

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.

In February 2013 Icelandair Group and Boeing finalized an agreement for the purchase of sixteen 737 MAX8 and 737 MAX9 aircraft with an option to purchase additional eight aircraft. The delivery of the first aircraft is scheduled in the first half of 2018. The commitment for all sixteen aircraft is valued at USD 1.6 billion at Boeing list prices. The Company received acceptable discounts which due to confidentiality agreements cannot be disclosed. The acquisition will be funded by internal resources and from aviation finance products.

Profit for the year 2013 amounted to USD 56.4 million and total comprehensive income amounted to USD 61.9 million according to the consolidated statement of comprehensive income. Total equity at year end 2013 amounted to USD 346.1 million, including share capital of USD 40.6 million, according to the consolidated statement of financial postition. Reference is made to the consolidated statement of changes in equity regarding information on changes in equity during the year.

The Board of Directors proposes a dividend payment to shareholders in 2014 of ISK 2.150 million, equal to USD 18.6 million, which represents 30% of total comprehensive income for the year 2013.

Share capital and Articles of Association

The nominal value of the Company's issued share capital amounted to ISK 5.0 billion at year-end, of which the Company held treasury shares 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 member 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 year end 2013 was 1,833, which is an increase of 375 during the year. At year end 10 largest shareholders were:

Name	Shares in ISK thousand	Shares in %
Lífeyrissjóður verslunarmanna	718,136	14.36
Stefnir – ÍS 15	495,975	9.92
Lífeyrissjóður starfsmanna ríkisins A-deild	370,500	7.41
Framtakssjóður Íslands	350,540	7.01
Stefnir - ÍS 5	308,008	6.16
Gildi – lífeyrissjóður	245,042	4.90
Íslandssjóðir hf.	180,030	3.60
Lífeyrissjóður starfsmanna ríkisins B-deild	171,000	3.42
Stafir lífeyrissjóður	158,079	3.16
Íslandsbanki hf.	149,996	3.00
	3,147,305	62.94
Other shareholders	1,827,235	37.05
Treasury shares	25,460	0.01
Total issued shares	5,000,000	100.00

Further information on matters related to share capital is disclosed in note 25. Additional information on shareholders are provided on the Company's webside www.Icelandairgroup.com.

Corporate Governance

The Group's management is 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 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.

Information on matters related to financial risk management is disclosed in note 31.

Statement by the Board of Directors and the CEO

The consolidated financial statements for the year ended 31 December 2013 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 2013, its assets, liabilities and consolidated financial position as at 31 December 2013 and its consolidated cash flows for the year 2013.

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 2013 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, 6 February 2014

Board of Directors:

Sigurður Helgason,
Chairman of the Board

Ásthildur Margrét Otharsdóttir

Herdís Dröfn Fjeldsted

Katrín Olga Jóhannesdóttir

Úlfar Steindórsson

Magnús Magnússon

President and 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 2013, 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 Consolidated Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated 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 2013, 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 104, Paragraph 2 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 consolidated financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the consolidated financial statements. ■

Reykjavík, 6 February 2014

KPMG ehf.

Alexander G. Eðvardsson

Guðný Helga Guðmundsdóttir

Consolidated Financial Statements

Consolidated Statement of Comprehensive Income for the year 2013

	Notes	2013	2012
Operating income			
Transport revenue	7	702,882	604,499
Aircraft and aircrew lease		117,969	120,815
Other operating revenue	7	202,106	173,552
		1,022,957	898,866
Operating expenses			
Salaries and other personnel expenses	8	239,432	203,815
Aircraft fuel		242,630	220,059
Aircraft and aircrew lease		34,570	46,740
Aircraft maintenance expenses		81,475	78,197
Aircraft handling, landing and communication		74,316	66,467
Other operating expenses	8	206,824	173,942
		879,247	789,220
Operating profit before depreciation and amortisation (EBITDA)		143,710	109,646
Depreciation and amortisation	9	(70,699)	(58,859)
Operating profit (EBIT)		73,011	50,787
Finance income		6,777	17,578
Finance costs		(8,702)	(10,551)
Net finance (costs) income	10	(1,925)	7,027
Share of loss of associates, net of tax	17	(38)	(366)
Profit before tax		71,048	57,448
Income tax	20	(14,630)	(13,173)
Profit for the year		56,418	44,275
Other comprehensive income			
Items that are or may be reclassified to profit or loss			
Currency translation differences		4,204	(2,285)
Net profit (loss) on hedge of investment, net of tax		169	(46)
Net investment hedge reclassified to profit or loss		(111)	(1,417)
Effective portion of changes in fair value of cash flow hedge, net of tax		1,230	(1,673)
Other comprehensive profit (loss) for the year		5,492	(5,421)
Total comprehensive income for the year		61,910	38,854

The notes on pages 95 to 125 are an integral part of these consolidated financial statements.

Amounts are in USD thousand

Consolidated Statement of Comprehensive Income for the year 2013, continued:

	Notes	2013	2012
Profit attributable to:			
Owners of the Company		56,386	44,228
Non-controlling interests		32	47
Profit for the year		56,418	44,275
Total Comprehensive income attributable to:			
Owners of the Company		61,928	38,834
Non-controlling interests		(18)	20
Total comprehensive income for the year		61,910	38,854
Earnings per share:			
Basic earnings per share expressed in USD cent per share	26	1.13	0.89
Diluted earnings per share expressed in USD cent per share	26	1.13	0.89

The notes on pages 95 to 125 are an integral part of these consolidated financial statements.

Amounts are in USD thousand

Consolidated Statement of Financial Position as at 31 December 2013

	Notes	2013	2012
Assets:			
Operating assets	11–14	299,197	282,997
Intangible assets and goodwill	15–16	179,676	176,715
Investments in associates	17	2,035	1,327
Long-term cost	18	258	3,648
Non-current receivables and deposits	19	15,791	9,223
Non-current assets		496,957	473,910
Inventories	21	22,166	17,417
Trade and other receivables	22	114,259	135,085
Marketable securites	23	7,955	15,734
Cash and cash equivalents	24	191,538	117,060
Assets classified as held for sale	6	0	3,689
Current assets		335,918	288,985
Total assets		832,875	762,895
Equity:			
Share capital		40,576	40,576
Share premium		154,705	154,705
Reserves		31,706	26,164
Retained earnings		118,856	74,230
Equity attributable to equity holders of the Company	25	345,843	295,675
Non-controlling interests		239	257
Total equity		346,082	295,932
Liabilities:			
Loans and borrowings	27	78,489	119,358
Payables	28	23,742	22,060
Deferred tax liabilities	20	27,995	19,671
Non-current liabilities		130,226	161,089
Loans and borrowings	27	43,528	31,548
Trade and other payables	29	159,504	152,237
Deferred income	30	153,535	122,089
Current liabilities		356,567	305,874
Total liabilities		486,793	466,963
Total equity and liabilities		832,875	762,895

The notes on pages 95 to 125 are an integral part of these consolidated financial statements.

Amounts are in USD thousand

Consolidated Statement of Changes in Equity for the year 2013

	Attributable to equity holders of the Company						
	Share capital	Share premium	Reserves	Retained earnings	Total	Non-controlling interest	Total equity
2012							
Balance at 1 January 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
Divided (0.13 USD cent per share)				(6,308)	(6,308)		(6,308)
Balance at 31 December 2012	40,576	154,705	26,164	74,230	295,674	257	295,932
2013							
Balance at 1 January 2013 ...	40,576	154,705	26,164	74,230	295,674	257	295,932
Total comprehensive income ...			5,542	56,386	61,928	(18)	61,910
Dividend (0.24 USD cent per share)				(11,760)	(11,760)		(11,760)
Balance at 31 December 2013	40,576	154,705	31,706	118,856	345,842	239	346,082

Information on changes in other reserves are provided in note 25.

