Icelandair Group Annual Report 2007

Icelandair's Boeing 757-200 TF-FIP in flight over Greenland en route from KEF to JFK. July 26, 2007.

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2007 Calendar

January

Icelandair signed an agreement to purchase a new in flight entertainment system from Thales and new seats from the Italian producer Aviointerios. These agreements confirm the Icelandair strategy of offering its passengers full service on its international flights. The total cost of these two contracts was ISK 1.8 billion.

Icelandair Group signed lease agreements with Israir. Latcharter, a Latvian charter airline owned by Loftleiðir Icelandic, a subsidiary of Icelandair Group, reached an agreement with Israir to lease two Airbus A320 aircraft to the Israeli airline for three years. Loftleiðir Icelandic simultaneously renewed a contract for the lease of one Boeing 767-300ER to Israir until the end of 2007. The combined worth of these contracts was 3.5 billion ISK or 50 million USD.

February

Icelandair Group published its first ever annual result and became part of the OMXI 15 index. Key figures in this first annual result were: net profits before taxes (EBT) ISK 3,060 billion in 2006, EBITDA ISK 6,058 billion in 2006, Operating profit (EBIT) ISK 3,326 billion, up 28%, net earnings ISK 2,615 billion, equity ratio 34%, net operating cash ISK 6.4 billion and total assets ISK 76.6 billion at year end 2006.

Icelandair Group signs agreements worth a combined ISK 8.3 billion with a Virgin subsidiary and Air Malta. Latcharter, the Latvian airline owned by Loftleiðir Icelandic, a subsidiary of Icelandair Group signed an agreement with Virgin Nigeria Airlines, a subsidiary of Virgin Atlantic Airways to operate two Boeing 767-300ER aircraft on the daily flight route between London, England and Johannesburg, South-Africa, through Lagos, Nigeria. Latcharter also reached an agreement with the Maltese national carrier, Air Malta, to lease one Airbus A320 aircraft for two years to Air Malta.

Icelandair won a top spot in the annual Technology for Marketing (TFM) Awards, held in London and Icelandair also walked away with the best Icelandic web award and best corporate website during the annual Icelandic web awards.

March

Icelandair took home 4 awards from the Icelandic Advertising Awards. Icelandair, which had been nominated for 10 awards, ended up being the most awarded company this year. Icelandair won in the key categories of best newspaper advertising, television advertising, magazine advertising and advertising campaign.

The first Icelandair Group Annual General Meeting was held in Reykjavik at the Nordica Hotel. The Annual Report was simultaneously published on paper and online at annualreport2006.icelandairgroup.com.

April

In April 40 children received grants from the Icelandair Special Children Fund. 40 children were given the grant award for the trip of a lifetime on the first day of the Icelandic summer, 30 children from Iceland and 10 from the United States. This year 70 children and their families received grants from The Icelandair Special Children Fund as part of the 70th anniversary of Icelandair Group. Iceland Travel moved it offices to a new location in Reykjavik. After 16 years in the same location, the company has now moved to new and improved offices that allow for a single floor operation for the first time.

May

Icelandair Group signs a letter of intent for the acquisition of Travel Service the largest privately owned airline in the Czech Republic. Travel Service operates charter flights to and from Prague and Budapest and also owns and operates the low cost airline Smart Wings. The turnover of Travel Service in 2006 was ISK 18 billion (EUR 190 Million). The company operates a total of 12 Boeing 737-800 and 737-500 passenger aircraft, carried over 1.8 million passengers last year and flies to multiple destinations on four continents.

Icelandair Cargo and Icelease, subsidiaries of Icelandair Group sign an agreement with Avion Aircraft Trading on the lease and purchase of four new Airbus A330-200 freighter aircraft.

The first Icelandair morning flight to the US departs for New York and marks a milestone in the history of Icelandair and flights from Iceland to North America. Icelandair resumes flights to Halifax, Canada.

Hilton Hotels Corporation announces that it will enter into a Franchise Agreement with Icelandair Hotels, a fully owned subsidiary of Icelandair Group, for the 252 room 4-star Nordica Hotel in Reykjavik.

June

Icelandair Group, celebrated its 70th anniversary as Flugfélag Akureyrar, the predecessors of Icelandair, was established on 3 June 1937. Icelandair Group made a historic contribution to the Icelandic Aviation museum to mark the anniversary.

Saga Capital Investment Bank hf. and Icelandair Group signed a market making agreement whereby Saga Capital acts as a market maker for shares issued by Icelandair Group.

Icelandair Hotels announced plans for a new downtown hotel. Icelandair Hotels intend to construct a new hotel at Lækjargata 12 in the centre of Reykjavík. The new hotel, which has not yet been named, will be a four-star, 133-bedroom luxury hotel with a gym in the basement, restaurant on the ground floor and a fabulous lounge on the top floor. Icelandair introduces both a new pricing structure and fare rules with an emphasis on more flexibility and transparency for its customers.

July

Icelandair announces that it will add Toronto flights to its schedule in the spring of 2008. This decision was taken following the completion of the new Open Skies agreement between Iceland and Canada. This is intended to be in addition to the Halifax flights and services to Montreal, Winnipeg, Ottawa and St. John in Canada are also being considered.

Boeing unveils the Boeing 787 Dreamliner in Seattle. Icelandair Group has made an agreement to purchase four Boeing 787 Dreamliner aircrafts, which are a great opportunity for Icelandair Group. The design and production of the Boeing 787 Dreamliner is based upon new technology. It's expected to use 20% less fuel and produce 20% less CO_2 than aircraft flying today.

August

Icelandair Group Financial Results for the first half of 2007. Total revenue for the first half of 2007 was ISK 28.1 billion compared to ISK 24.1 billion during the first half of 2006, an increase of 17%. Total revenue for Q2 2007 was ISK 16.2 billion compared to ISK 14.5 billion for 2006, an increase of 12%.

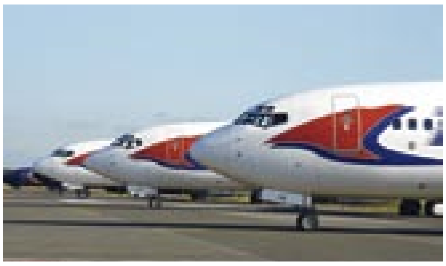
Icelandair Group was awarded the new annual Icelandic Transportation Award, created by the Icelandic Minister of Transportation, on 21 August 2007. This new award was presented to Icelandair Group in recognition of its contribution in the field of aviation and its pioneering work in building up the aviation and travel industries in Iceland.

September

New Board of Directors elected at Icelandair Group shareholders meeting. Finnur Ingólfsson stepped down as chairman of the Board and Gunnlaugur M Sigmundsson was elected the new chairman, reflecting the changes in the ownership of Icelandair Group.

Icelandair Awards USD 100 million maintenance contract to Rolls-Royce. Rolls-Royce signed a engine overhaul agreement with Icelandair, covering the RB211-535s which power the airline's fleet of 21 Boeing 757s.

Loftleiðir Icelandic, a subsidiary of Icelandair Group, has negotiated with Papua New Guinea flag carrier, Air Niugini, to charter one Boeing 727-200 jet for one year. The estimated value of the contract is ISK 850 million.



October

The Hilton Reykjavik Nordica opened its doors to its first guests, becoming the first Hilton to operate in Iceland. The hotel, run by Icelandair Hotels under a franchise agreement with Hilton, is the largest in Iceland and considered to be one of the region's flagship hotel properties. Hilton Hotels Corporation now operates seven properties across the Nordic region, with hotels in Stockholm, Malmö, Copenhagen and Helsinki, including the recently opened Hilton Helsinki Vantaa Airport.

In October Icelandair Cargo kicked off a new weekly freighter services between Reykjavik (Keflavik) and Stockholm (Arlanda). The service is operated on Wednesdays with dedicated freighter aircraft.

In October Icelandair Group invited a group of investors and analysts from the banks and other key investors to Prague to learn more about the operations of the Global Capacity Solutions part of Icelandair Group.

November

Icelandair Cargo in cooperation with Fly Fresh Freight, a Canadian freight forwarder, started a direct Boeing 757-200 freighter service between Keflavik, Iceland and Gander, Newfoundland.

Icelandair Group published its quarterly financial results for Q3 2007. Net Q3 profit 2007 was ISK 2.1 billion compared to a net profit of ISK 2.5 billion in Q3 2006. Total revenue for Q3 2007 was ISK 20.0 billion compared to ISK 19.5 billion for Q3 2006, an increase of 3%.

Icelandair received the Icelandic Continuous Education Award which recognizes the outstanding Icelandic company in terms of continuous education for its staff. The award was presented to Icelandair by Ólafur Ragnar Grímsson the president of Iceland.

December

Icelandair announces plans to shift its in focus in North-Atlantic flights in 2008. Toronto is a new destination, while Baltimore operations will be shut down. More capacity added to London, up to 5 daily flights to Copenhagen, along with morning departures to the US.

The Board of Directors of Icelandair Group announces changes in the key management of the Group as it's announced that Jón Karl Ólafsson will step down as President and CEO and that Björgólfur Jóhannsson has been appointed as the new President and CEO of Icelandair Group.

Dear Shareholder

The principal aim of a company's Board of Directors and managers should be to provide shareholders with the best possible return on their investment. In order to achieve this, a company must provide customers with reliable high-quality services and maintain a good working environment for its employees. These are and will be the guiding principles of the Board of Directors of Icelandair Group. Shares in the company must compete with shares in many other first-rate corporations and the board realises that long term market confidence is above all based on the ability to produce substantial profits.

Although the Group's operations have generally been successful in 2007 there is no disguising the fact that the performance of some companies within the Group has been unsatisfactory. The operating results of Icelandair, Icelandair Cargo and Bluebird have been below projections. Icelandair is the most important company within the Group and is responsible for the greatest part of its turnover.

Icelandair is also of considerable importance to its home country as the company forms Iceland's most important physical link with the rest of the world. We are aware that as a result Icelanders expect much of the company. At the same time shareholders naturally expect the Board and staff to produce acceptable returns. In 2008 improving financial results will take precedence for everyone responsible for managing the Company's operations. Without sustained profitability and growth the company's customers would suffer as well as its shareholders. Adequate profitability is the precondition for stability and development in the field of aviation in Iceland.

Icelandair Group's operating environment is constantly changing and tough competition means that no company within the field can take its position for granted. The companies that perform best in such circumstances are those that are managed by people who appreciate the need for a constant review and re-assessment of acquired methods.

In recent years we have seen Icelandic companies break free of old and fossilised ways of thinking and become vigorous and forward-looking companies operating in international markets. Nowadays many brand name companies are making increased use of outsourcing while maintaining a strong image. The brand name Icelandair is well known throughout the world and we have to build the company's future on that brand rather than a devotion to an acquired structure.

The aviation business is still in many respects in the shackles of old traditions, practices and ways of thinking and it often seems that a great amount of time and energy is put toward dealing with the narrow interests of individuals and circumscribed groups. If Icelandair Group intends to continue to hold its place among the most forward-looking and best companies in its field everyone within the Company must work toward a common goal.

We must strive to be a company that people are proud to work for and shareholders are proud to own. In collaboration with the company's staff and labor unions, Icelandair has managed to achieve an amicable resolution to a large number of issues. This does not alter the fact that we need to strengthen and improve the company's competitiveness. The key word in that respect is flexibility. If an agreement can be reached on a more flexible structure such an agreement would radically alter the company's competitive position. The number of employees would grow and the productivity of the company and its staff would improve dramatically.

Icelandair Group's strategy and structure differ in many respects from those of traditional European airlines. If we had to rely entirely on the domestic market, there would be no basis for sustaining the current level of operations. Icelandair Group thus seeks a broad compass, with diverse operations. This is reflected in the Company's structure which assigns different tasks to specialised subsidiaries, all of which are accountable to Icelandair Group and a shared purpose.

Out of a large number of projects undertaken by the subsidiaries during the year I would like to make special mention of two that are of major importance to shareholders. These are the development and reconstruction of Icelandair and the Group's growth into foreign markets, with an increased emphasis on international charter flights.

In the last few years Icelandair has successfully managed to develop scheduled flights with a high flight frequency between Iceland and a large number of cities on both sides of the Atlantic. The key to this success is a route network which is based on Iceland acting as a hub, making it possible to offer a wide variety of routes between North America and Europe and at the same time provide the home market with a wide range of destinations.

This network, ingenious as it is, has a constant need for fine tuning. In the past year new destinations were added together with the introduction of morning flights from Iceland to the USA. This year we will see a slight decrease in the frequency of flights to Norway and Sweden as well as a discontinuation of flights to Baltimore. Instead we will introduce a new route to Toronto in Canada.

Parallel to the launch of new destinations, a change was made to the company's fare policy. One-way fares were introduced along with a wholesale review of the company's very important revenue management mechanisms with the utilisation of new software and a new methodology. We are also embarking on a renewal of all seats in our Boeing 757 jets. The new leather seats, complete with a personal video and entertainment system, are already being installed at our maintenance centre at Keflavik airport. In addition we will introduce various intriguing innovations that we believe will improve services for our customers and revitalize Icelandair's image.

Icelandair Group is growing fast internationally. An emphasis has been put on building up a strong operation in the emerging markets of Central and Eastern Europe. In 2007 we finalised the purchase of a 50% stake in the Czech airline Travel Service, together with options for an additional 30% later this year. Travel Service is a charter airline that operates twelve passenger jets on flights between Prague and Budapest and several cities in the Mediterranean. Last year Travel Service carried 1.8 million passengers, which is somewhat more than Icelandair carried on its own routes. The low cost airline Smart Wings was included in the purchase and previously Icelandair Group had acquired the Latvian airline Latcharter which has grown considerably in the past year, with the fleet of passenger jets growing from two to nine.

The foreign part of operations, i.e. the operations of Loftleiðir, Bluebird, Travel Services and Latcharter, along with the aircraft trading company Icelease, belong to a segment within Icelandair Group known as Global Capacity Solutions. As things stand, we hope that this part of the operations will generate around 40% of the corporation's EBITDA this year. Changes were made to Icelandair Group's Board of Directors last autumn. A new Board of Directors was elected to the company in September and at the same time the number of board members was reduced from seven to five.

Near the end of last year Mr. Jón Karl Ólafsson stepped down as president and CEO of Icelandair Group after a long and productive career within the Company. I convey to Jón Karl my warmest thanks for our collaboration. In January this year Björgólfur Jóhannsson took over the position of company president and CEO. He has my best wishes in anticipation of a valuable contribution to the company in the future.

I offer the managing directors and all the employees of Icelandair Group my thanks for their excellent work and the goodwill they have shown towards the Board of Directors. I thank the shareholders for their trust in the Company and its management.

In 2008 the Board of Directors and management of Icelandair Group are faced with the task of implementing changes in order to improve the operations of the Company and increase its profitability. This is a challenging task as improved operating results must go hand in hand with a continued rise in the standard of service and increased job-satisfaction. Good morale, good services and improved economic results are integral factors that cannot be separated in the long run. The future success of the company depends on our ability to harmonise these factors.

Gunnlaugur M. Sigmundsson
Chairman of the Board

CEO's Comment

It is both a great challenge and an honour to take on the responsibility of leading Icelandair Group into the future as President and CEO. Icelandair Group is a growing, dynamic company in the aviation and travel industry and I look forward to work with our employees in taking the company forward.

Last year the total turnover of the company was ISK 63.5 billion, up by 13% from 2006. The operation had both positive and disappointing sides. We have a large and diversified group with many foundations. There was rapid growth and healthy profit in charter and aircraft trading activities. We had solid performance in the Travel and Tourism segment. On the other hand Icelandair, Icelandair Cargo and Bluebird Cargo operations did not meet expectations even though the development within the year was positive. EBITDA was ISK 5.5 billion, EBITDAR was ISK 11 billion, but net profit ISK 257 million. We saw lower cash status in 2007 due to down payments of debt and aircraft trading during the year, and higher financial expenses. Total assets amounted to ISK 67 billion. The largest business segment within Icelandair Group, Scheduled Airline Operations, underperfomed, even if improved revenue management and capacity control in Q4 partially offset revenue shortcomings from Q2 and Q3. The Icelandic passenger market continued to be strong last year, but we saw less export and lower revenue at Icelandair Cargo than anticipated. Maintenance cost was also higher than anticipated in network and cargo operations.

Icelandair increased its number of trips by 6% from 2006 and passenger numbers were up by 4%. The load factor was affected by overcapacity on the market in Q2 and Q3 and was down in 2007 from the previous year. In the second largest business segment, Global Capacity Solutions, operations showed healthy profits and growth at Latcharter and Loftleiðir Icelandic, while revenue at Bluebird dissappointed in Q2 and Q3. Sale profit due to the sale of aircraft at Loftleiðir was close to ISK 1 billion, and good profit from Icelease operations despite sale of distressed assets. Travel Service became an associate member of the Group as of November 1.

In the Travel and Tourism segment we saw improved utilization and tight cost control at Icelandair Hotels and postive outcome of the year. Higher passenger revenue at Air Iceland due to more demand outweighed higher employee and fuel cost. Implementation of new information systems led to higher employee cost at Iceland Travel and strong ISK led to lower profits from services than expected.

We have a job on our hands in improving the performance of the Group in 2008. Icelandair is off to a good start with improved revenue. We have less capacity in the network than last year and we will focus on cost and profitability above all. We also have a large task ahead of us in implementing the renewal of Icelandair services and products with new aircraft interiors. Another major task is to incorporate Travel Service into Icelandair Group and keep focus on synergy and further growth in Central- and Eastern-Europe.

All the companies within Icelandair Group have their own plans for growth and improved performance, as can be seen in this annual report. The Group's task is to make sure these ambitions will be realized.

Björgólfur Jóhannsson
President and CEO


LOFTLEIDIR ICELANDIC
ICELANDAIR


LOFTLEIÐIR
ICELANDIC
TF-FIT
ISLANDER CLUB

Another charter for today. TF-FIT decending to land at Princess Juliana Airport, Netherlands Antilles.

Corporate Governance

Icelandair Group holds the view that well functioning Corporate Governance principles are essential for assuring shareholders and other stakeholders that the Company is doing its best to ensure sound and effective control of the Company's affairs and a high level of business ethics. Exercising good Corporate Governance will, in the long run, build a solid Company returning shareholders satisfactory profits on their investment. Corporate Governance serves to ensure an open and transparent relationship between the Company's management, its Board of Directors, its shareholders and other stakeholders.

In 2004, the Iceland Chamber of Commerce, the Iceland Stock Exchange and the Confederations of Icelandic Employers issued guidelines on Corporate Governance. These guidelines along with the articles of associations, and rules for Issuers of Securities listed on the OMX Nordic Exchange make up the framework for Icelandair Group Corporate Governance practices.

It is the opinion of the Board of Directors that Icelandair Group is in full compliance with the Icelandic guidelines for Corporate Governance.

Shareholders' Meetings

Shareholders exercise their powers at shareholders' meetings, which represent the supreme authority in all the affairs of Icelandair Group within the limits provided for by the Company's Articles of Association and statutory law. All shareholders are permitted to attend shareholders' meetings, express their views and exercise their voting rights. Shareholders may be represented by proxies, and they may be accompanied by advisors. The auditors of the Company and the CEO also have full rights to speak and submit motions at shareholders' meetings whether they are shareholders or not.

Notices of shareholders' meetings must specify the business to be addressed at the meeting. If the agenda includes motions to amend the Articles of Association of the Company, the substance of the motion must be included in the notice of the meeting. Seven days before a shareholders' meeting, at the latest, an agenda, final submissions and, in the case of Annual General Meetings, the annual accounts, report of the Board of Directors and the auditor's report must be laid open for inspection by shareholders at the Company office.

Each shareholder is entitled to have a specific item of business included on the agenda of a shareholders' meeting, provided that such shareholder submits a written request to this effect to the Board of Directors of the Company with sufficient advance notice for the item to be included on the agenda in accordance with the Company's Articles of Association.

Items of business which are not included on the agenda may not be accepted for final decision at a shareholders' meeting except with the consent of all the shareholders in the Company, but a resolution may be passed to provide guidance to the Board of Directors of the Company. Lawfully submitted motions for amendments may be put to a vote at the meeting itself, even if they have not been laid open for inspection by shareholders. An Annual General Meeting is always permitted to conclude matters which it is required to address pursuant to statutory law or the company's Articles of Association.

Rights, Preferences and Restrictions on Shares

All voting shares carry equal rights, and no privileges are attached to any shares in the Company. All the shares are freely transferable except as otherwise provided by law.

Actions Necessary To Change Shareholders' Rights.

According to Article 23 of the Company's Articles of Association, the Articles may be amended only at a lawful Annual General Meeting or extraordinary shareholders' meeting, provided that the notice of the meeting clearly indicates that such an amendment is proposed and outlines the main substance of the amendment. A decision to amend the Articles is valid only if it has the support of at least 2/3 of the cast votes and the support of shareholders controlling at least 2/3 of the share capital represented at the meeting, provided always that no other force of vote is required by the Articles or statutory law, as further provided in Article 93 of the Companies Act.

The Annual General Meeting shall be held before the end of May each year.

An Extraordinary Shareholders Meeting

On 12 September an extraordinary shareholder's meeting was held, as major shareholder changes had taken place and Finnur Ingólfsson Chairman of the Board of Directors announced his resignation from the Board of Icelandair Group. At the extraordinary shareholders meeting a proposal to amend the Articles of Associations was accepted, i.e the members of the Board of Directors shall be five instead of seven. Following that a new Boards of Directors was elected. At the shareholders meeting the following person were elected to the Board of Directors of Icelandair Group:

Gunnlaugur M. Sigmundsson;
Ásgeir Baldurs;
Ómar Benediktsson;
Einar Sveinsson;
Finnur Reyr Stefánsson,

and as alternate Board members:

Jón Benediktsson;
Martha Eiríksdóttir;
Sigurður Atli Jónsson.

From the Annual General Meeting 2007 until 12 September, the members of the Board were:

Finnur Ingólfsson, Chairman;
Einar Sveinsson;
Gunnlaugur M. Sigmundsson;
Helgi S. Guðmundsson;
Hermann S. Guðmundsson;
Jóhann Magnússon;
Ómar Benediksson,

and alternate members were

Guðsteinn Einarsson;
Jón Benediktsson;
Martha Eiríksdóttir.

Board Practices

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 CEO for the Company and decide the terms of his or her employment.

The Board of Directors 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 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 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 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 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 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 two 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 Vice chairman from among its members, and otherwise allocates its obligations among its members as needed. The Chairman calls Board meetings. A meeting must also be held if requested by a member of the Board of Directors or the 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 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 the discussion 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 CEO.

Auditing and Accounts

An auditing firm is elected at the Annual General Meeting each year. The auditors examines the Company's annual accounts, in accordance with generally accepted accounting stardards, and has access to all the books and documents related to this. The accounting firm working for Icelandair Group is KPMG hf, and acting on their behalf are Jón S.Helgason, and Guðný H. Guðmundsdóttir.

Insider Information

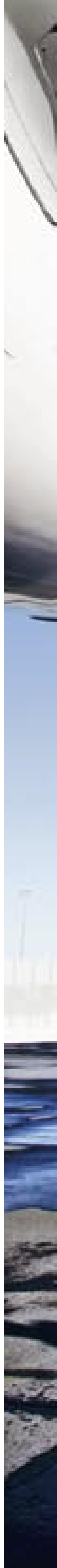
The Board of Directors appoints a Compliance Officer and his or hers substitute. The Compliance officers responsibilities are to ensure that all rules set by the Company regarding insider trading and insider information are followed at all times.

Audit Committee

The main tasks of the Audit Committee include coordinating all auditing work within the Group in co-operation with the Company's internal auditors, and acting in an advisory capacity to the Board of Directors with respect to financial reporting. The Audit Committee is appointed by the Company's Board of Directors and is composed of three members. The current members of the Committee are three alternate members of the Board of Directors: Martha Eiríksdóttir chairman, Jón Benediktsson, and Sigurður Atli Jónsson.

Wage Terms Committee

The purpose of appointing a Wage Terms Committee was to avoid placing the Company's managers 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 the shareholders. The main tasks of the Wage Terms 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 current members of the Committee are three members of the Board of Directors: Gunnlaugur Sigmundsson, Chairman, Ómar Benediktsson, and Finnur Reyr Stefánsson.



Board of Directors

Gunnlaugur M.Sigmundsson, Chairman

Gunnlaugur M. Sigmundsson has been the CEO of Máttur Investment since 2006. Before joining Máttur he was the CEO and one of the founders of Kögun Air Surveillance Systems from 1989-2006 and took that company public in 2002. Gunnlaugur was one of the founders and the CEO for Icelandic Finance, a Venture Capital company in Iceland, from 1986-1993, and Assistant to an Executive Director at the World Bank in Washington DC from 1981-1984. From 1974 to 1981 he was Director for cash-flow at the Icelandic Ministry of Finance. Gunnlaugur has a degree in Business Administrator from the University of Iceland; he was a member of Parliament 1995-1999 and has served on the Board of Directors in a number of companies and institutions in Iceland, the US and in various European Countries.

Ásgeir Baldurs, Board Member

Ásgeir Baldurs is the managing director of Spectors ehf since 2007. Ásgeir was the CEO of Vátryggingarfélag Íslands hf.(VÍS) and the Managing Director of Líftryggingarfélag Íslands hf from 2005-2006. Prior to that he held senior management positions at VÍS from 2000, in both sales and marketing and business development. Ásgeir is currently a member of the Board of Directors of Frumherji hf and SPRON and is the Chairman of the Board of Viking Redningstjeneste A/S in Norway. Formerly Ásgeir has been a member of the Board of Directors of the English insurance company IGI Group, of Öryggismiðstöð Íslands and of Lýsing hf. Ásgeir graduated with an MBA degree from the University of Iceland in 2004 and a BSc in Business Administration and Marketing form the J&W University, Providence RI in 1994.

Ómar Benediktsson, Vice Chairman

Ómar Benediktsson was the CEO of Islandsflug from 1997 until 2004 when the company merged with Air Atlanta Icelandic, becoming the CEO of the joint company. After the merger was complete he left the company at the end of 2005. He was the Managing Director of Island Tours in Germany 1986-1992 and after that he was involved in several companies as an investor and a Board member. Ómar was one of the founders of Icelandair Group Holding hf. when it was established on 15 October 2006. Ómar has a degree in Business Administration from the University of Iceland.

Einar Sveinsson, Board Member

Einar is the former CEO of Sjóvá-Almennar insurance company. He was employed at Sjóvátryggingarfélag Íslands hf. from 1972 to 2004 (Sjóvá-Almennar tryggingar hf. from 1989), being Chief Executive Officer from 1984 to 2004. He was Chairman of the Iceland Chamber of Commerce from 1992 to 1996. Among other things, he has been Chairman of the Board of several companies: the life insurance company Sameinaða Líftryggingafélagið hf., fisheries company Haraldur Böðvarsson hf., Frumherji hf., NAIG (Nordic aviation insurance group), and the Association of Icelandic Insurance Companies. He has also served on the Board of Directors of the fisheries companies Grandi hf. and Útgerðarfélag Akureyringa hf., and the financing company Lýsing hf.

Finnur Reyr Stefánsson, Board Member

Finnur Reyr Stefansson has been a Board member and partner at Sigla Investment Company from 2007. He was a member of the Executive Board of Glitnir and EVP for Shared Services at Glitnir Bank 2006-2007 and EVP for Capital Markets 2000-2006. Before that he worked at Glitnir and its predecessor, FBA, from 1997 in Risk management and Funding. From 1994 Finnur was Fund Manager and Director at Landsbanki Securities. He was awarded an MBA in Finance from Virginia Tech in 1994 and a BSc in Economics from the University of Iceland in 1992.

Martha Eiríksdóttir, Alternate Board Member

Martha Eiríksdóttir is currently Head of Marketing and Business Relations for Landsnet which is the electricity transmission service operator in Iceland. Prior to that, she was ExecutiveDirector of Marketing of Consumer Products at Íslandssími. Between 1994-2000 Martha Eiríksdóttir worked as Manager Commercial Programmes for Europay International, European headquarters of MasterCard, Maestro and Eurocheque. Before joining Europay Int. she worked for five years as Head of Marketing at Eurocard Iceland. Martha has also worked as a consultant on several projects in the credit card industry. Martha holds a degree in Economics and Business Administration from the University of Iceland. She also holds a B.Ed. degree from the University College of Education in Iceland.

Jón Benediktsson, Alternate Board Member

Jón Benediktsson has been a freelance IT consultant since 2006. From 1992-2006 Jón worked for Marel hf as a software engineer and IT Director. Jón was employed from 1988-1991 at the Systems Engineering Laboratory of the University of Iceland. He has been a board member of several companies, including Kögun hf, Nes hf, Bílanaust hf, Olíufélagið hf and is currently a Board member of BNT hf. Jón Benediktsson has an MSEE degree in Electrical Engineering from Purdue University, Indiana USA.

Sigurður Atli Jónsson, Alternate Board Member

Sigurður Atli Jónsson is a co-founder and managing partner of Alfa Investment Consulting in Iceland. He is also a part-time lecturer in Finance at Reykjavík University. Sigurður Atli was previously the CEO of Landsbréf in Iceland and Managing Director and Head of Capital Management at Landsbanki Íslands. He has served on the Board of Directors in a number of companies, e.g. the Iceland Stock Exchange, Heritable Bank in the U.K., Líftryggingafélag Íslands and Atorka. Sigurður Atli holds a Master's degree in Economics from Queen's University, Canada and a B.Sc. in Economics from the University of Iceland. He is also a chartered securities broker in Iceland.