The notes on pages 95 to 125 are an integral part of these consolidated financial statements.

Amounts are in USD thousand

Consolidated Statement of Cash Flows for the year 2013

	Notes	2013	2012
Cash flows from operating activities:			
Profit for the year		56,418	44,275
Adjustments for:			
Depreciation and amortisation	9	70,699	58,859
Other operating items	41	35,268	38,356
Working capital from operations		162,385	141,490
Net change in operating assets and liabilities	42	68,489	25,253
Net cash from operating activities		230,874	166,743
Cash flows to investing activities:			
Acquisition of operating assets	11	(86,916)	(62,529)
Proceeds from the sale of operating assets		1,594	6,822
Acquisition of intangible assets	15	(3,475)	(2,497)
Acquisition of long-term cost		(23,849)	(26,848)
Long-term receivables, change		(8,622)	(2,605)
Marketable securites, change		8,045	11,181
Net cash used in investing activities		(113,223)	(76,476)
Cash flows to financing activities:			
Dividend paid	25	(11,760)	(6,308)
Repayment of long term borrowings		(33,472)	(45,145)
Net cash used in financing activities		(45,232)	(51,453)
Increase in cash and cash equivalents		72,419	38,814
Effect of exchange rate fluctuations on cash held		2,059	(1,159)
Cash and cash equivalents at beginning of the year		117,060	79,405
Cash and cash equivalents at 31 December	24	191,538	117,060
Investment and financing without cash flow effect:			
Sale of operating assets		2,700	875
Trade and other payables		(2,700)	0
Repayment of long term debt		0	(875)
Aquisition of operating assets		0	(4,000)
Long term receivables		0	4,000

Information on interest paid and received are provided in note 43.

The notes on pages 95 to 125 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 2013 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. They were authorised for issue by the Company's board of directors on 6 February 2014.

b. Restatement of comparative figures

When preparing the financial statements for the year 2013, new and improved methods of eliminating intercompany transactions were put in place. As the change affects the classification of cost, comparative figures for 2012 have been adjusted accordingly. The effect on the comparative figures is a reduction in Aircraft and aircrew lease of USD 29 million and comparative increase in Aircraft maintenance expenses. Insignificant adjustments were made to other line items of operating expenses. The restatement of the comparative amounts has no other effect on the consolidated financial statements.

c. 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.

Details of the Group's accounting policies, including changes during the year, are included in Note 45.

03 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, unless otherwise indicated.

04 Use of estimates and judgements

In preparing these consolidated financial statements, management has made judgements, estimates and assumptions that affect the application of the Group's 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 estimates are recognised prospectively.

Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ending 31 December 2013 is included in the following notes:

Note 16 | measurement of the recoverable amounts of cash-generating units;
Note 32 | provisions and valuation of financial instruments;
Note 37 | reassessment of taxes.

Measurement of fair values

A number of the Group's accounting policies and disclosures require the measurement of fair value, for both financial and non-financial assets and liabilities.

The Group has an established control framework with respect to the measurement of fair values. The management has overall responsibility for overseeing all significant fair value measurements, including Level 3 fair values.

The management regularly reviews significant unobservable inputs and valuation adjustments. If third party information, such as broker quotes or pricing services, is used to measure fair values, then management assesses the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

Significant valuation issues are reported to the Group Audit Committee.

When measuring the fair value of an asset or a liability, the Group uses market observable data as far as possible. Fair values are catagorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

Notes, continued:

04 continued:

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The Group recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

Further information about the assumptions made in measuring fair values is included in the following notes:

Note 23 | marketable securities;
Note 30 | deferred income;
Note 32 | derivatives;
Note 32 | non-derivative financial liabilities.

05 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: Air Iceland, Fjárvakur - Icelandair Shared Services, Feria, Icelandair, Icelandair Cargo, Icelandair Ground Services and Loftleidir Icelandic.

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	
	2013	2012	2013	2012	2013	2012
External revenue	916,178	817,121	103,777	78,315	1,019,955	895,436
Inter-segment revenue	154,661	148,055	5,252	4,278	159,913	152,333
Segment revenue	1,070,839	965,176	109,029	82,593	1,179,868	1,047,769
Segment EBITDAR*	176,753	153,351	14,580	12,361	191,333	165,712
Operating lease expenses	(36,967)	(47,810)	(9,193)	(8,316)	(46,160)	(56,126)
Segment EBITDA	139,786	105,541	5,387	4,045	145,173	109,586
Finance income	7,387	16,564	158	179	7,545	16,743
Finance costs	(6,741)	(7,861)	(1,125)	(951)	(7,866)	(8,812)
Depreciation and amortisation	(67,786)	(55,585)	(1,742)	(1,504)	(69,528)	(57,089)
Share of profit (loss) of equity accounted invetsees	12	1	(50)	(290)	(38)	(289)
Reportable segment profit before income tax	72,658	58,660	2,628	1,479	75,286	60,139
Reportable segment assets	668,005	615,880	28,411	21,933	696,416	637,813
Investment in associates	763	24	543	503	1,306	527
Capital expenditure	111,611	93,467	2,586	2,361	114,197	95,828
Reportable segment liabilities	479,463	459,263	23,788	17,948	503,251	477,211

*EBITDAR means EBITDA before operating lease expenses.

Amounts are in USD thousand

Notes, continued:

05 continued:

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

	2013	2012
Revenue		
Total revenue for reportable segments	1,179,868	1,047,769
Other revenue	3,002	3,430
Elimination of inter-segment revenue	(159,913)	(152,333)
Consolidated revenue	1,022,957	898,866
Profit or loss		
Total profit of reportable segments	75,286	60,139
Unallocated corporate expenses	(4,238)	(2,691)
Consolidated profit before tax	71,048	57,448
Assets		
Total assets for reportable segments	696,416	637,813
Investments in associates	1,306	527
Other assets	135,153	124,555
Consolidated total assets	832,875	762,895
Liabilities		
Total liabilities for reportable segments	503,251	477,211
Elimination of inter-segment liabilities	(16,458)	(10,248)
Consolidated total liabilities	486,793	466,963

Other material items 2013	**Reportable segment totals**	**Adjustments**	**Consolidated totals**
Segment EBITDAR	191,333	(1,463)	189,870
Segment EBITDA	145,173	(1,463)	143,710
Finance income	7,545	(768)	6,777
Finance costs	(7,866)	(836)	(8,702)
Depreciation and amortisation	(69,528)	(1,171)	(70,699)
Share of loss of associates	(38)	(0)	(38)
Capital expenditure	114,197	43	114,240
Other material items 2012			
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

Amounts are in USD thousand

Notes, continued:

06 Assets and liabilities classified as held for sale

At year end 2012 assets held for sale consisted of 30% shareholding in Travel Service. In January 2013 an agreement was reached on the sale of the shares for USD 3.7 million.