ICELANDAIR
ICELANDAIR

Market Overview

The Aircraft Market In 2007

The trend of the last few years continued in 2007 and through the beginning of 2008, with demand for quality narrow-body and wide-body far exceeding supply. Both major manufacturers, Boeing and Airbus, had record order books with Boeing recording 1,413 net orders and Airbus having 1,341 net orders. The consequence of this is that neither manufacturer has any order positions available until at least 2011 for any type of aircraft, and in the case of the B787 Boeing, is sold out until 2014/15. Icelandair Group has five B787s on order, delivering between 2010 and 2013. As airlines cannot acquire new aircraft, the demand for used aircraft is strong. However most major lessors are sold out for 2008 and 2009 and anything that is available is expensive.

However a number of concerns are beginning to surface. The problems in the banking sector are starting to make themselves felt in the aircraft market and it will come as no surprise if some deliveries in 2008 run into difficulties raising the necessary finance. However for 2008/9 both manufacturers are reported to be over-ordered and would welcome a small level of cancellations. Airlines in the US continued to have difficulties, mainly with high fuel prices and it is probable that there will be some airline mergers in 2008, which may also free up some aircraft capacity.

On the other hand, Chinese banks' credit is tightly controlled and this is limiting the number of aircraft Chinese airlines can buy – they are seeking more leased aircraft to compensate. The Russian market continues to open up, with tax reductions being proposed on the 120-150 seat capacity aircraft. The main effect of this is to keep demand high on older aircraft.

The Group is seeking investment opportunities in good quality aircraft but will continue to be patient until the correct deals come along.

The B757 Market

The B757 aircraft suffered large devaluations subsequent to September 11, 2001. However in the last two years the aircraft type has made a strong recovery with values for older models (1993) increasing by nearly 30% in this period. The youngest B757s are fetching good lease rates again. The revival in the market valuations has stemmed from a general strengthening in the market for all types and has been aided by the strong cargo conversion programme for this aircraft. FedEx is looking to acquire 87 aircraft over 8 years to replace its 727 aircraft. The aircraft has also begun to be used by a number of carriers on direct transatlantic routes. Winglets have made this aircraft more cost-efficient. There are very few quality B757s on the market at this time for lease or rent. The aircraft has a high concentration of US operators and with mergers likely in this market some B757 aircraft may become available in the next year or two. However such aircraft will be older models and will require an investment of time and money to bring them under European regulations. These aircraft will be more likely to end up in the cargo conversion programme than operating as passenger aircraft.

During the financial year Icelandair sold and leased back two of its B757-200 aircraft and in the coming months will consider further sale and leaseback opportunities.

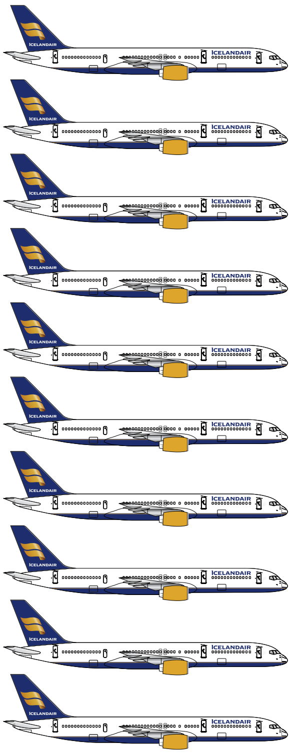
Boeing and Airbus are both working on a narrow-body replacement aircraft at the moment. Both are concentrating on replacing their most popular narrow-bodies (B737 and A320 models) but are also looking to see if they can design an aircraft which could also satisfy B757-type demand. However Airbus does not foresee an entry into service date for such an aircraft until 2017.

Icelandair Group Fleet

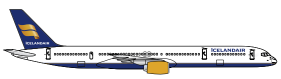
In total 71 aircraft were involved in Icelandair Group's operation at the end of 2007

ICELANDAIR

10 Boeing 757-200

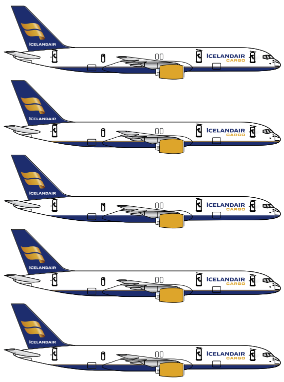


1 Boeing 757-300



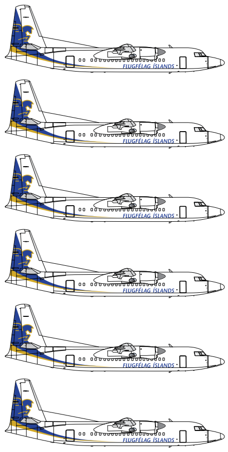
ICELANDAIR CARGO

5 Boeing 757-200

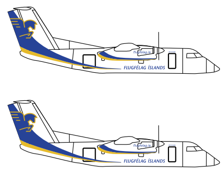


FLUGFÉLAG ÍSLANDS Air Iceland

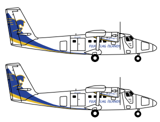
6 Fokker Friendship



2 Dash 8

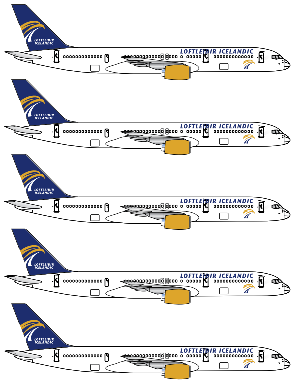


2 Twin Otter

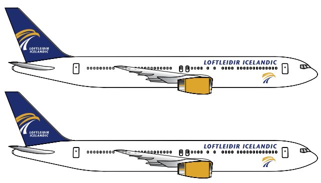


LOFTLEIDIR ICELANDIC

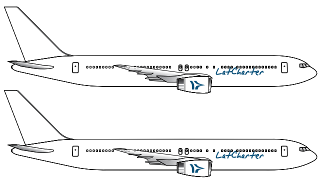
5 Boeing 757-200



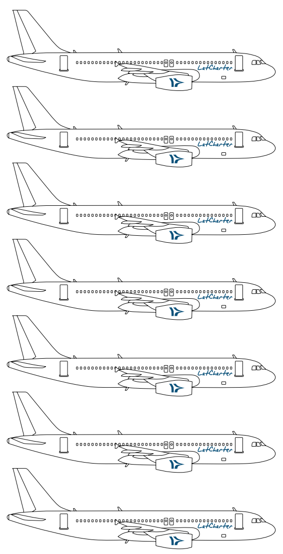
2 Boeing 767-300



2 Boeing 767-300

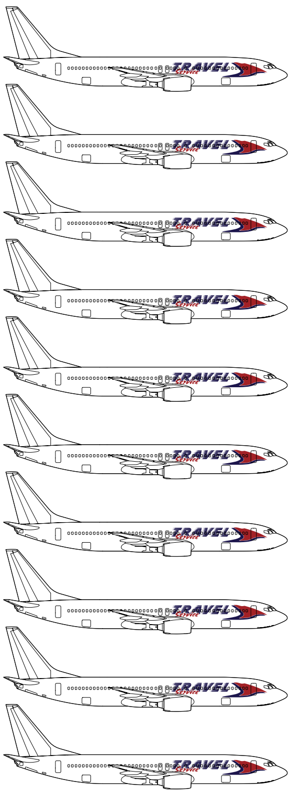


7 Airbus A320-200

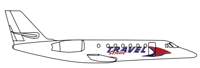


2 Boeing 737-500

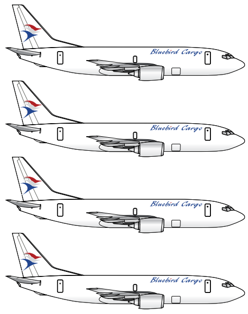
10 Boeing 737-800



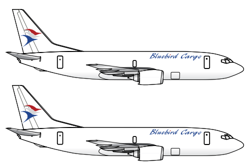
1 Sovereign



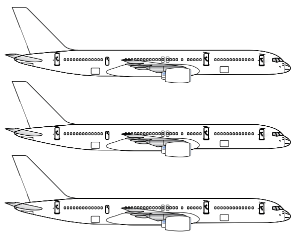
4 Boeing 737-300



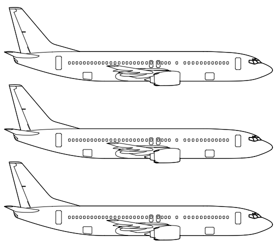
2 Boeing 737-400



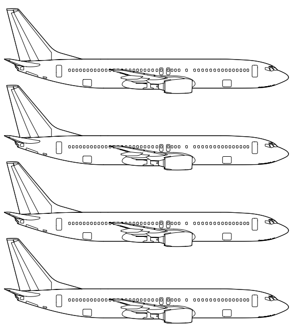
3 Boeing 757-200



3 Boeing 737-500



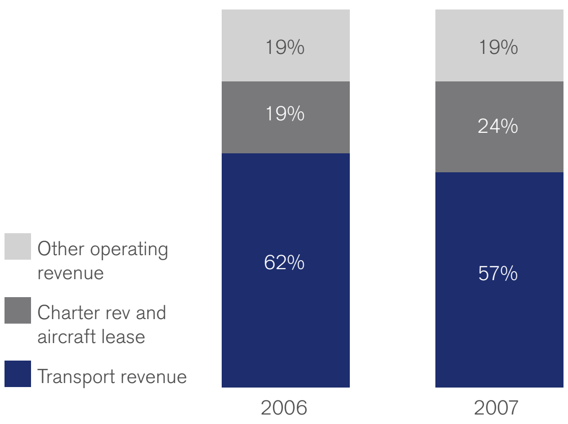
4 Boeing 737-800



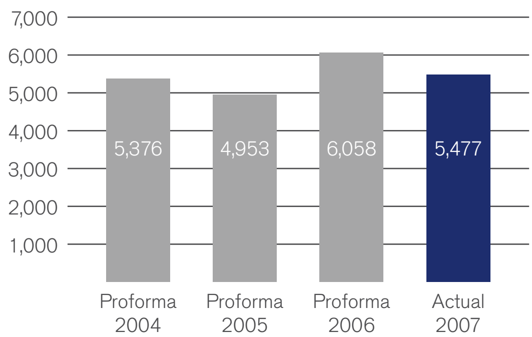
Financials

- Net earnings ISK 257 million
- EBITDA ISK 5.5 billion
- Revenue growth 13%
- Total assets ISK 67 billion
- Equity ratio 37%
- Net operating cash ISK 3.9 billion

Revenue Distribution



EBITDA
ISK million



Income Statement

Our net earnings result of ISK 257 million for 2007 is a drastic decrease on the previous year's result and does not reflect the performance of the core operations of the Company. It does however illustrate the difficulty in financing expansionary and other capital intensive projects, under the current economic conditions of increasing interest rates. A strengthening ISK has also given rise to substantial translation loss on foreign denominated assets and cash flows.

The EBITDA for 2007 amounted to ISK 5.5 billion compared to ISK 6.1 billion in 2006 which, although 10% less than the previous year, was very close to our expectations.

INCOME

Total revenue for 2007 was ISK 63.5 billion, a healthy 13% revenue increase on the previous year. Transport revenue in 2007 was ISK 35. 9 billion, up 3.4% from last year. While Icelandair did not quite meet expectations in Q2 and Q3 it did outperform in Q4 in light of a new and improved revenue management system and better capacity control. Icelandair also saw an increase in the number of passengers and trips by 4% and 6% respectively. Icelandair Cargo did not perform as well as forecasted, due to low demand mainly attributed to developments in the Icelandic fishing industry. Charter and AC lease amounted to ISK 15.5 billion compared to ISK 10.7 billion in 2006, increasing 45.3%. This was primarily driven by tremendous growth in Latcharter, but was also due to rapid growth in Charter, ACMI and Aircraft Trading. Other operating revenue totaled ISK 12 billion, increasing 14.3% from last year, mainly due to aircraft trading.

OPERATING EXPENSES

Operating expenses in 2007 totaled ISK 58 billion compared to ISK 50.1 billion in 2006, a 16% increase. The increase was primarily due to operating growth from the previous year, caused by the implementation of nine new aircraft in the middle of the year. An 11% year on year increase in average full time equivalent units employed at the group as well as a 59% increase in maintenance expenses which can mostly be attributed to network and cargo operations also contributed to this increase.

FINANCIAL INCOME AND EXPENSES

Rising interest rates have led to an increase in financing cost which, along with a strong ISK, has been the major influence on the disappointing net earnings result. Finance income was lower in 2007 than in 2006 because of a lower cash balance during the year. The reasons for the lower cash balance were primarily the financing of new aircraft and repayment of loans. Finance expense increased by ISK 520 million because of the introduction of new debt at the end of 2006, which has been subject to the previously mentioned rising interest rates.

Balance Sheet

ASSETS

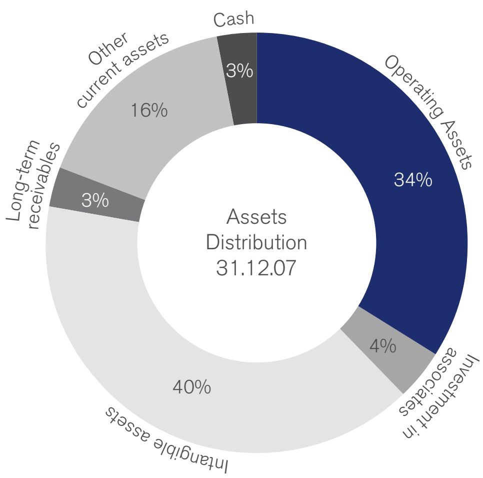
Icelandair Group's total assets as of 31 December 2007 totaled ISK 67 billion. Total assets decreased by 13% from ISK 77 billion between years. The largest effect came from the reduction in purchase prepayments (PDP) as five Boeing 737-800 aircraft were sold. Operating assets totaled ISK 22.8 billion and consist mainly of aircraft. Intangible assets were a total of ISK 26.8 billion. Goodwill created through the acquisition of companies, accounted for ISK 20 billion of this figure. Investment in associates was ISK 2.3 billion at year-end 2007, up from ISK 2.1 billion in 2006. The company sold four associates related to Boeing 737-800 aircraft but the acquisition of 50% in Travel Service took place in Q4. Prepaid aircraft acquisitions totaled ISK 249 million at year-end, compared to ISK 9.7 billion at year-end 2006. Six 737-800 were delivered and sold during 2007, bringing the prepaid aircraft acquisitions to a total of ISK 249 million. This was mainly because of an agreement with Boeing to purchase four Boeing 787 Dreamliner aircraft which are to be delivered in the years 2010 and 2012. Cash and cash equivalents totaled ISK 2 billion at year-end 2007 compared to ISK 2.8 billion at year-end 2006 due to repayments of long-term debt and investments in new aircraft.

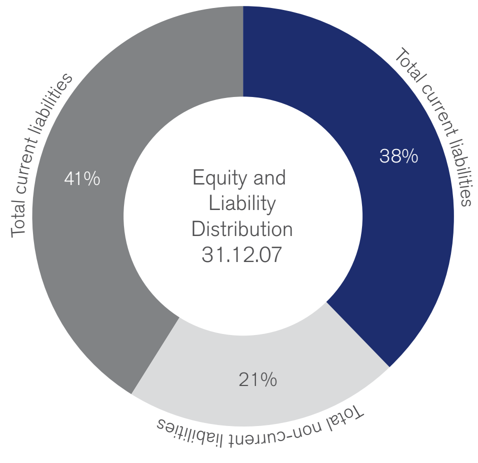
LIABILITIES

Icelandair Group's total loans and borrowings as of 31 December 2007 totaled ISK 25 billion compared to ISK 35 billion at year-end 2006. Total prepaid aircraft acquisitions accounted for ISK 8.5 billion of the decrease during the course of the year. Total non-current loans and borrowings were ISK 14 billion at year-end 2007 compared to ISK 21.6 billion at year-end 2006. Total current loans and borrowing at year-end were ISK 11 billion in 2007 compared to ISK 4.6 billion in 2006. The reason for the change between non-current and current loans and borrowing are new short term bonds which were issued during the year to repay unfavorable longer term bonds.

EQUITY

The Group's total equity amounted to ISK 25 billion. The equity ratio was 37%. Numbers of shareholders at the end of the year 2007 were 1,271 but were 1,507 at the beginning of the year. Three shareholders owned over 10% of the share capital: Langflug ehf. with 23.8%, Fjárfestingafélagið Máttur ehf. with 23.1% and Naust ehf. with 14.8%.





Shareholder Information

Share Capital

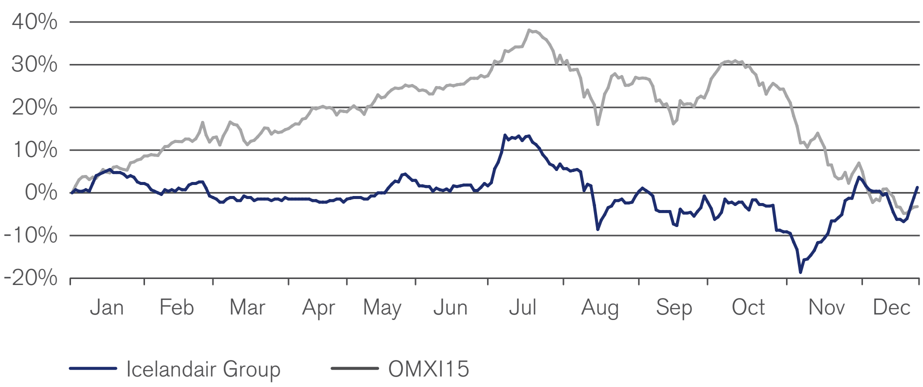
The share capital of the Icelandair Group as of 31 December 2007 is ISK 1,000,000,000 in nominal value, divided into an equal number of shares, each with a nominal value of ISK 1.0. Each issued share carries one vote. Icelandair Group holds 19,200,000 shares in itself or 1.92% of the total shares

Icelandair Group has been listed on the Iceland Nordic Exchange since December 2006, therefore 2007 being the first whole year of the company's listing. The ticker symbol for Icelandair Group is ICEAIR.

Share Performance

At the end of 2007, the market capitalisation of Icelandair Group was ISK 27.75 billion. The share price of Icelandair Group in 2007 took some change. The share price started out at 27.4 and the year closed at 27.75, this is an increase of 1.28%. In comparison the OMXI15 fell by 3.22% in 2007. During the year 2007, the high and low share prices were. 22.3 and 31.05 respectively. Total turnover in 2007 amounted to ISK 3.2 billion, corresponding to a turnover rate of 116%. Average monthly trading volume was ISK 2.8 billion on 2007.

2007 Share Price Development



Dividend Policy

The Board of Directors of Icelandair Group will propose to the Annual General Meeting that no dividends should be paid with respect to the financial year 2007.

Shareholders

At the end of 2007 Icelandair Group shares were held by a total of 1,271 shareholders. A total of 417 employees held shares in Icelandair Group at the end of 2007. 1.2% of the totals shares in Icelandair Group were held by foreign investors. Ownership in Icelandair Group is considerably tight, three shareholders hold more than 10% of the total shares and the same three hold 61.76% of the total shares.

Stock Option Plan

In the beginning of 2007 a stock option plan was implemented in Icelandair Group. The purpose of the stock option plan is to enable Icelandair Group to attract and retain qualified employees through an attractive system of remuneration and at the same time provide employees with an opportunity to acquire an interest in the Company and thereby contribute to increased incentives and rewards for promoting the increased growth and prosperity of the Company in the long term. At the end of 2006, a shareholders meeting agreed two motions for empowerment of the Board of Directors, on the one hand by an authorisation to approve a stock option scheme for key managers of the Company and/or its subsidiaries, including authorisation for the issue and sale of new shares in connection with the stock option scheme and, on the other hand, by an authorisation to buy treasury shares in the Company.

The authorisation of the Board of Directors to issue stock options is limited, so that the outstanding options at any time must never amount to a proportion greater than 6% of the total shares in the Company at any time. The amount of the stock option of any single employee must not exceed 10% of the total issued stock options, although this rule does not apply to the CEO of the Company. The Company is permitted to use its own shares, purchase shares, or issue new shares as authorised by a shareholders' meeting, in order to meet Company obligations pursuant to stock option contracts.

On the delivery of stock options to employees, the Company enters into a written stock option contract with the employee. The terms and conditions of stock option contracts need not be uniform, and options may be adapted to the needs of individual employees.

The selling price of shares in the Company to holders of stock options is decided by the Board of Directors of the Company at any time; the price must not be lower than 27 times the nominal value, but is in other respects determined by the average price of market trading in the Company's stock ten days prior to the signature of each stock option contract. The authorisation granted to the Board of Directors to increase the Company's share capital is effective for five years from its approval and may be exercised by the Board in part or in full, at the discretion of the Board.

Shareholders' pre-emptive rights pursuant to the Company's Articles of Association do not apply to increases in share capital pursuant to the authorisation held by the Board of Directors. In the event that the share capital of the Company is increased during the period of the authorisation beyond ISK 1,000,000,000 the authorisation will be increased so as to remain always at the level of 6% of the total share capital of the Company at any time. Shares acquired through the exercise of options are not subject to any trading restrictions. New shares carry rights in the Company from the date of their listing.

20 Largest Shareholders as of 31 December 2007

Shareholder	Holdings	Shares
Langflug ehf	238,350,000	23.80%
Fjárfestingafélagið Máttur ehf	231,101,393	23.10%
Naust ehf	148,148,148	14.80%
Urður ehf	55,555,556	5.60%
Alnus ehf	26,022,831	2.60%
Saga Capital Fjárfestingarbanki hf	26,000,000	2.60%
Glitnir banki hf	25,471,077	2.60%
Sigla ehf	20,000,000	2.00%
Icelandair Group hf	19,200,000	1.90%
Flugval ehf	18,518,519	1.90%
Arkur ehf	17,500,000	1.80%
Stafir lífeyrissjóður	14,317,038	1.40%
N1 hf	12,844,611	1.30%
Lífeyrissjóður verslunarmanna	11,616,111	1.20%
BK-42 ehf	10,000,000	1.00%
GLB Hedge	9,992,231	1.00%
Landsbanki Luxembourg S.A.	8,510,000	0.90%
Almenni lífeyrissjóðurinn	6,571,047	0.70%
Fluglind ehf	5,555,556	0.60%
Glitnir Sjóðir hf. sjóður 10	5,494,954	0.60%
Total	**910,769,072**	**91.08%**

Investor Relations

It is the aim of Icelandair Group to provide investors, analysts and other stakeholders with current and detailed information on the activities and operations of the Company. This is executed through a variety of channels.

The Company's website provides access to all press releases, presentations and financial accounts published by Icelandair Group, as well as live share price data. In addition to that all information regarding Icelandair Group is available through RSS feed, and e-mails. Subscription to these services is available at the Icelandair Group website.

To strengthen even further the Investor Relations Icelandair Group hosted Capital Markets days in Prague in October. The aim was to introduce the Groups' growth into Central and Eastern Europe. The event had a good and broad attendance, encouraging the Company to host such events again in the future in order to keep investors and analysts up date on Company matters.

The Annual Report of Icelandair Group is published in English only, it is available in Web and PDF format. A printed copy of the Annual Report is available upon request.

Along with the publications of Annual and interim accounts a briefing is held for investors and analysts. After the briefing the presentation is available on the Company's website as well as a web cast of the presentations.

Financial Calendar for 2008

Publishing dates for the financial reports of Icelandair Group are as follows.

1st quarter results 2008
Tuesday 20 May 2008

2nd quarter results 2008
Tuesday 19 August 2008

3rd quarter results 2008
Tuesday 18 November 2008

4th quarter and Annual Results 2008
Week 9 2009

Shareholders	Holding	Percent of Shares	Number of Shareholders	Percent of Shareholders
Over 10,000,000	864,645,284	86.46%	14	1.10%
1,000,001-10,000,000	95,756,852	9.57%	28	2.20%
100,001-1,000,000	25,630,053	2.57%	79	6.20%
10,001-100,000	11,309,759	0.43%	573	45.10%
0-10,000	2,658,052	0.97%	577	45.40%
Total	**1,000,000,000**	**100.00%**	**1,271**	**100.00%**

Risk Management

Risk Management

Various sources of financial risk inevitably play some part on the Group's operations by nature. The Board of Directors is responsible for defining treasury policy measures to reduce the exposure of risk. The approved treasury policy, outlines the parameters and framework to which the Group is subject to, when dealing with financial risk arising from price volatility, liquidity fluctuations, asset management and corporate financing. An internal Risk Management Team, chaired by the CEO, actively controls the risk exposure within the Board's policy limits.

The main policy objectives outline the methods to be used to reduce costs and inconvenience arising from price volatility and uncertainty. To that end, the financial budget is used as a benchmark when evaluating market conditions and hedging strategies.

Foreign currency risk

The Group seeks to reduce its foreign exchange exposure arising from transactions in various currencies through a policy of matching, as far as possible, i.e. receipts and payments in each individual currency. Any mismatch is dealt with by currency trades within the Group before turning to outside parties. The biggest currency mismatch is found in Icelandair where US dollar cash inflow falls short of dollar outflow by roughly USD 100 millions due to fuel costs and capital related payments that 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 hedging policy of 40-80% hedging ratio, 12 months in advance, and uses a portfolio of instruments, mainly collar options and forwards. Due to two years of continous weakening of the US dollar against the Euro the hedge ratio of EUR/USD has been kept at modest levels, thus allowing for enhanced participation of the beneficial upward trend.

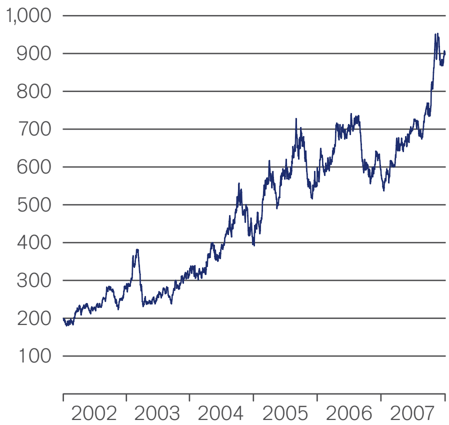
Fuel price risk

The jet fuel price has proved to be increasingly volatile in recent years. Not only has the price development been characterised by a steep upward trend, generated by excessive world demand, but also surprises and unanticipated sharp movements due to volatile sentiment and speculative forces. Moreover, swap prices had for two years followed a positive curvature until returning to the more familiar "backwardation" during 2007. In 2007, the monthly average of jet fuel prices reached a record level of USD 920 pr tonne in November after starting off in January with the settlement price of USD550.

The Group follows a policy of 40-80% hedging ratio, 12 months in advance and has recently maintained its ratio between 40 and 50% i.e. close to the lower policy boundaries due to the historically high prices. Hedge instruments used in 2007 weere to a big extent swaps and 3 way collars. Despite the unfavourable price developments, Icelandair and Air Iceland managed to keep fuel costs within budget limits.

Price of EUR in terms of USD
EUR in terms of USD

Price of Jet fuel
Price in USD pr. Tonne

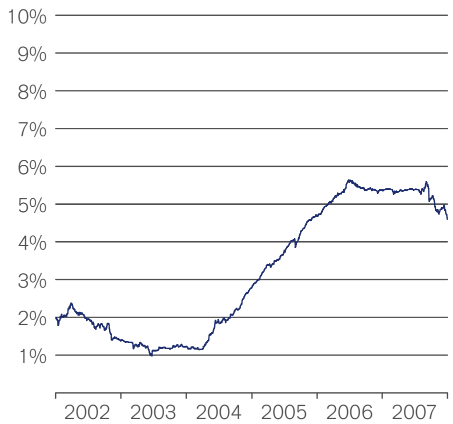


Interest rate risk

The largest share of outstanding loans are directly related to aircraft financing and denominated in US dollars. This is a consequence of the fact that the most liquid market for commercial aircraft denominates prices in US dollars. The Group follows a policy of hedging 40-80% of interest rate exposure of long term financing, 2-5 years in advance.

Currently, only the aircraft loans are hedged against interest rate fluctuations with swap contracts, where the 6 month floating rate is exchanged for fixed interest rates. Forward rate agreements and options have occasionally also been used to that end. The contracts amount to USD 100 million and have been considerably favourable in recent years, as the floating rate has been increasing for some time. The average fixed interest rate is 4% compared to the 6 month floating rate, mid year 2007 of 5.5%. Most of the swap contracts expire in 2009 and 2010 so the recent US interest rate reductions will bring opportunities for improved hedge positions beyond 2009.

6 month USD Libor



Liquidity risk

The Group's policy extends to two tiers of liquidity preferences. Tier one relates to the necessary minimum benchmark to maintain adequate operational liquidity and tier two relates to a preferred minima for strategic liquidity. In both cases, certain asset classes are identified to qualify for each tier based on duration and value sensitivity. The amounts are re-valued annually with regards to the estimated turnover, annual fixed costs, cost of capital and uncertainty.

Balance sheet risk

Some part of the Group´s loan portfolio is composed of rather unfavourable ISK short term loans. To reduce the effects of those loans on total financial costs, currency and interest rate swaps were used to exchange ISK rates for lower EUR and USD rates. To the extent that such contracts cause imbalance between currency composition of assets and liabilities, exchange rate exposure will result and the net effects feed into the financial items of the income statement. The relatively strong ISK in 2007 supported such actions and thus donated some improvements to the financial items in the income statement.

Senior Management of Icelandair Group

Björgólfur Jóhannsson

PRESIDENT AND CEO ICELANDAIR GROUP

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

Sigþór Einarsson

COO ICELANDAIR GROUP

Sigþór was appointed Chief Operating OfficerCOO of Icelandair Group in March 2006. He was Managing Director of Loftleiðir Icelandic from its foundation on January 1, 2002 until 2006. He joined Flugleiðir in April 1996, first in positions related to strategic planning, but as of May 1999 he served as Director of Resource Management where he assumed responsibility for management of all flight-related costs, including aircraft leasing, station management and fuel purchasing. He holds a master's degree in industrial engineering and management.