07 Operating income

Transport revenue is specified as follows:

	2013	2012
Passengers	659,992	564,886
Cargo and mail	42,890	39,613
Total transport revenue	702,882	604,499

Other operating revenue is specified as follows:

Sale at airports and hotels	66,358	57,496
Revenue from tourism	73,543	61,235
Aircraft and cargo handling services	28,700	26,534
Revenue from maintenance and aircraft handling	18,207	11,416
Gain on sale of operating assets	1,100	2,805
Other operating revenue	14,198	14,066
Total other operating revenue	202,106	173,552

08 Operating expenses

Salaries and other personnel expenses are specified as follows:

Salaries	153,953	133,700
Contribution to pension funds	20,351	17,697
Other salary-related expenses	21,187	16,980
Other personnel expenses	43,941	35,438
Total salaries and other personnel expenses	239,432	203,815
Average number of full year equivalents	2,848	2,566

Other operating expenses are specified as follows:

Operating cost of real estates and fixtures	21,909	18,921
Communication expenses	13,703	12,379
Advertising expenses	20,704	18,242
Booking fee and commission expenses	37,597	30,162
Cost of goods sold	20,926	19,366
Customer services	15,383	12,277
Tourism expenses	44,326	34,201
Other operating expenses	32,276	28,394
Total other operating expenses	206,824	173,942

09 Depreciation and amortisation

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

Depreciation of operating assets, see note 11	67,956	57,733
Amortisation of intangible assets, see note 15	2,743	1,126
Depreciation and amortisation recognised in profit or loss	70,699	58,859

Amounts are in USD thousand

Notes, continued:

10 Finance income and finance costs

Finance income and finance costs are specified as follows:

	2013	2012
Interest income on bank deposits	1,538	1,219
Other interest income	1,173	2,196
Net currency exchange gain	4,066	14,163
Finance income total	6,777	17,578
Interest expense on loans and borrowings	7,860	9,900
Other interest expenses	842	302
Loss from sale of shares	0	349
Finance costs total	8,702	10,551
Net finance (costs) income	(1,925)	7,027

11 Operating assets

Operating assets are specified as follows:

	Aircraft and flight equipment	Buildings	Other property and equipment	Total
Cost				
Balance at 1 January 2012	345,163	23,662	25,245	394,070
Additions	57,264	4,306	4,959	66,529
Sales and disposals	(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
Additions	78,899	1,767	6,250	86,916
Sales and disposals	(48,355)	(198)	(574)	(49,127)
Reclassification to long-term cost	(1,386)	0	0	(1,386)
Reclassification to non-current receivables and deposits	(1,680)	0	0	(1,680)
Effect of movements in exchange rates	279	3,268	3,850	7,397
Balance at 31 December 2013	402,830	30,347	38,686	471,863
Depreciation and impairment losses				
Balance at 1 January 2012	101,150	5,954	10,791	117,895
Depreciation	53,019	1,246	3,468	57,733
Sales and disposals	(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
Depreciation	62,463	1,455	4,038	67,956
Sales and disposals	(44,648)	(198)	(460)	(45,306)
Effect of movements in exchange rates	123	933	2,214	3,270
Balance at 31 December 2013	145,190	8,534	18,942	172,666
Carrying amounts				
At 1 January 2012	244,013	17,708	14,454	276,175
At 31 December 2012	247,821	19,166	16,010	282,997
At 31 December 2013	257,640	21,813	19,744	299,197
Depreciation ratios	5–29%	2–6%	5–33%	

Aquisition of operating assets 2013 includes four Boeing 757 aircraft and engine overhauls amounting to USD 56.5 million.

Amounts are in USD thousand

Notes, continued:

12 Mortgages and commitments

The Group's operating assets, aircraft and spare parts are mortgaged to secure debt. The remaining balance of the debt amounted to USD 107.6 million at year end 2013 (2012: USD 137.5 million). The Group owns 26 aircraft, of which 15 are unencumbered, including 8 Boeing 757.

13 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	
	2013	2012	2013	2012
Boeing – 19/15 aircraft	527,000	417,000	213,512	198,836
Other aircraft	42,608	64,000	22,441	29,691
Flight equipment	71,816	66,900	21,687	19,294
Total aircraft and flight equipment	641,424	547,900	257,640	247,821

14 Insurance value of buildings and other operating assets

The principal buildings owned by the Group are the following:

	Official assessment value		Insurance value		Carrying amount	
	2013	2012	2013	2012	2013	2012
Maintenance hangar, Keflavík	15,263	13,897	32,061	28,021	4,960	4,858
Freight building, Keflavík	3,683	3,197	7,267	6,400	2,489	2,367
Office building, Reykjavík	7,875	5,948	11,949	10,444	7,722	5,611
Service building, Keflavík	4,079	3,518	7,830	6,842	1,261	1,263
Other buildings in Reykjavik	6,504	4,475	10,343	9,050	2,001	2,020
Other buildings	3,742	3,134	10,604	9,410	3,380	3,047
Buildings total	41,146	34,169	80,054	70,167	21,813	19,166

Official valuation of the Group's leased land for buildings at 31 December 2013 amounted to USD 7.9 million (2012: USD 6.8 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 50.9 million at year end 2013 (2012: USD 46.8 million). The carrying amount at the same time was USD 19.7 million (2012: USD 16.0 million).

Amounts are in USD thousand

Notes, continued:

15 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 2012	149,494	35,971	5,228	9,951	200,644
Additions	0	0	0	2,497	2,497
Sales and disposals	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
Additions	0	0	0	3,475	3,475
Sales and disposals	0	0	0	(416)	(416)
Effect of movements in exchange rates	2,132	27	48	98	2,305
Balance at 31 December 2013	150,646	35,985	5,202	9,370	201,203
Amortisation and impairment losses					
Balance at 1 January 2012	11,427	2,602	3,817	6,134	23,980
Amortisation	0	0	348	778	1,126
Sales and disposals	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
Amortisation	0	0	342	2,401	2,743
Sales and disposals	0	0	0	(416)	(416)
Effect of movements in exchange rates	0	0	36	40	76
Balance at 31 December 2013	11,431	2,605	4,480	3,011	21,527
Carrying amounts					
At 1 January 2012	138,067	33,369	1,411	3,817	176,664
At 31 December 2012	137,083	33,353	1,052	5,227	176,715
At 31 December 2013	139,215	33,380	722	6,359	179,676

16 Impairment test

Goodwill and other intangible assets that have indefinite life 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 life are specified as follows:

	2013	2012
Goodwill	139,215	137,083
Trademarks and airport slots	33,380	33,353
Total	172,595	170,436

The increase in the carrying amount of goodwill is do to translation differences of subsidiaries with functional currencies other than USD.

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 amounts of goodwill allocated to each cash generated unit (CGU) are as follows:

	Goodwill		Trademarks and slots	
	2013	2012	2013	2012
Route Network	136,778	134,750	33,380	33,353
Tourism services	2,437	2,333	0	0
Total goodwill	139,215	137,083	33,380	33,353

Amounts are in USD thousand

Notes, continued:

16 continued:

The recoverable amounts of cash-generating units was based on their value in use and were 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 and internal sources (historical data). Value in use was based on the following key assumptions:

	Route Network		Tourism services	
	2013	**2012**	**2013**	**2012**
Long term growth rate	2.5–4.0%	2.5–4.0%	4.0%	4.0%
Revenue growth:				
Weighted average 2013 / 2012	6.4%	9.6%	19.9%	27.3%
2014–2024 / 2013–2023	8.1%	9.8%	11.9%	11.0%
Budgeted EBITDA growth	5.4%	11.1%	10.4%	9.0%
WACC	10.0–14.8%	8.7–13.7%	12.4%	11.9%
Debt leverage	18.0–56.5%	18.0–64.0%	23.5%	19.0%
Interest rate for debt	7.7–9.4%	7.1–8.8%	6.7%	6.0%
Recoverable amounts	775,398	896,055	39,307	25,720

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

	2013	**2012**
Long term growth rate – 1%	0	(921)
WACC +1%	0	(2,352)
EBITDA – 5%	0	0

No impairment loss is recognised in the Financial Statements.