Hlynur Elísson

CFO ICELANDAIR GROUP

Hlynur was appointed Chief Financial Officer of Icelandair Group in 2006 after being Icelandair's Senior Vice President of Finance and Resource Management since April 2005. He joined Flugleiðir in 1995 as Director of Finance of the domestic airline operation and of Air Iceland from 1997. He holds a BS degree in Business from Rockford College, Ilinois since 1991.

Guðjón Arngrímsson

VP CORPORATE COMMUNICATIONS OF ICELANDAIR GROUP

Guðjón joined Flugleiðir in 2000 as Manager of Public Relations and Company Spokesman and then became Director for Communications for FL Group and Icelandair. He studied English and literature at the University of Iceland and started his carrier in journalism in 1976, working as a reporter and editor for newspapers and TV in Iceland. He also worked in advertising before starting up and managing the PR company Athygli 1990-1998. Gudjon has also written several historical books.

Senior Management of Subsidiaries

Andri Áss Grétarsson

SVP OF FINANCE AND RESOURCE MANAGEMENT, ICELANDAIR

Andri was appointed to his current position in April 2006. He joined Flugleiðir in 1998, working first in the Management and Financial Information department and then in the Strategic and Finance division at Flugleiðir. He holds a Cand.Oceon degree from the University of Iceland, and has worked in accounting since 1993.

Guðmundur Pálsson

SVP OF FLIGHT OPERATIONS, ICELANDAIR

Guðmundur was appointed to his current position in 1996. He joined Flugleiðir in 1974, and served initially in the Budget and Long Range Planning Department. In 1980 he became Director of Cash Management and Insurance, serving in that position until 1986 when he was appointed SVP Operations, in which capacity he worked until 1988, when he was appointed SVP Technical. Guðmundur has a degree in business from the University of Iceland.

Gunnar Már Sigurfinnsson

SVP OF SALES AND MARKETING, ICELANDAIR

Gunnar Már was appointed to his current position in March 2005. He started at Icelandair Domestic in Vestmannaeyjar in 1986 and in 1994 he became Sales and Marketing Manager for Air Iceland. In 1997 he became 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 region. Gunnar Már has a degree in Business from the University of Iceland.

Hilmar Baldursson

VP FLIGHT OPERATIONS ICELANDAIR

Captain Hilmar Baldursson received his ATP licence in 1975 and joined the company as a co-pilot in 1978, operating domestically within Iceland. He has been a co-pilot and captain on F27, F50, DC8, B727, B757 & B767 aircraft- operated by the Group on domestic and international routes. Over the years he has held the position of B757 Chief Training Pilot, the position of Deputy Chief Pilot since 1997, the position of Chief Pilot since 2004 and then nominated Director of Operations since 2006. Hilmar Baldursson graduated from the University of Iceland in 1977 where he majored in Business Administration.

Hjörtur Þorgilsson

VP INFORMATION TECHNOLOGY,
ICELANDAIR

Hjörtur was appointed to his current position in January 2006. He joined Flugleiðir in 1985, started in the Technical Department's cost control unit, became Manager in the Planning Department 1988 and Director in 1994, and then Director of Information Development in 1997. Hjörtur received his Cand.Oceon degree from the University of Iceland in 1985.

Jens Bjarnason

SVP TECHNICAL SERVICES
ICELANDAIR

Jens was appointed to his current position on 20 September 2005. He joined Flugleiðir in September 1996 as Director of Flight Operations after working for the Icelandic CAA as Director of Flight Safety. He is an Aeronautical Engineer and received his Ph.D. from Northwestern University in the USA in 1992.

Una Eyþórsdóttir

VP OF HUMAN RESOURCES,
ICELANDAIR

Una was appointed to her current position in 2001. She joined Flugleiðir in 1975, first in Human Resources, and from 1983 to 1987 in the Information Technology department, first as a supervisor and later a divisional manager, and then in the Information Department 1987-1996 as a Divisional Manager. She was appointed Manager of Employee Development in 1996 and Personnel Manager in 2001. Una studied English and Psychology at the University of Iceland and earned an MBA degree from the same university in 2002.

Pétur J. Eiríksson

MANAGING DIRECTOR
OF ICELANDAIR CARGO

Pétur was appointed to his present position in January 2000. He joined Flugleiðir in June 1981 and has held several positions within Icelandair, including Director for Scandinavia and Finland, Senior Vice President of Marketing and Senior Vice President of Business Development before taking over his present position when Icelandair Cargo was founded. Pétur holds a B.Sc degree in Economics from the University of Edinburgh and a master's degree from the University of Gothenburg, Sweden.

Gunnar S. Olsen

MANAGING DIRECTOR
OF IGS

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

Guðni Hreinsson

MANAGING DIRECTOR
OF LOFTLEIÐIR-ICELANDIC

Guðni Hreinsson took over as Managing Director of Loftleiðir Icelandic in 2006. Guðni joined Flugleiðir in 1997 as a marketing representative in Sales Control and from 2000-2003 he worked at The Icelandic Web Agency. Since 2003 Guðni has been Director of Marketing at Loftleiðir Icelandic. Guðni holds a Bachelor's degree in Humanistic Informatics & Communication from Aalborg University, Denmark.

Skúli Skúlason

MANAGING DIRECTOR
OF BLUEBIRD CARGO

Skúli has been the managing director of Bluebird Cargo since February 2008. Before that he was the Commercial Director for Bluebird since 2006. From 1996 Skúli was the managing director of Flugflutningar station manager at Keflavik Airport. He became managing director for Flugflutningar in 1996 and with Flugflutningar as one of the key shareholders in start up airline Bluebird Cargo he took active role in the start up process as board member and the quality manager. Skúli received his degree in Mechanical Engineering from the University of Iceland in 1991.

Kári Kárason

MANAGING DIRECTOR OF ICELEASE
AND IG INVEST

Kári was appointed to his current position in 1 June 2006. He joined Flugleiðir in 1994, and worked in finances until 1999. From 1999 to 2005 Kári was the Managing Director for Icelandair Hotels. He received his Cand.Oecon degree from the University of Iceland.

Gardar Forberg,

MANAGING DIRECTOR OF LATCHARTER
AIRLINES.

Gardar has worked in the world of aviation since 1996. He started his career as operations officer with Air Atlanta Icelandic in Jeddah, Saudi Arabia. In 2001, he became their Marketing Manager. In 2003, he became Chief of Air Movement and Commander at Pristina Airport, Kosovo. In 2004 he moved to Islandsflug Airlines as Deputy Managing Director. Later that same year he was called back to NATO to run Kabul Airport. In 2005 when Mr. Forberg returned to Air Atlanta Icelandic as Vice President Sales and Marketing.

Árni Gunnarsson

MANAGING DIRECTOR
OF AIR ICELAND

Árni was appointed to his current position in March 2005. He previously worked as Director of Sales and Marketing at Air Iceland, Managing Director at Ferðaskrifstofa Íslands / ITB, Managing Director of Iceland Travel and as Director of Icelandair Holidays. He worked for the German Tour Operator FTI in Münich as director of Risk Management in 1993-1997. Árni holds an MSc. in Economics from Augsburg University, Germany.

Jóhann Kristjánsson

MANAGING DIRECTOR
OF ICELAND TRAVEL

Jóhann was appointed in January 2006 after over 10 years as a manager in the information technology business at Skyrr and Glitnir banki hf. Previously he had obtained hands-on experience within the travel industry in Denmark. He received his Cand.Oecon from the University of Iceland in 1992 and an MBA degree from Copenhagen Business School (CBS) in 1997.

Magnea Þórey Hjálmarsdóttir

MANAGING DIRECTOR
OF ICELANDAIR HOTELS

Magnea was appointed to her current position in July 2005, but joined Icelandair Hotels in 1994. Magnea has worked in the hotel industry since 1991 and held management positions within hotels in Iceland, Switzerland and Japan. She received her MBA from the University of Surrey UK in 2003.

Magnús Kr. Ingason

MANAGING DIRECTOR
OF ICELANDAIR SHARED SERVICES

Magnús has been the General Manager of the Company Shared Services since its incorporation in the year ending 2002. He joined Flugleiðir in 1998 and was previously Director of Flugleiðir's accounting department. Magnús received his Cand.Oceon degree from the University of Iceland in 1993 and became a certified public accountant in 1999.

The Environment

Icelandair Group aims to create long-term growth in shareholder value through sustainability. The Company's focus is, therefore, on high quality resource management in all its operations, which leads to a lower environmental impact and lower costs. Icelandair Group, along with rest of the aviation and tourism industry, is committed to reducing its environment impact.

For airlines, three key elements relate to their contribution to environmental protection. The first is the amount of fuel consumed by the aircraft, as fuel combustion causes a rise in carbon dioxide, assumed to cause global climate change. The second element is the noise generated by air traffic at airports, and the third is the emission of pollutants by aircraft engines.

Fuel consumption and fuel efficiency

The production of so-called greenhouse gases, of which CO_2 is the most important, is in direct relation to the fuel consumed. Therefore lower fuel consumption results in lower levels of CO_2. Aviation accounts for 2% of worldwide CO_2 emissions from fossil fuel use, according to a forecast by the UN International Panel on Climate Change. Aviation is responsible for 12% of CO_2 emissions from all transport sources, compared to 76% from road transport, according to the Stern review. The aircraft types operated by Icelandair are amongst the most fuel-efficient available. They generally use on average about 2.8 litres of fuel per 100 passenger kilometres. Latcharter operates the Airbus A320, which averages about 2.0 litres of fuel per 100 passenger kilometres. By comparison, today's modern aircraft consume, on average, 3.5 litres per 100 passenger kilometres.

Aircraft noise

International requirements in this field are stated in ICAO Annex 16, "Environmental Protection", Vol. I. It 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 of ICAO Annex 16, Vol. I.

Aircraft engine emissions

According to ICAO Annex 16, "Environmental Protection", Vol. II, unburned Hydrocarbons (HC), Carbon Monoxide (CO), Oxides of Nitrogen (Nox) and smoke, emitted by aircraft engines, shall be controlled. All aircraft operated by Icelandair have since October 1990 fully complied with the most stringent requirements of ICAO Annex 16, Vol. II concerning aircraft engine emissions. Over the past 15 years, oxides of nitrogen (NOX) from aircraft engines have been progressively reduced by 50%.

Carbon offsetting

Icelandair became the first Icelandic airline to offer a full carbon offsetting program through the Iceland Carbon Fund in 2007. The goal of the Iceland Carbon Fund (ICF) is to reduce the level of carbon dioxide in the atmosphere by sequestering carbon in vegetation and soils. The planting, done under the auspices of the ICF, takes place in designated areas under a long-term (90-year) contract with the ICF. The planting and supervision of ICF forests is performed by local forestry associations or other contractors. The work is certified and audited by KPMG Iceland.

Emissions trading

Emissions trading is one of the economic instruments that can be used to address climate change, together with technological progress, infrastructure improvements and operational best practices. Today, emissions trading is not applicable to the aviation sector except in the United Kingdom, through a voluntary scheme.

However, in December 2006, the European Commission proposed legislation that would, if approved, apply an emissions trading scheme (ETS) to the aviation sector from 2011. In addition, the International Civil Aviation Organization (ICAO) – which is the UN body dealing with aviation at the worldwide level – has adopted universal guidance for states that choose to consider the implementation of emissions trading.

Our Roots in the Community

Icelandair Group has for more than 70 years had an extensive influence on Icelandic history and through its operations the Company has played a key role in shaping modern Iceland. With a network providing Icelanders with direct regular flights to over 20 major cities in Europe and North America, Icelandair Group has been responsible for providing this small island nation with transport services and communication opportunities that are second to none, and at the same time the Company has built up tourism as an important sector of the Icelandic economy. With the recent acquisitions of Travel Service and Latcharter, Icelandair Group now has roots in the Czech Republic and Latvia respectively.

The transportation of passengers and freight creates value for individuals and for society at large. Icelandair Group contributes to a long-term high standard of living and quality of life for its employees. It aims to provide a physically and mentally favourable working environment and opportunities for all its employees to develop as professionals and as human beings. By its existence and activities, the Group also contributes to economic and social welfare in the countries and societies where it operates.

The various companies within Icelandair Group also support a wide variety of community activities throughout the year. They are among the main sponsors of various public events, as well as directly supporting the activities of numerous organisations. The individual companies within Icelandair Group each support a number of worthy causes. The following is a brief list of some of the principal beneficiaries.

The Icelandair Special Children Travel Fund

The main objective of this fund is to help children suffering from long-term illness or other adverse circumstances to see something of the world. The fund is supported both directly by Icelandair and through the generous donations of its customers. Each year, the Icelandair Special Children Travel Fund enables about 50 children and their families, from all over the world, to go on their “dream journey”. Vigdis Finnbogadottir, former President of Iceland, is the patron of the fund. Detailed information is available on www.vildarborn.is.

Icelandic Musical Talent

Icelandair Group is proud of its support for Icelandic musical talent, support that helps talented musicians right from the outset, from the first performance at Musiktilraunir (Musical Experiments), an Icelandic music competition which provides an opportunity for “garage bands” to step into the limelight and perform their music, the winners of which are rewarded by Icelandair with a performance spot at the annual music festival Iceland Airwaves. Icelandair is the founder and main sponsor of Iceland Airwaves (or Icelandair Waves!), a music event that started in 1999 as a showcase for Icelandic musical talent for foreign record company executives. Since then, Iceland Airwaves has grown and blossomed and is now an integral part of the cultural life in Reykjavik, with over 150 artists performing in various Reykjavik city locations. The fruits of the festival’s labour have been ripening and today many Icelandic artists have made their way on to the international music scene. For this reason, the logical next step was the formation of the Reykjavik Loftbrú fund (Reykjavik Airbridge), which Icelandair, along with the city of Reykjavik and the Association of Icelandic Musicians, initiated. The fund enables talented Icelandic musicians to travel abroad to perform, promote and market their music outside Iceland. Air Iceland is also a sponsor of the Eyrarrós award, a major Icelandic art award that in 2007 was awarded to the “Aldrei fór ég suður” festival, which also is sponsored by Air Iceland.

Cultural support

Icelandair Group is proud of its support for various cultural events, and was a pioneer in this field. The first sponsorship agreement was signed in Iceland back in 1972, when Icelandair became the main sponsor of The Reykjavik Arts Festival, held biannually since 1970 and annually since 2004. The Festival is one of the oldest and most respected arts festivals in Northern Europe, with the purpose of promoting Icelandic and international culture in all fields of art. With food-related travel as an ever-growing market segment, Icelandair established in 2001 the Food & Fun festival, 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 collaborating with Reykjavik's best restaurants. Each chef is assigned to one of the participating restaurants, where they prepare a special menu made exclusively from Icelandic ingredients. The menu is offered 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 & Fun event.

Icelandic theatrical talent is growing in popularity outside Iceland and Icelandair has provided support by partnering with The National Theatre of Iceland to enable it to promote Icelandic theatre abroad. In addition, the Talia Airbridge fund was established for Icelandic actors, directors and writers. The aim of the fund is to support participants in the theatrical arts to perform and market themselves abroad. Icelandair, in co-operation with the city of Reykjavik, the Actors' Association and Glitnir Bank, is a sponsor of this fund.

Sports

The companies within Icelandair Group support numerous sports organizations. Icelandair prides itself on supporting many of the Icelandic national sports teams, as they travel abroad and symbolise Iceland wherever they go. The Football Association of Iceland (KSÍ) was established in 1947, and Icelandair has been its faithful sponsor for a long time, a fact highlighted in Icelandair's latest advertising campaign. Travel Service is the official carrier of the Czech national football team. The Icelandic Handball Federation (HSÍ) is another sports association whose athletes have travelled the world, proudly bearing the Icelandic flag on their hearts and the Icelandair logo on their chests. With the aim of attracting more and more runners each year, Icelandair has from the beginning been one of the main sponsors of the Reykjavik Marathon, which is held on the third weekend in August every year and has been running for more than 20 years. Icelandair is the main sponsor of the Icelandair Open Bridge Tournament, which is an annual event, held each February. The tournament has been staged for a quarter of a century and has attracted some of the best bridge players in the world, many of whom have returned again and again. Icelandic horses are unique animals, and as such they have their own event, the Icelandair Horse Festival. Landsmót is the Icelandic name of this biannually National Horse Show of Iceland, a unique and unforgettable occasion - the biggest event involving Icelandic horses in the world. At the Landsmót people come from all over the world to see the best horses in Iceland performing in various different types of equestrian competitions.

Scheduled Airline Operations

Scheduled Airline Operations is an Icelandair Group business platform comprising three companies: Icelandair, the international full-service airline with a hub in Iceland; Icelandair Cargo, a full-service air-freight company and Icelandair Ground Services, which handles airlines and passenger services at Keflavik Airport. These companies work closely together and have long historical ties. In 2007 they accounted for roughly two thirds of the Group's income.

Their main joint task is to run a profitable airline network operation and take advantage of any potential opportunities for growth. This involves aggressive sales and marketing activities on the part of all companies, as well as tight revenue management and cost control throughout the operation.

In 2007 the Icelandair network offered more flights and carried more passengers than ever before in its 70 year history. Icelandair increased its number of trips 6% from 2006 and passenger numbers were up by 4%. Load factor was affected by overcapacity in the market in Q2 and Q3 and was down in 2007 from the previous year. Icelandair's business strategy is based on the geographical position of Iceland between huge passenger and freight markets in North America and Europe. By combining in its aircraft passengers visiting Iceland, passengers departing Iceland and passengers travelling across the Atlantic the network has grown steadily.

Icelandair's TF-FIO arriving from Keflavik, about to park on stand 29 at Abbotsinch International Airport (GLA / EGPF), Glasgow, Scotland, on May 29, 2007.

In 2007 Icelandair underperformed even if improved revenue management and capacity control in Q4 partially offset revenue shortcomings from Q2 and Q3. The Icelandic passenger market continued to be strong last year, but export and revenue at Icelandair Cargo was lower than anticipated. Maintenance cost was higher than anticipated in network and cargo operations.

A renewal of Icelandair's services and aircraft interiors is planned for the year 2008.

The total turnover in Scheduled Airlines Operations in 2007 was ISK 51.5 billion and EBITDA was ISK 2.7 billion.

Icelandair

Icelandair is the largest subsidiary within the Group, accounting for around 53% of its income. In 2007 Icelandair carried 1.6 million passengers on its scheduled flights between Iceland, Europe and North America to a total of 24 destinations. The company operated a fleet of 12 Boeing 757 aircraft during the summer season for its scheduled operations.

The Icelandair business strategy is based on the geographical position of Iceland on the flight route between northern Europe and the eastern shore of the USA/Canada. By combining in its aircraft, passengers visiting Iceland, passengers departing from Iceland and passengers traveling across the Atlantic via Iceland, Icelandair has been able to expand its network steadily over the past decades.

In 2007 the Icelandair network revenue grew by 3%, while the number of passengers grew by 4% and load factors were down by 1 percentage points. Icelandair divides its customer base into three main markets:

Passengers from Iceland (32% of passengers):

With its large network Icelandair offered Icelandic customers direct scheduled flights to 24 destinations in Europe and North America, an astounding range for a market of 300 thousand people. The biggest routes in the Network are to London and Copenhagen. The year 2007 saw continued strong demand for all travel from Iceland.

Icelandair's revenue from passengers from Iceland has grown by 15-20% annually over the last 3 years. The Icelandair frequent flyer program (Vildarklúbbur) now has over 150,000 members in Iceland and is still growing. The pricing policy of Icelandair and it's schedule is built up to meet different needs of customers flying to, from and via Iceland. Main focus is business and must go travelers as well as high end leisure tourist traffic.

Passengers to Iceland (35% of passengers):

Iceland has enjoyed increasing popularity as a tourist destination over the past 25 years. The number of tourists visiting Iceland grew from 72 thousand in 1981 to 460 thousand in 2007, which corresponds to an increase of over 12% annually. The vast majority of these tourists travel to Iceland by Icelandair. The company has fuelled this increase by the establishment and development of a network with a very high frequency of flights to Iceland and by strong marketing efforts in Europe and North America.

Transatlantic passengers traveling via Iceland (33% of passengers):

Even though its market share on the North Atlantic market is less than 1%, it is a key factor in Icelandair's operation. Due to the immense size of this market and the nominal market share held by Icelandair, it serves in effect as a gigantic reservoir of passengers. In its "via" marketing Icelandair focuses on city pairs with limited direct flights, and with its centrally located hub and quick turnaround times at Keflavik International Airport the company is able to offer competitive prices and flying times.

Marketing and selling the product

Icelandair has decades of experience in selling its products globally on the general consumer market. Among airlines, Icelandair attracts an unusually high percentage, or 68% of its customers, from outside its home market. In 2007 Icelandair reached its customers through four main channels:

01 Websites in local languages in all key markets. An increasing number of tickets are sold through the Internet, both on Icelandair's own websites and third-party websites. Icelandair gets around 10 million people a year visiting the different Icelandair websides. The Icelandair web page is today the biggest seller for the Icelandair network.

02 Own sales offices in key markets, i.e. Iceland, the USA, the UK, Denmark, Sweden, Norway, Finland, France, the Netherlands and Germany with call centers staffed by people who speak the local languages. Additionally Icelandair has agreements with general sales agents in about 20 different countries all over the world which organize and take care of Icelandair sales activities in their markets.

03 Sales through more than 12,000 travel agents, tour operators and airlines all over the world through various contracts and agreements. Icelandair uses the Amadeus CRS system, which enables travel agents to book tickets with Icelandair instantly at their offices or on websites.

04 An Internet Club of about 600,000 active members, who receive special offers and information on a regular basis.

In 2007 the Icelandair website was also voted the best Icelandic website by IMARK. The website was also nominated the Best Website Design of the year by Technology for Marketing. The reward is given once a year and is accepted in the “internet world” to be the most important in Europe.

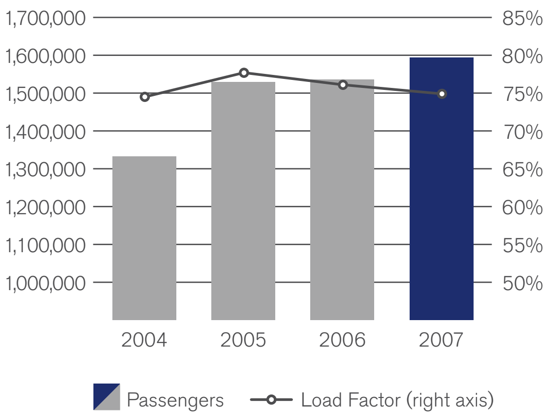
In 2007 Icelandair Technical Services, which provides maintenance and technical services for the Icelandair fleet which includes aircraft for Loftleiðir’s charter flights and cargo aircraft for Icelandair Cargo was incorporated into Icelandair. The majority of the work is performed at the Service Centre at Keflavik Airport, but increasingly maintenance is performed abroad with increased international flight operations.

In 2008 Icelandair is making several significant changes in order to increase the profitability of its operation.

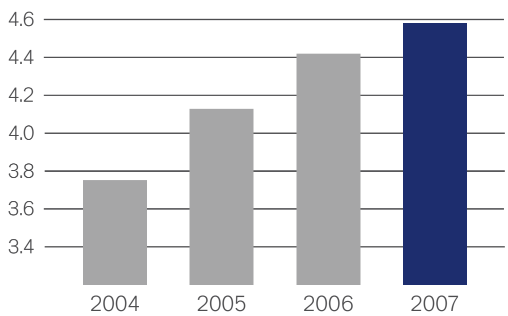
One new destination will be added to the Icelandair route network – Toronto, Canada, but overall capacity in the network will be reduced. Halifax becomes a full year destination as well as Berlin and Icelandair will maintain it’s strong position in the Scandinavian market. In addition to the introduction of a new destination, Icelandair has scheduled an increase in the number of flights to London, Paris, Frankfurt, Amsterdam, Helsinki, Munich and Barcelona next summer, while the Baltimore route has been closed.

As of summer 2008, Icelandair will maintain it’s new Iceland connections into the route network, including early morning departures from Copenhagen, Frankfurt and Paris to Keflavik and late morning departures to Boston and New York from Keflavik in addition to afternoon departures, Boston

Passenger and Load Factor



Unit Revenues
Developement on fixed exchange rates



and New York to Keflavik and night departures from Keflavik to Copenhagen, Frankfurt and Paris. One of the main reasons for this increase is to provide better services and flexibility for business passengers.

A new income-generating operation in connection with in-flight entertainment, shopping and services for passengers has been set up following the purchase of a new in-flight entertainment system and new seats for the Icelandair fleet. As of March 2008 Icelandair will start offering its passenger a whole new flying experience. The new seats and in-flight entertainment system will be installed in all of Icelandair's Boeing 757 passenger jets that are used on the company's scheduled routes. The service will be upgraded and new uniforms will be designed. This will make Icelandair more competitive on it's North Atlantic routes and give the company a unique position in it's home market.

A new Operations Control Centre will be opened in March 2008 in order to increase the flexibility, efficiency and safety of the Icelandair network operation and improve passenger services. Fleet and crew management will be re-organized in connection with the establishment of the Centre.

A new Revenue Management System and Pricing structure has been implemented and resources have been placed at the disposal of the company management in order to increase passenger revenue for 2008.

Icelandair will continue on-going efforts to lower cost through increased utilization of resources and by constantly looking for the most cost efficient ways of providing customers with a highly valuable service. As part of this Icelandair will increasingly use information technology to simplify operation and make life easier for it's customers.

Icelandair Cargo

The main business of Icelandair Cargo is scheduled airfreight services supplemented by ACMI (aircraft, crew, maintenance and insurance) leases of freighter aircraft. The company serves ten destinations in Europe and North America. 82% of total tonnage is carried on the company´s five Boeing 757-200 freighters and 18% in the holds of Icelandair´s passenger aircraft.

The year´s results were very much influenced by the fall in value of the USD and appreciation of the ISK. This hit exports from Iceland hard, causing only a modest 2.7% growth in total tonnage of. In total, Icelandair Cargo carried 42,000 tons on scheduled flights. Exports, which are dominated by fresh seafood, declined by 8%, but during the latter part of the year monthly fluctuations were down by up to 30% in total, but up to 50% for the US. Imports to Iceland grew by 14% and transit freight across the North Atlantic grew by 13%. Yields, however, improved by 1.6% increases freight revenue was up by 4.6% for the full year. Turnover was ISK 7,555 million equalling a 12.8% growth over 2006.

Three aircraft were on an ACMI lease to TNT on weekdays, but were operated in the Icelandair Cargo schedule at weekends. Two aircraft served the market to and from Iceland on a daily basis.

There were no major changes in the network. Liege was served nine times per week, Brussels and Humberside four times, as well as East Midlands, Jönköping and Norrköping all with one weekly flight. Halifax also had one weekly flight, but New York was served with six flights per week. Flights to Charlotte were discontinued but a new weekly flight to Gander was introduced in November. This network of freighter aircraft was enhanced by the 24 destinations in Icelandair´s passenger network.

Icelandair Cargo offers its customers a competitive and quick global service through the extensive interline and special prorate agreements it has with other airlines. The company also operates a trucking network within Europe and the United States. The company runs its own sales offices in Iceland, Benelux, Italy and North America and is represented by general sales agents in other key markets in Europe and Asia.

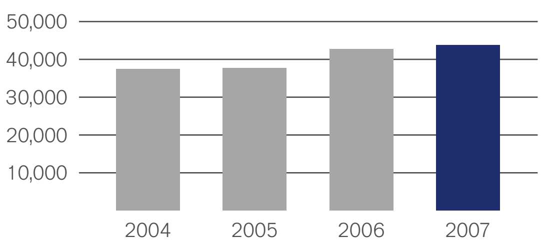
For a number of years Icelandair Cargo has carried express freight for TNT across the Atlantic. Express freight to and from Iceland is also carried for TNT and DHL on overnight freighters. The company also counts FedEx among its important customers.

Future strategy - Outlook

In 2008 Icelandair Cargo is not expecting more than marginal growth in total tonnage. A moderate increase is forecast in imports and transit, while exports are expected to decline further by 2-3%. The movements in the value of the USD and the ISK are, however, hard to predict and could cause major swings in the directionality of trade and total volumes.

In 2007 about 80% of the tonnage on scheduled flights was either to or from Iceland, the rest being between other European countries and North America. This makes Icelandair Cargo too dependent on a small and volatile market. The Icelandic market has a history of fluctuating up or down by up to 30% with fluctuations in currency and levels of economic activity. A new strategy aims at making the company less dependant on the home market by expanding into new international arenas. To support this strategy, four Airbus A330-200 freighters will be joining the fleet in 2010 and 2011. At the same time, the network will be expanded to include new destinations in the USA and Canada as well as Asia. The aircraft will be on long-term leases and will mainly complement the existing Boeing 757 fleet.

Total transported tons



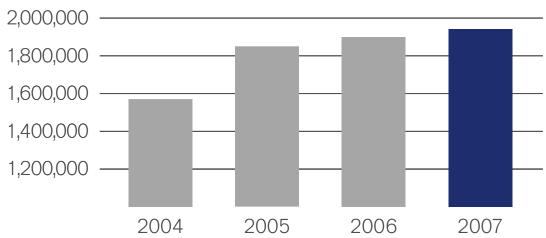
Icelandair Ground Services

Icelandair Ground Services provides comprehensive airport ground handling services for airlines and passengers at Keflavík International Airport. IGS was established in 2001, but airport and ground operations in Iceland have been a part of the airline operation from the foundation of Icelandair Group predecessors. IGS provides aircraft ground handling services for all types of aircraft, a flight kitchen and bonded stores, a new cargo centre and a restaurant division in the Leifur Eiriksson Air Terminal. IGS also operates ready-to-eat meal operations and services for off-airport companies and schools. All these units are organized and run as independent profit units.