17 Investments in associates

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

	Ownership	
	2013	**2012**
Ábyrg spilamennska ehf.	50%	50%
EBK ehf.	25%	25%
Gufa ehf.	36%	36%
Icelease ehf.	25%	25%
Landsbréf – Icelandic Tourism Fund I slhf.	29%	–
Tjarnir ehf.	22%	22%
Assets	7,146	4,863
Liabilities	3,807	3,188
Revenues	1,663	1,222
Expenses	2,365	2,015
Net loss	(702)	(793)
Share of loss of associates	(38)	(366)

Amounts are in USD thousand

Notes, continued:

18 Long-term cost

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

	2013	2012
Long-term cost	1,025	8,365
Current portion, classified as prepayments among receivables	(767)	(4,717)
Total long-term cost	258	3,648

Long-term cost will be expensed as follows:

Expensed in 2013	–	4,717
Expensed in 2014	767	3,187
Expensed in 2015	89	310
Expensed in 2016	52	46
Expensed in 2017	56	51
Expensed in 2018	61	54
Total long-term cost, including current maturities	1,025	8,365

19 Non-current receivables and deposits

Non-current receivables consist of notes, deposits for aircraft and engine lease agreements and various other travel related security fees.

Long-term receivables and deposits are specified as follows:

	2013	2012
Loans, effective interest rate 6%	466	233
Interest bearing receivable, interest rate 5%	0	7,969
Deposits	13,510	13,595
Prepayments on aircraft purchases	9,612	1,680
	23,588	23,477
Current maturities	(7,797)	(14,254)
Long-term receivables and deposits total	15,791	9,223

Contractual repayments are specified as follows:

Repayments in 2013	–	14,254
Repayments in 2014	7,797	5,262
Repayments in 2015	2,156	649
Repayments in 2016	99	494
Repayments in 2017	934	475
Repayments in 2018	9,627	409
Subsequent	2,975	1,934
Total non-current receivables and deposits, including current maturities	23,588	23,477

Long-term receivables and deposits denominated in currencies other than the functional currency comprise USD 1.3 million (2012: USD 1.4 million).

Amounts are in USD thousand

Notes, continued:

20 Taxes

Tax recognised in profit or loss

	2013	2012
Current tax expense		
Current year	6,613	0
	6,613	0
Deferred tax expense		
Origination and reversal of temporary differences	8,256	14,022
Exchange rate difference	(239)	(849)
	8,017	13,173
Total tax expense recognised in profit or loss	14,630	13,173

Tax recognised in other comprehensive income

	2013	2012
Net profit on hedge of net investment in foreign operations	(28)	279
Effective portion of changes in fair value of cash flow hedge	0	328
Total tax recognised in other comprehensive income	(28)	607

Tax recognised directly in equity

	2013	2012
Currency exchange	(40)	33
Total tax recognised directly in equity	(40)	33

Reconciliation of effective tax rate

		2013		2012
Profit before tax		71,048		57,448
Income tax according to current tax rate	20.0%	14,210	20.0%	11,490
Tax exempt revenue	(0.0%)	(27)	(0.0%)	(18)
Non-deductible expenses	0.2%	175	0.3%	151
Other items	0.4%	272	2.7%	1,550
Effective tax rate	20.6%	14,630	22.9%	13,173

Recognised deferred tax liabilities

Deferred tax liabilities are specified as follows:

	2013	2012
Deferred tax liabilities 1 January	19,671	6,289
Exchange rate difference	239	849
Income tax recognised in profit or loss	14,630	13,173
Income tax recognised in other comprehensive income	28	(607)
Income tax recognised directly in equity	(40)	(33)
Income tax payable	(6,613)	0
Deferred tax liabilities 31 December	27,995	19,671

Deferred tax assets and liabilities is attributable to the following:

	Assets		Liabilities		Net	
	2013	2012	2013	2012	2013	2012
Operating assets	0	0	(26,173)	(22,732)	(26,173)	(22,732)
Intangible assets	0	0	(2,206)	(2,007)	(2,206)	(2,007)
Derivatives	60	90	0	0	60	90
Trade receivables	661	601	0	0	661	601
	721	691	(28,379)	(24,739)	(27,658)	(24,048)
Tax loss carry-forwards	0	4,967	0	0	0	4,967
Other items	0	0	(337)	(590)	(337)	(590)
Deferred income tax	721	5,658	(28,716)	(25,329)	(27,995)	(19,671)

Amounts are in USD thousand

Notes, continued:

20 continued:

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
2013					
Operating assets	(22,732)	(3,923)	482	0	(26,173)
Intangible assets	(2,007)	(336)	137	0	(2,206)
Derivatives	90	0	(2)	(28)	60
Trade receivables	601	53	7	0	661
Tax loss carry-forwards	4,967	(4,062)	(905)	0	0
Other items	(590)	251	42	(40)	(337)
	(19,671)	(8,017)	(239)	(68)	(27,995)
2012					
Operating assets	(21,451)	(1,338)	57	0	(22,732)
Intangible assets	(702)	(1,291)	(14)	0	(2,007)
Derivatives	(285)	47	0	328	90
Trade receivables	628	(27)	0	0	601
Tax loss carry-forwards	14,396	(9,177)	(252)	0	4,967
Other items	1,125	(1,387)	(640)	312	(590)
	(6,289)	(13,173)	(849)	640	(19,671)

The tax calculations above do not take into consideration the effects of reassessment of taxes for the years 2007 to 2011 that took place in December 2013. The management does not agree with the ruling and an appeal to the State Internal Revenue Board is in process. The reassessment did not result in payments of taxes as it only reduced the Company´s carry forward losses. If the reassessment will however be confirmed the Company's net equity will be reduced by approximately USD 11 million. Further information on the reassessment is provided in note 37.

21 Inventories

Inventories are specified as follows:

	2013	2012
Spare parts	17,500	13,444
Other inventories	4,666	3,973
Inventories total	22,166	17,417

22 Trade and other receivables

Trade and other receivables are specified as follows:

	2013	2012
Trade receivables	76,537	90,764
Maintenance prepayments	767	4,717
Other prepayments	3,138	3,812
Restricted cash	8,686	7,472
Derivatives used for hedging	1,853	0
Current maturities of long term-receivables	7,797	14,254
Other receivables	15,481	14,066
Trade and other receivables total	114,259	135,085

At year end trade receivables are presented net of an allowance for doubtful debts of USD 11.9 million (2012: USD 8.7 million).

Prepaid expenses which relate to subsequent periods amounted to USD 3.1 million (2012: USD 3.8 million) at year end. The prepayments consist mainly of insurance premiums and prepaid leases.

Restricted cash is held in 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 31.

Amounts are in USD thousand

Notes continued:

23 Marketable securities

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

24 Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	2013	2012
Securities	4,956	17,414
Bank deposits	186,192	99,217
Cash on hand	390	429
Cash and cash equivalents total	191,538	117,060

25 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 year end 2013 (2012: ISK 25 million).