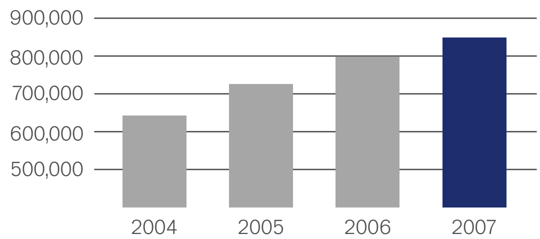
IGS is a service provider enabling airlines and other customers to obtain all services required through one service provider. IGS competes with two other suppliers of ground handling services at Keflavík Airport. Icelandair is the biggest client of IGS, but the company also has contracts with other airlines, such as Iceland Express, Icelandair Cargo, SAS and LTU among others, for ground handling services. The company experienced good growth in turnover in the year 2007 in all its business units. New markets opened, such as restaurant operations for schools and companies outside the Icelandair Group and the airline sector. Future growth is expected in that area. New restaurants opened in the Leifur Eiriksson air terminal in the year of 2007, which will meet the expected growth in passenger numbers in the coming years. The new restaurants have already proven to be a success.

IGS has contracts with most airlines using Keflavik Airport and aims to maintain its market share. Opportunities for growth go hand in hand with the expected growth in the number of passengers passing through the airport. The company will be ISO 9001 approved early in the year 2008; this will certify the high quality and standards of the company's services.

Number of produced servings



Number of checked in passengers in KEF



Global Capacity Solutions

Icelandair Group offers a wide variety of aviation related solutions through Global Capacity Solutions. This includes all types of leasing, ranging from VIP passenger charter flights to ACMI cargo operations and even dry lease and financing. GCS can offer its customers both cargo and passenger aircraft ranging from short range narrow-bodies to long range wide-bodies. For this reason, in addition to the leasing aspect, all aircraft trading activities on behalf of the Icelandair Group are channelled through GCS.

With its array of products and services GCS has a global reach and is currently involved in different activities on all continents, both in the most mainstream locations, like London and Brussels, as well as some of the most remote places on Earth (Yakutia & Papua Niu Gini).

The international aircraft market is forecast to double in volume over the next 20 years, adding 20,000 new aircraft. From this number about 80% are from the narrow body and mid-size wide-body segment. This is why the commercial strategy of GCS is to focus on this fast growing and lucrative part of the market, while keeping an eye out for opportunities in the relatively underdeveloped regional aircraft segment. Less emphasis will be put on large capacity aircraft due to the different risk characteristics involved.

The GCS portfolio of companies consists of a network of individually managed small to medium sized aviation companies with a coordinated commercial strategy and financial control, Loftleiðir Icelandic, Latcharter Airlines, Bluebird Cargo and Icelease. Great emphasis is placed on utilizing the specific expertise within each

Travel Service Boeing 737
fleet of aircraft lined up at Prague airport

company by giving the management of each subsidiary full control over how they conduct day to day business while adhering to the unified strategy. This is important in order to reap maximum benefit from both local and industry specific knowledge thus creating added value for the Group.

An emphasis has been put on building up a strong operation in the emerging markets of Central and Eastern Europe. In 2007 we finalized the purchase of a 50% stake in the Czech airline Travel Service, together with options for an additional 30% later this year. Travel Service is a charter airline that operates aircraft between Prague and Budapest and several cities in the Mediterranean. Last year Travel Services carried 1.8 million passengers, which is somewhat more than Icelandair carried on its own routes. The company became an associate member of Icelandair Group in November 2007.

EBITDA for the business segment was ISK 2.2 billion, up by 943 million from 2006

Loftleiðir Icelandic

Loftleiðir Icelandic was established in 2002 as a subsidiary of Icelandair Group predecessors to provide services and solutions to passenger airlines and tour operators on a global scale. By re-entering the international charter operations that had been a part of Icelandair´s operations for decades, was able to better utilize its resources such as crews, maintenance etc.

The company has developed from focusing mainly on the sales and marketing of Icelandair's winter surplus capacity and then offering just standardized ACMI or full charter solutions by adjusting to each client's specific requirements. The company now offers a greater variety of services and products, ranging from Dry Lease, ACMI (Aircraft, Crew, Maintenance & Insurance), Aircraft with Full Maintenance and full charter solutions for tour operators, as well as brokering services and technical consultancy.

In early 2006, the company bought a majority of the shares in the Latvian charter operator Latcharter Airlines as part of Loftleiðir Icelandic's strategy to strengthen its position in the Baltic and CIS region and add the Airbus family into its worldwide ACMI product line, thereby expanding its horizon beyond the aircraft types traditionally operated under the Icelandair Air Operator's Certificate. In 2007 Loftleiðir Icelandic acquired the remaining shares of Latcharter Airlines.

The company currently operates and manages contracts in Europe, Africa, North and South America and successfully entered new markets in the South Pacific and the CIS in 2007 with new contracts in Papua New Guinea and Yakutia, making its operations truly global.

Loftleiðir Icelandic has established itself as a top class VIP operator serving one of the most prestigious operators in the USA, A&K (Abercrombie & Kent), by operating first-class flights around the world where all seats are business class.

The company currently has six Boeing 757-200 and two Boeing 767-300ER aircraft. Its subsidiary, Latcharter Airlines, has expanded its fleet from two Airbus 320 aircraft in early 2006 to seven Airbus 320s and two Boeing 767-300s in 2007.

Markets

Current market conditions are favourable in both the wide- and narrow body market due to a continuing lack of aircraft availability. The wider range of products and services offered by the company, combined with its extensive market knowledge and network, puts it in a good position within its segment of the market.

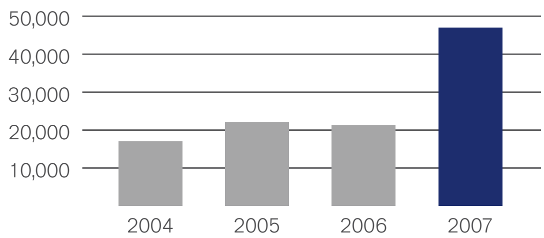
The company has, furthermore, strategically widened its market and successfully entered new and heavily legislated markets such as the CIS (Commonwealth of Independent States). Additionally, the company has increased its AM (Aircraft, Maintenance) activities, which has enabled it to enter into long-term contracts and projects with increased profitability.

Outlook

Loftleiðir Icelandic will continue to secure continued growth in both revenue and profitability by further utilizing its extensive sales & marketing network and know-how, and benefiting from its continually growing brand recognition within the market. The company is perceived as being a strong partner offering flexibility, innovation, reliability and experience.

Global Reach

Total number of Block hours



Latcharter Airlines

Latcharter Airlines has developed from a small, local charter airline in the Baltic to a medium-sized European Airline offering a diversity of services in the aviation sector.

Operation

Latcharter operations increased dramatically in 2007. The company grew its fleet by 450%, from two Airbus 320 aircraft to a total of nine aircraft, including two 767-300 aircraft. The two 767-300s are, incidentally, the first western-built wide body aircraft to be registered in the Baltic countries. The foundation of Latcharter Airlines' operational model is to build on maintaining a strong home base in Riga and diversifying it with ACMI projects worldwide.

Latcharter Airlines' operation can be split into three segments;

The first segment is the local Baltic charter market, where the company now operates two to three Airbus 320 aircraft on a permanent basis. This marks a significant increase from the single aircraft that operated out of Riga in the past. Flights out of Riga are predominantly on behalf of Tour Operators, although aircraft are also operating on an ad hoc ACMI basis for various European carriers.

The second segment is that of providing ACMI solutions on a worldwide basis. This was successfully introduced in 2007 with a project on behalf of Air Malta, based at East Midlands, UK. Furthermore, two 767-300 aircraft were introduced into the fleet and are operating on behalf of Virgin Nigeria, based at London Gatwick, UK.

The third segment is that of providing flexible aircraft solutions to airlines. The solutions that Latcharter Airlines provides are leased aircraft on sublease or variations of ACMI, such as for instance AM projects. One such project is Israir Airlines, where initially the aircraft operated on ACMI, then migrated to an AM solution and finally ended in an outright dry lease. Two A320 Aircraft are currently with Israir Airlines on dry lease. One Airbus 320 is on dry lease to XL France and another one is on dry lease to Hellas Jet in Greece.

In addition to these three segments, the company engages in Aircraft Trading activities when the opportunity arises. A successful transaction was achieved during 2007 where one A320 Aircraft was purchased and then consequently sold on a sale/leaseback. With this flexible approach, Latcharter is able to supply a niche market with solutions that are currently in high demand.

Outlook

The outlook for growth is positive. The intention is to expand operations in all three segments. The goal is also to increase market-share in the Baltic charter market using narrow body aircraft. A further milestone or step forward would be the introduction of a wide-body aircraft, operating charter flights out of the Baltics. The aim is to introduce a 767-200/300 aircraft later this year. Furthermore, there are great possibilities in the ACMI market. Latcharter will be able to greatly benefit from the wide-body market experience of Loftleiðir in this regard. Moreover, the company is always on the lookout for possible ACMI, AM or dry-lease opportunities (or variations thereof) that may arise. As already mentioned, flexibility and diversity are Latcharter's strengths. Latcharter Airlines is now a recognized entity in this market, known for flexible, quality service.

Bluebird Cargo

Bluebird Cargo operates six freighter aircraft, two B737-400s and four B737-300s. Bluebird Cargo operates several aircraft on a wet-lease basis for other airlines and for some of the major global express parcel service companies. General cargo services are offered to freight forwarders and large shippers to and from Iceland on daily, scheduled services. Bluebird Cargo is the first European Airline to operate Boeing 737-400 converted freighters. In 2007 the company spent a considerable amount on conversions, modifications and maintenance to prepare the fleet for future contracts.

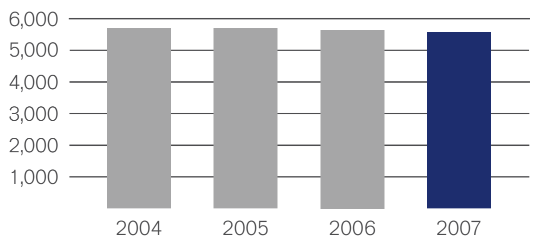
Markets

Bluebird Cargo has carved out a niche for itself in operating short-haul freighter flights in time sensitive markets within Europe. As such, the company enjoys a fairly favourable market position and serves three out of the four largest integrators in the world. The target customer group consists of express service companies, post offices, and airlines operating their own overnight networks within Europe.

The air cargo sales function of Bluebird Cargo in Iceland dates back to 1994 and during 2007 the company has focused on providing local sales and marketing representation for airlines such as Cargolux Airlines, UPS Air Cargo and others. Through these companies, Bluebird Cargo has obtained valuable access to the world-wide air cargo networks of some of the world's leading airfreight companies. Using these networks, Bluebird Cargo is able to offer the Icelandic market reliable and fast access to and from almost any major destination in the world.

Most leading experts agree that the global air freight market will grow rapidly in the coming years. Air freight is projected to grow considerably faster than the passenger side of the industry. The future growth strategy of Bluebird Cargo is based on a two-pronged approach to the market. On the one hand, the company will continue to grow with the Icelandic air freight market, building on the strengths outlined above. On the other hand, there is tremendous potential in providing aircraft and air freight capacity to the various segments of the air freight industry, including wet lease services to other airlines, contract operations for freight forwarders, and dedicated services to postal services and express parcel corporations.

Total Block Hours



Icelease & IG Invest

Operation

Icelease is a business unit specialising in aircraft trading in the international marketplace. Icelease is an arrangement company which ties together and utilizes the vast knowledge, experience and business contacts within Icelandair Group in the business of buying, selling and leasing of aircraft. All aircraft-related assets for aircraft trading purposes are kept in the holding company IG Invest ehf., which is managed by Icelease.

Icelease has been involved in numerous aircraft transactions in the past three years. The transactions can be categorized either as Investment or Trading. Trading is when an aircraft is bought and sold with back-to-back agreements, usually kept for a short period of time and not affecting the balance sheet. Investment is when an aircraft is bought and kept for a period of time in a rising market, and will then be sold later for a higher price. Usually when Icelease arranges an aircraft purchase for investment purposes, a new limited-liability company (special purpose company, SPC) is set up in co-operation with outside investors. Icelease manages the holding company, IG Invest, which in turn holds the shares of the SPCs. The aircraft is sold into the SPC, then leased to a financially trustworthy airline on a long-term lease agreement that fully covers the aircraft investment company's operations. The SPCs are eventually sold out of Icelandair Group, with the attached leasing contract, when the market conditions are right, yielding a profit. By negotiating long-term lease agreements, the company increases the likelihood of being able to exit when the market cycle is at a favourable stage. Additionally, Icelease arranges back-to-back aircraft trading, where aircraft are sold immediately upon purchase, thereby eliminating the need for the SPC structure.

In 2007 Icelease received six new generation Boeing 737-800 aircraft from Boeing. Five aircraft were sold outright, but one aircraft was sold into SPC, in which IG Invest holds 40% of the shares. These aircraft are part of a 15 aircraft agreement with Boeing in 2005 and were bought as an investment. During the year 2007, three of the SPCs in relation to the 737 investment package were sold, in addition to the five aircraft sold outright, yielding acceptable sale profits.

In December 2007 Icelease sold the biggest single asset in its portfolio, with a significant loss. The aircraft, a 747-400 freighter leased to Singapore Airlines, was part of a transfer of assets from FL Group in relation to the IPO of Icelandair Group in the year 2006. The loss from the sale of the aircraft at year end is the main reason why Icelease did not meet its profit target for the year 2007. The aircraft was probably the most critical and volatile asset in the portfolio, and it was decided to realize a loss on that asset in the year 2007 so that all assets in the existing portfolio would be "in the money".

The assets

In the beginning of the year 2007 it was decided to sell part of the portfolio within the year, to take advantage of a strong market for aircraft. In 2007 a total of nine aircraft and SPCs were sold from the portfolio. IG Invest's current portfolio consists of 10 passenger aircraft in SPCs, and four future deliveries of passenger aircraft with an additional three purchase options. As mentioned above, all assets in the current portfolio are seen as investments which will generate profit when sold. The future deliveries and all three purchase options are B787 Dreamliner aircraft. As the B787 is a new aircraft type, the market for the aircraft hardly existed a year ago. In the past few months there have been strong indications that the B787 order positions could become very valuable. In 2007 Icelease signed a Letter of Intent to purchase two Airbus 330-200 Freighter aircraft which would be delivered new from the manufacturer in 2010.

Markets and outlook

Icelease is fully aware that the success of its operation is highly dependent on the market cycle. The company intends to utilize the market cycle to maximize the return on equity. The aircraft market has been historically very strong in the past few years and remains so. That is the reason why Icelease will probably sell more of its assets in the coming months. Availability of aircraft is currently very limited, and long delivery lines with aircraft manufacturers make it difficult to buy new equipment to make a profit within a certain period of time. Therefore Icelease is seeking opportunities in trading with older aircraft in the coming years.

Icelease is currently working on some structures on the B787 order positions, which will be announced within the next few months.