(ii) 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 having functional currencies other than the Group, as well as from the translation of liabilities that hedge net investment.

Other reserves are specified as follows:

	Hedging reserve	Translation reserve	Total reserves
Balance 1 January 2012	335	31,222	31,557
Currency translation differences		(2,257)	(2,257)
Currency translation differences reclassified to profit or loss		(46)	(46)
Net loss on hedge of investment, net of tax		(1,417)	(1,417)
Effective portion of changes in fair value of cash flow hedges, net of tax	(1,673)		(1,673)
Balance at 31 December 2012	(1,338)	27,502	26,164
Currency translation differences		4,254	4,254
Net profit on hedge of investment, net of tax		169	169
Net investment hedge reclassified to profit or loss		(111)	(111)
Effective portion of changes in far value of cash flow hedges, net of tax	1,230		1,230
Balance at 31 December 2013	(108)	31,814	31,706

(iv) Dividends

The Board of Directors has approved to the following dividend policy: "The Gompany's goal is to declare 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 11.8 million was paid to shareholders in the year 2013 (2012: USD 6.3 million).

The Board of Directors proposes a dividend payment to shareholders in 2014 of ISK 2.150 million, equal to USD 18.6 million, which represents 30% of total comprehensive income for the year 2013.

Amounts are in USD thousand

Notes continued:

26 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 per share. The calculation of diluted earnings per share is identical to basic earnings per share as no convertible notes or stock options have been issued.

	2013	2012
Basic earnings per share:		
Profit for the year attributable to equity holders of the parent company	56,386	44,228
Weighted average number of shares for the year	4,974,540	4,974,540
Basic earnings per share of ISK 1 expressed in USD cent per share	1.13	0.89
Diluted earnings per share expressed in USD cent per share	1.13	0.89

27 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 31.

Loans and borrowings are specified as follows:

	2013	2012
Secured bank loans	107,621	137,532
Unsecured loans	14,396	13,374
Total loans and borrowings	122,017	150,906
Current maturities	(43,528)	(31,548)
Total non-current loans and borrowings	78,489	119,358

Terms and debt repayment schedule

	Currency	Nominal interest rates year end 2013	Year of maturity	Total remaining balance 2013	2012
Secured bank loans	USD	4.7%	2014–2018	74,921	103,110
Secured bank loans	EUR	3.7%	2017	15,518	16,972
Secured bank loans	ISK	7.7%	2017–2023	16,209	16,538
Secured bank loan, indexed	ISK	6.3%	2021–2028	973	912
Unsecured bond issue, indexed	ISK	5.7%	2023	14,396	13,374
Total interest-bearing liabilities				122,017	150,906

Repayments of loans and borrowings are specified as follows:

	2013	2012
Repayments in 2013	–	31,548
Repayments in 2014	43,528	44,678
Repayments in 2015	15,898	15,379
Repayments in 2016	16,350	15,851
Repayments in 2017	29,471	28,055
Repayments in 2018	7,430	7,267
Subsequent repayments	9,340	8,128
Total loans and borrowings	122,017	150,906

Amounts are in USD thousand

Notes, continued:

28 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 2014. Non-current obligations are specified as follows:

	2013	2012
Non-current payables	43,907	49,247
Current portion, classified in trade and other payables	(20,165)	(27,187)
Total non-current payables	23,742	22,060

Non-current payables will be repaid as follows:

Repayments in 2013	–	27,187
Repayments in 2014	20,165	6,913
Repayments in 2015	19,417	10,158
Repayments in 2016	900	3,239
Repayments in 2018	1,750	1,750
Subsequent repayments	1,675	0
Total non-current payables, including current maturities	43,907	49,247

29 Trade and other payables

Trade and other payables are specified as follows:

Trade payables	38,125	43,985
Current portion of engine overhaul and security deposits from lease contracts	20,165	27,187
Derivatives used for hedging	2,050	1,610
Income tax payable	6,613	0
Other payables	92,551	79,455
Total trade and other payables	159,504	152,237

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in Note 31.

30 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 is specified as follows:

	2013	2012
Sold unused tickets	129,373	95,431
Frequent flyer points	12,610	12,677
Other prepayments	11,552	13,981
Total deferred income	153,535	122,089

The amount allocated to 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. That amount is recognised as deferred income.

Amounts are in USD thousand

Notes, continued:

31 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	**2013**	**2012**
Long-term receivables and deposits	19	15,791	9,223
Trade and other receivables	22	110,354	126,556
Marketable securities	23	7,955	15,734
Cash and cash equivalents	24	191,538	117,060
		325,638	268,573

Trade and other receivables

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

Credit risk is linked to trade receivables, investment of liquid assets and agreements with financial institutions related to financial operations, e.g. hedging. The relative spread of trade receivables across counterparties is also crucial for credit risk exposure. The risk involved is directly related to the fulfilment of outstanding obligations of the Group's counterparties. The Group is aware of potential losses related to credit risk exposure and chooses its counterparties subject to business experience and satisfactory credit ratings.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

Guarantees

The Group's policy is to provide financial guarantees only to wholly-owned subsidiaries. However at year end 2013 the Group is still guaranteeing from divested companies (see note 38), 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.

Amounts are in USD thousand

Notes, continued:

31 continued:

Impairment losses

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

	Gross 2013	Allowance for Impairment 2013	Gross 2012	Allowance for Impairment 2012
Not past due	52,815	(569)	61,784	(239)
Past due 0–30 days	5,861	(523)	6,327	(185)
Past due 31–120 days	6,578	(462)	22,637	(3,644)
Past due 121–365 days	19,422	(7,602)	6,572	(3,271)
More than one year	3,770	(2,753)	2,112	(1,329)
Total	88,446	(11,909)	99,432	(8,668)

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

	2013	2012
Balance at 1 January	8,668	8,507
Exchange rate difference	48	(26)
Impairment loss allowance, increase	3,193	187
Balance at 31 December	11,909	8,668

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.

Following are the contractual maturities of financial liabilities, including estimated interest payments:

31 December 2013	Carrying amount	Contractual cash flows	Within 12 months	1–2 years	2–5 years	More than 5 years
Financial liabilities						
Unsecured bank loans	14,396	19,282	1,928	1,928	5,785	9,641
Secured bank loans	107,621	124,844	47,683	19,689	56,082	1,390
Payables & prepayments	183,246	183,246	159,504	19,417	2,650	1,675
Exposure to liquidity risk	305,263	327,372	209,115	41,034	64,517	12,706
31 December 2012						
Financial liabilities						
Unsecured bond issue	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
Exposure to liquidity risk	325,203	352,369	191,124	57,724	86,338	17,183

Amounts are in USD thousand

Notes, continued:

31 continued:

Unused loan commitments at year end 2013 amounted to USD 4.3 million (2012: USD 3.9 million).

In addition to the liquidity exposure presented in the balance sheet the Group is exposed to off balance sheet liabilities. Further information on these liabilities are provided in note 33 and 36.

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.

Exposure to currency risk

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

2013	**ISK**	**EUR**	**GBP**	**DKK**	**SEK**	**NOK**
Net balance sheet exposure	(25,872)	(18,759)	(7,072)	919	2,715	1,911
Forecast revenue	339,060	237,680	73,705	39,890	47,195	43,760
Forecast purchases	(409,650)	(167,882)	(40,722)	(14,670)	(4,141)	(4,799)
Forward FX contracts	0	(64,711)	0	0	0	0
Net currency exposure	(96,462)	(13,672)	25,911	26,139	45,769	40,872
2012						
Net balance sheet exposure	(31,402)	(18,824)	(3,135)	12,123	7,561	8,684
Forecast revenue	314,927	227,843	69,769	37,616	43,468	45,331
Forecast purchases	(347,343)	(160,576)	(41,066)	(13,017)	(3,351)	(4,939)
Forward FX contracts	0	(25,882)	0	0	0	0
Net currency exposure	(63,818)	22,561	25,568	36,722	47,678	49,076

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

	Average rate		**Reporting date spot rate**	
	2013	**2012**	**2013**	**2012**
ISK	0.0082	0.0080	0.0087	0.0078
EUR	1.33	1.29	1.38	1.32
GBP	1.56	1.59	1.65	1.62
DKK	0.18	0.17	0.18	0.18
SEK	0.15	0.15	0.16	0.15
NOK	0.17	0.17	0.16	0.18

Amounts are in USD thousand

Notes, continued:

31 continued:

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 2012.

	Equity	Profit or loss
2013		
ISK	7,717	7,717
EUR	1,094	864
GBP	(2,073)	(2,073)
DKK	(2,091)	(2,091)
SEK	(3,662)	(3,662)
NOK	(3,270)	(3,270)
2012		
ISK	5,105	5,294
EUR	(1,805)	(2,022)
GBP	(2,045)	(2,045)
DKK	(2,938)	(2,938)
SEK	(3,926)	(3,926)
NOK	(3,814)	(3,814)

A 10% weakening of the USD against the above currencies would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

Interest rate risk
The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group follows a policy of hedging 40-80% of the net interest rate exposure of long-term financing with up to a 5-year horizon. This is achieved by using fixed rate loan and swaps contracts.

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

	Carrying amount	
	2013	2012
Fixed rate instruments		
Financial liabilities	(42,206)	(50,205)
	(42,206)	(50,205)
Variable rate instruments		
Financial assets	186,192	99,217
Financial liabilities	(79,811)	(100,701)
	106,381	(1,404)

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.

Amounts are in USD thousand

Notes, continued:

31 continued:

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 stated below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

	100 bp increase	100 bp decrease
31 December 2013		
Variable rate instruments	(205)	112
Cash flow sensitivity (net)	(205)	112
31 December 2012		
Variable rate instruments	(156)	156
Cash flow sensitivity (net)	(156)	156

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 the financial instruments in place at year end 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	
	2013	2012	2013	2012
Increase in fuel prices by 10%	6,800	2,909	0	0
Decrease in fuel prices by 10%	(6,800)	(2,909)	0	0

Capital management
The Board's policy is to maintain strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The policy is to have an average of three months operating cost available as liquidity where 30% of the liquidity can be in the form of unused lines of credit. Furthermore according to the policy the equity ratio shall be no less than 35%.

32 Financial instruments and fair values

The following table shows the carrying amounts and fair values of financial assets and financial liabilities. It does not include fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value.

	Carrying amount 2013	Fair value 2013	Carrying amount 2012	Fair value 2012
Derivatives, included in loans and receivables	1,853	1,853	0	0
Marketable securities	7,955	7,955	15,734	15,734
Unsecured bond issue	(14,396)	(17,398)	(13,374)	(16,378)
Secured bond loans	(107,621)	(117,219)	(137,532)	(153,598)
Derivatives, included in payables and prepayments	(2,050)	(2,050)	(1,610)	(1,610)
Total	(114,259)	(126,859)	(136,782)	(155,852)

Amounts are in USD thousand

Notes, continued:

32 continued:

Fair value hierarchy:
The table below analyses the fair value of assets and liabilities and their levels in the fair value hierarchy:

	Level 1	Level 2	Level 3	Total
31 December 2013				
Derivatives, included in loans and receivables		1,853		1,853
Marketable securities	7,955			7,955
Unsecured bond issue			(17,398)	(17,398)
Secured bond loans			(117,219)	(117,219)
Derivatives, included in payables and prepayments		(2,050)		(2,050)
Total	7,955	(197)	(134,617)	(126,859)
31 December 2012				
Marketable securities	15,734			15,734
Unsecured bond issue			(16,378)	(16,378)
Secured bond loans			(153,598)	(153,598)
Derivatives, included in payables and prepayments		(1,610)		(1,610)
Total	15,734	(1,610)	(169,976)	(155,852)

The basis for determining the levels is disclosed in note 4.

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 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.

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.

33 Off-balance sheet items

Leases as lessee
As a lessee the Group has in place operating leases for 11 aircraft at year end 2013. The leases are for 3 Boeing 737 aircraft, 5 Boeing 757 aircraft and 3 Boeing 767 aircraft. The Group also has in place operating leases for storage facilities, hotels, equipment and fixtures for its operations, the longest until the year 2037. During the year USD 46.2 million was recognised as an expense in profit or loss in respect of operating leases (2012: USD 56.1 million). At year end 2013 the leases are payable as follows in nominal amounts for each year:

	Real estate	Aircraft	Other	Total 2013	Total 2012
In the year 2013	–	–	–	–	46,118
In the year 2014	13,849	24,593	2,466	40,908	29,973
In the year 2015	13,675	22,325	858	36,858	25,813
In the year 2016	14,296	16,230	749	31,275	19,985
In the year 2017	13,902	13,113	721	27,736	17,331
In the year 2018	13,815	11,185	0	25,000	16,351
Subsequent	160,030	10,575	0	170,605	113,042
Total	229,567	98,021	4,794	332,382	268,613

Amounts are in USD thousand

Notes, continued:

34 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 2013 amounted to USD 118.0 million (2012; USD 120.8 million). Contracted leases at year end were as follows:

	2013	**2012**
In the year 2013	–	63,632
In the year 2014	62,458	37,982
In the year 2015	66,429	30,093
In the year 2016	59,946	26,224
In the year 2017	43,190	26,618
In the year 2018	42,983	26,196
Subsequent	35,646	0
Total	310,652	210,745

35 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 2013 and the number of shares in the Company held by management are specified below:

	Salaries and benefits	**Number of shares held at year-end 2013 in thousands**
Board of Directors:		
Sigurður Helgason, Chairman of the Board	65.2	14,000
Ásthildur Margrét Otharsdóttir	36.3	
Herdís Dröfn Fjeldsted	35.0 *	
Katrín Olga Jóhannesdóttir	48.5	413
Úlfar Steindórsson	49.5	
Magnús Magnússon, alternative board member	13.3 **	
Key employees:		
Björgólfur Jóhannsson CEO of Icelandair Group hf.	362.3	1.300
Bogi Nils Bogason, CFO of Icelandair Group hf.	299.9	1.000
Birkir Hólm Guðnason, CEO of Icelandair ehf.	301.3	
Seven MD's of Group companies	1,395.5	7.111

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

* The salaries of one board member is 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 2013 the Group purchased services from associates for USD 0.1 million (2012: USD 0.1 million). The Group's revenues were USD 0.1 million from associates (2012: USD 0.2 million). The Group has not granted repayment of loans for 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 2013. 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 2013 from these entities amounted to USD 0.1 million (2012: USD 0.1 million). Total sales amounted to USD 0.1 million (2012: USD 0.1 million).

Notes, continued:

36 Capital commitments

In February 2013 Icelandair Group and Boeing finalized an agreement for the purchase of sixteen 737 MAX8 and 737 MAX9 aircraft with an option to purchase additional eight aircraft. The delivery of the first aircraft is scheduled in the first half of 2018. The commitment for all sixteen aircraft is valued at USD 1.6 billion at Boeing list prices. The Company received acceptable discounts which due to confidentiality agreements cannot be disclosed. Prepayments according to the agreement will be made over the construction period. The acquisition will be funded by internal resources and from aviation finance products.

37 Reassessment of taxes

In December 2013 the Directorate of Internal Revenue ruled that interest expenses on loans that had been transferred to the Company as a result of a reverse acquisition in 2006 did not qualify as tax deductible expenses and reassessed tax calculations for the years 2007 to 2011. As the Company had carry forward losses no tax payments will result directly from the ruling. The Company's management does not agree with the reasoning for the ruling and an appeal to the State Internal Revenue Board is in process. The management is of the opinion that the ruling by the tax authorities will be overruled and the effect of reassessment is therefore not included in the financial statements. If the ruling will however be confirmed the Company's net equity will be reduced by approximately USD 11 million.

38 Guarantees

IG Invest, a former subsidiary of the Company, has signed an agreement with Boeing for 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. Icelandair Group guarantees that the final sale price will be at least USD 34.7 million (ISK 4.0 billion), however the maximum guarantee is USD 4.3 million (ISK 0.5 billion). If the creditors will receive more than USD 59.1 million (ISK 7.6 billion) plus REIBOR+3% interest on the sale of the assets, Icelandair Group will receive 50% of the upside. Based on the managements estimate the Company has fully provided for potential losses due to the guarantee.

39 Litigations and claims

In 2012 the Supreme Court of Iceland ruled that the Company had violated competition law in 2004 on flights to Copenhagen due to predatory pricing. Following the ruling a former competitor filed a suit claiming ISK 300 million (appr. USD 2.6 million) for alleged damages arising from the violations.

The Winding-up Board of a financial institution has filed a suit claiming rescission of a money market deposit payment received in November 2008 of ISK 586 million (appr. USD 5 million).

Both claims have been rejected by management which is of the opinion that either court rulings will be in favor of the Company or settlements will be reached. The possible effects of the claims have not been recognized in the financial statements.

40 Group entities

The Company held eleven subsidiaries at year end 2013 which are all included in the consolidated financial statements. They are as follows:

	Ownership interest 2013	2012
Route Network:		
Air Iceland ehf.	100%	100%
Fjárvakur – Icelandair Shared Services ehf.	100%	100%
Feria ehf.	100%	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%

The subsidiaries further own 16 subsidiaries that are included in the consolidated financial statements.

Amounts are in USD thousand

Notes, continued:

41 Statement of cash flows:

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

	2013	2012
Expensed long term cost	24,852	26,250
Exchange rate difference and indexation of liabilities and assets	3,461	1,023
Gain on the sale of operating assets	(1,100)	(2,805)
Share of loss of associates	38	366
Income tax	8,017	13,173
Other items	0	349
Total other operating items in the statement of cash flow	35,268	38,356

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

	2013	2012
Inventories, increase	(4,791)	(2,337)
Trade and other receivables, decrease (increase)	22,934	(11,471)
Trade and other payables, increase	18,910	17,991
Deferred income, increase	31,436	21,070
Net change in operating assets and liabilities in the statement of cash flows.	68,489	25,253

43 Additional cash flow information:

	2013	2012
Interest paid	8,081	10,129
Interest received	3,531	3,715

44 Ratios

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

	2013	2012
Current ratio	0.94	0.94
Equity ratio	0.42	0.39
Intrinsic value of share capital	8.52	7.29

45 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.

The Group has adopted the following new standards and amendments to standards, including any consequential amendments to other standards, with a date of initial application of 1 January 2013.

- IFRS 13 Fair Value Measurement
- Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)
- Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36) (2013)

The nature and effects of the changes are explained below.

(i) Fair value measurement

IFRS 13 establishes a single framework for measuring fair value and making disclosures about fair value measurements when such measurements are required or permitted by other IFRSs. It unifies the definition of fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It replaces and expands the disclosure requirements about fair value measurements in other IFRSs, including IFRS 7. As a result, the Group has included additional disclosures in this regard.

In accordance with the transitional provisions of IFRS 13, the Group has applied the new fair value measurement guidance prosepctively and has not provided any comparative information for new disclosures. Not withstanding the above, the change had no significant impact on the measurements of the Group's assets and liabilities.

Amounts are in USD thousand

Notes, continued:

45 continued:

(ii) Presentation of items of Other Comprehensive Income

As a result of the amendments to IAS 1, the Group has modified the presentation of items of OCI in its statement of profit or loss and OCI, to present separately items that would be reclassified to profit or loss from those that would never be. Comparative information has been re-presented accordingly.

(iii) Disclosures of recoverable amount for non-financial assets

The Group has early adopted the amendments to IAS 36 (2013). As a result, the Group has expanded its disclosures of recoverable amounts when they are based on fair value less costs of disposals and an impairment is recognised (see Note 16).

a. Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

(ii) Loss of control

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

(iii) Investments in associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity. Investment in associates are accounted for using the equity method and are recognised initially at cost. The cost of the investment includes transaction costs. The consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the carrying amount of the interests that form part thereof, including any long-term investments is reduced to zero, and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the investee.

(iv) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

b. Currency exchange

(i) Currency transactions

Intra-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

Notes, continued:

45 b. continued:

(ii) Subsidiaries with other functional currency

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

Currency differences are recognised in other comprehensive income, and presented in the translation reserve in equity. However, if the operation is not a wholly owned subsidiary, then the relevant proportion of the translation difference is allocated to the non-controlling interests.

When the settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely in the foreseeable future, foreign exchange gains and losses arising from such a monetary item are considered to form part of a net investment in a foreign operation and are recognised in other comprehensive income, and presented in the translation reserve in equity.

(iii) Hedge of net investment in foreign operations

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

Currency differences arising on the translation of a financial liability designated as a hedge of a net investment in a subsidiary are recognised in other comprehensive income to the extent that the hedge is effective, and are presented in the translation reserve within equity. To the extent that the hedge is ineffective, such differences are recognised in profit or loss. When the hedged net investment is disposed of, the relevant amount in the translation reserve is transferred to profit or loss as part of the gain or loss on disposal.

c. Financial instruments

(i) Non-derivative financial assets

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

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

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.

Notes, continued:

45 c. continued:

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.

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 32). 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.

Notes, continued:

45 continued:

d. Operating assets

(i) Recognition and measurement

Items of operating assets are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use.

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

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

(ii) Aircraft and flight equipment

Aircraft and flight equipment, e.g. aircraft engines and aircraft spare parts, are measured at cost less accumulated depreciation and accumulated impairment losses. When an aircraft is acquired the purchase price is divided between the aircraft itself and engines. Aircraft is depreciated over the estimated useful life of the relevant aircraft until a residual value is met. Engines are depreciated according to actual usage based on cycles flown. When an engine is overhauled the cost of the overhaul is capitalised and the remainder of the cost of the previous overhaul that has not already been depreciated, if any, is expensed in full.

(iii) Subsequent costs

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

(iv) Depreciation

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

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

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

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

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.

Notes, continued:

45 e. continued:

(ii) Other intangible assets

Other intangible assets acquired by the Group and have finite useful lives are measured at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. The estimated useful lives for the current and comparative years are as follows:

	Useful life
Software	3 years
Customer relations	7–10 years
Favourable aircraft lease contracts	2–3 years
Other intangible assets	6–10 years

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

(iii) Subsequent expenditure

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognised in profit or loss as incurred.

f. Leased assets

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

g. Inventories

Goods for resale and supplies are measured at the lower of cost and net realisable value. The cost of inventories is based on first-in first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

h. Impairment

(i) Non-derivative financial assets

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if there is objective evidence of impairment as a result of one or more events has occurred after the initial recognition of the asset, and that loss events had an impact on the estimated future cash flows of that asset that can be estimated reliably.

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.

Notes, continued:

45 h. continued:

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.

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

Subsequent expenditure is capitalised only when it increases the future 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.

Notes, continued:

45 continued:

l. Operating income

(i) Transport revenue

Passenger ticket sales are not recognised as revenue until transportation has been provided. Sold refundable documents not used within twelve months from the month of sale are recognised as revenue. Non-refundable documents are recognized as revenue two months after expected transport if not used. Revenue from mail and cargo transportation is recognised when transportation has been provided.

For customer loyalty programmes, the fair value of the consideration received or receivable in respect of the initial sale is allocated between the award credits (frequent flyer points) and the other components of the sale. Awards can also be generated through transportation services supplied by the Group. Through transportation services the amount allocated to the points is estimated by reference to the fair value of the services for which they could be redeemed, since the fair value of the points themselves is not directly observable. The fair value of the services is estimated taking into account the expected redemption rate and the timing of such expected redemptions. Such amount is deferred and revenue is recognised only when the points are redeemed and the Group has fulfilled its obligations to supply the services. The amount of revenue recognised in those circumstances is based on the number of points that have been redeemed in exchange for services, relative to the total number of points that is expected to be redeemed.

(ii) Aircraft and aircrew lease

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

(iii) Other operating revenue

Revenue includes revenue from tourism, sales at airports and hotels, maintenance service sold and other revenue. Revenue is recognised in profit or loss when the service has been provided or sale completed by delivery of products.

Gain on sale of operating assets is recognised in profit or loss when the risks and rewards of ownership are transferred to the buyer.

m. Lease payments

Operating lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

n. Finance income and finance costs

Finance income comprises interest income on funds invested, dividend income, foreign currency gains, and gains on hedging instruments that are recognised in profit or loss. Interest income is recognised as it accrues in profit or loss, using the effective interest method. Dividend income is recognised in profit or loss on the date that the Group´s right to receive payment is established.

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

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

o. Income tax

Income tax expense comprises current and deferred tax. It is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in other comprehensive income.

Current tax is expected tax payable on the taxable income for the period, using tax rates enacted at the reporting date.

Current tax comprises the expected tax payable on the taxable income for the year. It is measured using tax rates enacted at the reporting date.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that do not affect accounting, or taxable profit or differences relating to investment in subsidiaries.

A deferred tax asset is recognized 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 used. 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 realized.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted at the reporting date.

Notes, continued:

45 continued:

p. 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.

q. 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.

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 regarding corporate governance.

In 2012 The Iceland Chamber of Commerce, the Confederation for Icelandic Employers and Nasdaq OMX Iceland hf. 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 held nine meetings in the year 2013.

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 held four meetings in the year 2013.

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 of Cash Management 1974–1980, Senior Vice-President of Finance 1980–1983 and General Manager of 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 is CEO of Toyota in Iceland ehf. 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 Eignarhaldsfélagið Bifreiðar ehf., Bergey ehf., Bifreiðainnflutningur ehf., Bílaútleigan ehf., Okkar bílaleiga ehf., and TK bílar ehf. He is a Board member of Toyota á Íslandi ehf, Króksslóð ehf, TMH Iceland ehf, AB 257 ehf, Blue Lagoon international ehf., Eldvörp ehf., Hótel Bláa lónið ehf., Bláa Lónið Heilsuvörur ehf., UK fjárfestingar ehf, Johan Rönning hf, 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.

Ásthildur Margrét Otharsdóttir
Ásthildur was born in 1968 and 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 Chairman of the Board of Directors of Marel hf. and JÖR ehf. Ásthildur is a member of the Board of Directors of Marorka ehf. and the Research Center for Business Ethics at the University of Iceland and the Court of Arbitration of the Icelandic Chamber of Commerce. 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 Dröfn Fjeldsted was born in 1971 and is an 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. Previously, she was a member of the investment team at Thule Investments. Herdis is Chairman of the Board of Icelandic Group hf., a Vice- Chairman of the Board of Promens hf., a member of the Board of Copeinca ASA, Icelandic Group Investments ehf. and Invent Farma ehf.

Katrín Olga Jóhannesdóttir
Katrin Olga Johannesdóttir was born in 1962 and is the former Chief Strategy Officer of Skipti hf. and the current Chairman of Já upplýsingaveitur hf. Before that she was VP for sales and marketing and VP for residential markets at Síminn hf. 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 Ölgerðin hf., Reykjavik University, the Iceland Chamber of Commerce and Njála ehf., having previously served on the Boards of the Central Bank of Iceland., 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.

Corporate Governance Statement, continued:

Executive committee

Björgólfur Jóhannsson, President and CEO

Björgólfur was born in 1955 and joined Icelandair Group in January 2008. Before joining Icelandair Group, Björgólfur was the CEO of Icelandic Group hf. from March 2006. From 1992–1996 Björgólfur was the CFO of UA in Akureyri. He became the CEO of Síldarvinnslan hf. in 1999 and served as the Director of Innovation and Development at Samherji hf. 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. Björgólfur is the Chairman of the Conferderation of Icelandic Employers. 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 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.

Corporate Governance Statement, continued:

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 convened eighteen 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 Otharsdóttir. Sigurður Helgason, Katrín Olga Jóhannesdóttir, Ásthildur Margrét Otharsdóttir and Úlfar Steindórsson were independent from the Company's major shareholders in 2013.

Quarterly statements (unaudited)

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

Year 2013	**Q1**	**Q2**	**Q3**	**Q4**	**Total**
Operating income	173,045	265,600	371,662	212,650	1,022,957
Operating expenses without depreciation	(181,359)	(222,664)	(269,421)	(205,803)	(879,247)
Operating (loss) profit before depreciation (EBITDA)	(8,314)	42,936	102,241	6,847	143,710
Depreciation	(14,684)	(18,167)	(20,073)	(17,775)	(70,699)
Operating (loss) profit (EBIT)	(22,998)	24,769	82,168	(10,928)	73,011
Net finance income (expense)	29	(1,409)	(306)	(239)	(1,925)
Share of profit (loss) of associates	46	(55)	(11)	(18)	(38)
(Loss) profit before income tax	(22,923)	23,305	81,851	(11,185)	71,048
Income tax	4,634	(4,815)	(16,526)	2,077	(14,630)
(Loss) profit	(18,289)	18,490	65,325	(9,108)	56,418
Other comprehensive income (loss)	1,549	(777)	1,756	2,964	5,492
Total comprehensive (loss) income	(16,740)	17,713	67,081	(6,144)	61,910
Working capital (used in) from operations	(1,481)	48,154	111,138	4,574	162,385
Net cash from (used in) operating activities	78,453	106,436	30,272	15,713	230,874
Net cash used in investing activities	(40,795)	(15,477)	(24,288)	(32,663)	(113,223)
Net cash used in financing activities	(11,239)	(15,690)	(10,361)	(7,942)	(45,232)

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	(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)

Amounts are in USD thousand