Chefs at the Hilton Reykjavik Nordica restaurant VOX
prepare another delicacy

Travel & Tourism

Three companies form the Travel and Tourism part of the Group. They are Iceland Travel, a tour operator and travel agency in incoming tourism, Icelandair Hotels, which markets and operates two hotel chains, Icelandair Hotels and Edda Hotels, and Air Iceland a scheduled domestic carrier which also offers regular flights to Greenland and the Faeroe Islands.

Even though these companies all provide strategic support to the International Scheduled Operations their main focus is on profitable operations. In 2007 the Travel and Tourism segment had a generally succesful operation. We saw improved utilization and tight cost control at Icelandair Hotels and a postive outcome for the year. Higher passenger revenue at Air Iceland due to more demand and traffic outweighed higher employee and fuel cost. Implementation of new information systems led to higher cost than planned at Iceland Travel and strong ISK led to lower profits from services than expected.

The total turnover of these companies in 2007 was ISK 9.3 billion and their EBITDA was ISK 1.1 billion

Air Iceland

Operation

Air Iceland is a market-driven service company offering eight scheduled domestic destinations, as well as routes from Iceland to the Faeroe Islands and Greenland.

In total, around 430,000 passengers were carried on Air Iceland flights in 2007, an increase of 14% from 2006, which is the highest number ever in the history of the company. The total turnover of the company increased by 6% in 2007 from the previous year, and the company is showing positive results for the 6th consecutive year. About 90% of the company's passenger traffic on scheduled flights is on the routes between Reykjavík, Akureyri, Ísafjördur and Egilsstadir, with Akureyri being the most popular destination with around 200,000 passengers, followed by Egilsstadir with around 134,000 passengers and Ísafjörður with around 47,000 passengers. Air Iceland carried around 22,000 passengers to Vestmannaeyjar in 2007. In October Air Iceland renewed the contract with the Icelandic Government for flights to Vestmannaeyjar and now holds the contract until the end of 2009.

The purchase of two 37-seat DASH 8 aircraft in 2006 is giving Air Iceland new opportunities to develop the route structure to/from and within Greenland. A new route was opened up between Keflavik and Nuuk, linking Iceland directly with the capital of Greenland. Operating during the summer of 2007 from mid June until the end of August, the route was immediately successful. A big part of this success came through a code-share agreement with Icelandair, which is the first code-share agreement Air Iceland has concluded with its sister company Icelandair. Other destinations offered in Greenland were, as before, Kulusuk, Constable Point and Narasarsuaq. Another new route was opened up by Icelandair offering flights between Akureyri and Keflavik, linking Northern Iceland with the hub in Keflavik; this route was operated by Air Iceland on DASH 8 aircraft.

In October 2006, Air Iceland entered into a 6-month lease contract with the Maltese company Medavia for one DASH 8 aircraft in Libya. The aircraft re-entered Air Iceland's operation in May 2007. In November 2007, Air Iceland entered into a 6-month dry-lease contract with the Swedish company Skyways for one Fokker 50. These contracts are a lucrative addition to the winter operations of Air Iceland, as they help to even out seasonality in the operation. The company operates six Fokker 50s, two DASH 8 aircraft and two smaller DHC-6/Twin Otters. In total the company's fleet consists of ten aircraft.

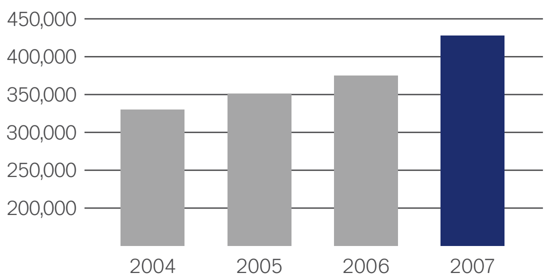
Markets

Air Iceland holds a very strong position in the Icelandic domestic market and has operated with healthy profits over the past few years. With the strong economy and large-scale industrial projects in East Iceland, demand has been high on Air Iceland's main routes. With around 80% of Air Iceland's customers having purchased their trips on the company website, Air Iceland has reaped benefits from its extremely effective distribution system, which is important in a competitive environment where time and money play a significant role in customers' decisions.

Outlook

Air Iceland plans to grow and increase its profitability by offering the Icelandic market, and the tourism market in Iceland and Greenland, the best possible service. Demand is, however, expected to decrease on the routes to East Iceland as industrial projects are coming to an end. Expectations are that other routes will be growing and demand, particularly on the routes offered to Greenland, will be increasing. Based on its success in 2007, the route between Keflavik and Nuuk will be offered from the end of May until the beginning of September.

Total passengers



Air Iceland operated 15,736 flights in 2007, or an average of 43 departures per day. Average passenger numbers were around 1,200 per day. Air Iceland's aircraft were in the air for around 35 hours per day.

Icelandair Hotels

Icelandair Hotels is the largest and the leading hotel company in Iceland. The company runs and franchises two hotel chains: Icelandair Hotels, a chain of 3 and 4 star hotels and Hotel Edda a chain of summer hotels with a total of 1,500 rooms, which are located all around the country. In 2007 Nordica, the flagship, was separated from IH hotels and a franchise agreement was signed with Hilton International.

Markets

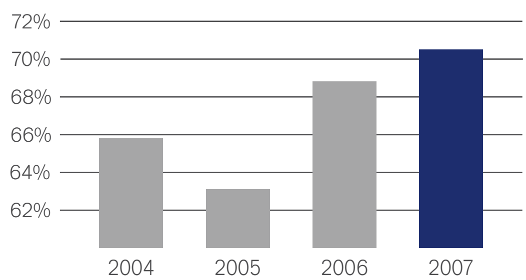
The market environment is still dominated by a steadily growing last-minute booking trend. The Internet plays a bigger role than before, resulting in a higher yield per guest. The Hilton brand gives us access to valuable resources and customers, which are intended to be utilized to the fullest, especially in the field of meetings and conferences. Furthermore, the company's leading position in the domestic market has secured for its flagship hotel, the Hilton Reykjavík Nordica, an excellent reputation and a high level of satisfaction in the very demanding local corporate market.

Outlook

Competition in the 4 star-category in Reykjavík grew by nearly 500 new rooms in 2007, leaving the Icelandair Hotels with 20% market share. Measures have been taken to secure the company's continued leading position as a reliable, quality hotel provider in Iceland by signing on two new hotel properties in the city centre, as well as expanding the network in the countryside. Aggressive sales & marketing targets have been set for 2008, along with a strong focus on cost. The agreement with Hilton will strengthen the operation; it brings international recognition and a brand image second to none. Our intentions are to survive in a fierce market, where supply outweighs demand, by maintaining a position of leadership founded on quality and professionalism.

We are committed to profitable growth of the Icelandair Hotels operation, and this agreement with Hilton is a major step for us in that direction. With a continued focus on cost and aggressive marketing, we expect healthy growth over the next few years.

Occupancy




VOX

Iceland Travel

At Iceland Travel sales- and booking systems were changed at the beginning of the year as well as the company's financial systems. The operation was run with a new organizational structure from 1st of January 2007. The company moved to a new location after 16 years in rather unsuitable offices. Following the turbulence of these important changes the future looks bright as the operation is stabilizing and running smoothly.

Iceland Travel has four profit units and two supporting units. Three profit units are focusing on the leisure market and one is focusing on the MICE (Meetings – Incentives – Conferences – Events) market. In the leisure part of the operation, there are a few business segments such as FIT tours, Self drive tours, Scheduled tours, Tailor-made tours, management of cruise tours and variations around those tours. The motto is "if it can be done in Iceland - Iceland Travel can make it happen!" Iceland Travel reached its revenue goal for the year 2007 and strengthened its position as the market leader in incoming travel services to Iceland.

The MICE unit turnover increased from last year, finishing 25% above the budget goal, and the level of service was increased considerably. The leisure units had a good year and saw substantial growth in the Far East markets, Russia, North America, Spain and the Netherlands to name a few. The Scandinavian market, with the exception of Finland, experienced some downturn, as did the German market. Some of this may be explained by the cold summer in Europe, which shifted much tourist traffic to southern Europe instead.

Outlook for 2008

MICE units will focus more heavily on the events market and will be approaching the domestic company market with new services. This will entail a higher quality of service and more emphasis on sales- and marketing, as well as a stronger focus on higher-margin projects and clients. The leisure outlook for 2008 is promising. Icelandair´s route network has changed from 2007 with flights to Baltimore being discontinued and a new destination, Toronto in Canada, added to the network. Toronto being a new market towards Iceland should influence bookings.

In general the outlook for 2008 is good and the year expected to be a good one for Iceland Travel. The internet is the fastest growing sales channel in tourism today, and the products have been adjusted to that outlet, but with an increased emphasis on local sales representatives as well.

Fjárvakur

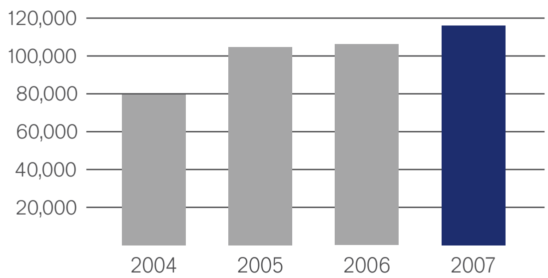
Fjárvakur - Icelandair Shared Services offers expert services to companies in the area of financial services, such as accounting and salary processing, credit and treasury management, tax planning and reporting. Its biggest customers include all Icelandair Group companies.

The company is the largest in Iceland of this kind and was originally intended to operate a supporting role to the finance functions for the companies of Icelandair Group, with the shared services concept as a cornerstone. The company has now been taken to the next level, that is, offering services to companies outside the Group, with a number of companies already in service. Fjárvakur – Icelandair Shared Services is leader in Iceland in its field of operation and its 70 employees possess extensive expertise.

In June 2006 the company bought Airline Services Estonia, a company based in Tallinn, Estonia which specializes in Sales- and Revenue accounting for airlines. The biggest customers today are Icelandair and Estonian Air.

Fjárvakur – Icelandair Shared Services aims to continue expanding, offering more services to existing customers and to new ones as well. The focus has always been on unit-cost reduction and higher service levels, which are the key to success in this area of business.

Number of invoices handled



Endorsement & Statement by the Board of Directors & the CEO

Operations in the year 2007

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

On 18 September 2007 the Company signed a purchase agreement for the acquisition of the Czech airline Travel Service, the largest private airline in the Czech Republic. Travel Service operates charter flights to and from Prague and Budapest and also owns and operates the low cost airline Smart Wings. According to the agreement Icelandair Group hf. will purchase the shares in two stages, 50% of the shares in 2007 and 30-50% during 2008.

According to the income statement net profit for the year 2007 amounted to ISK 257 million. According to the balance sheet, equity at the end of the year amounted to ISK 25,033 million, including share capital in the amount of ISK 981 million. Reference is made to the notes to the consolidated financial statements regarding information on changes in equity.

The Board of Directors proposes that no dividend will be paid to shareholders in the year 2008.

Share capital and Articles of Association

The share capital amounted to ISK 1,000 million at the end of the year, from which the Company held own shares in the amount of ISK 19 million. The share capital is divided into shares of ISK 1, each with equal rights within a single class of shares listed on the Icelandic Stock Exchange (OMX Iceland). The Board of Directors has the right to increase the share capital until 12 September 2012 up to ISK 60 million in the purpose to satisfy share option agreements. The Company issued 5 year convertible notes in October 2006. The nominal amount, ISK 2,000 million, will be paid in a single amount in 2011. The notes are convertible at the option of the holder into ordinary shares over the 5 year period at the price ISK 29.7 per share, 20% each year. The Board of Directors has the right to issue new shares in relation to the convertible notes. The Company has the right to purchase up to 10% of the nominal value of the shares of the Company according to the Company's Act.

Share option agreements have been made with employees of the Group, which enables them to purchase shares in the Company at the exercise price of ISK 27.5 per share after a vesting period of 12 to 36 months. Further information on the share option agreements is disclosed in note 35.

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

Shareholders at the end of the year 2007 were 1,271 but were 1,507 at the beginning of the year, a decrease of 236 during the year. Three shareholders held more than 10% of outstanding shares each at year end 2007. They are Langflug ehf. with 23.8% share, Fjárfestingarfélagið Máttur ehf. with 23.1% share and Naust ehf. with 14.8% share.

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

Statement by the Board of Directors and the CEO

The annual consolidated financial statements for the year ended 31 December 2007 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional Icelandic disclosure requirements for consolidated financial statements of listed companies.

According to our best knowledge it is our opinion that the annual consolidated financial statements give a true and fair view of the consolidated financial performance of the Company for the financial year 2007, its assets, liabilities and consolidated financial position as at 31 December 2007 and its consolidated cash flows for the financial year 2007.

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

The Board of Directors and the CEO have today discussed the annual consolidated financial statements of Icelandair Group hf. for the year 2007 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, 21 February 2008

Board of Directors:
Gunnlaugur M. Sigmundsson, Chairman of the Board of Directors
Ómar Benediktsson
Ásgeir Baldurs
Einar Sveinsson
Finnur Reyr Stefánsson

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. and its subsidiaries, (the "Group"), which comprise the consolidated balance sheet as at December 31, 2007, and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

We have also audited the pro forma financial information presented in the consolidated income statement and consolidated statement of cash flows and the related disclosures made in the notes to these consolidated financial statements, which have been compiled on the basis described in note 2e to these consolidated financial statements, for illustrative purposes only, to provide information about how the Group's operations and cash flows might have been if the acquisition of Icelandair Group hf. had been effective at the beginning of the year 2006.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. Management is also responsible for the preparation and fair presentation of the pro forma financial information presented in these consolidated financial statements on the basis described in note 2e to these consolidated financial statements.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the pro forma financial information has been properly compiled on the basis stated.

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 hf. as at 31 December 2007, 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.

In our opinion, the pro forma financial information has been properly compiled on the basis stated in Note 2e to these consolidated financial statements. Without qualifying our opinion, we draw attention to Note 2e, which states that the pro forma financial information is not necessarily indicative of the operations and cash flows that would have been attained if the acquisition of Icelandair Group hf. had indeed taken place at the beginning of the year 2006.

Reykjavík,
21 February 2008

KPMG hf.
Jón S. Helgason
Guðný H. Guðmundsdóttir

Consolidated Income Statement

for the year 2007

	Notes	2007	Pro forma 2006
Operating income:			
Transport revenue		35,949	34,954
Aircraft and aircrew lease		15,510	10,675
Other operating revenue		12,018	10,514
		63,477	56,143
Operating expenses:			
Salaries and other personnel expenses	7	20,008	17,761
Aircraft fuel		9,769	9,821
Aircraft and aircrew lease		7,353	4,489
Aircraft handling, landing and communication		4,367	4,038
Aircraft maintenance expenses		5,128	3,229
Other operating expenses		11,375	10,747
		58,000	50,085
Operating profit before depreciation and amortisation (EBITDA)		5,477	6,058
Depreciation and amortisation	9	(3,140)	(2,732)
Operating profit before net finance expense (EBIT)		2,337	3,326
Finance income		396	1,599
Finance expenses		(2,545)	(2,025)
Net finance expense	10	(2,149)	(426)
Share of (loss) profit of associates, net of income tax	20	(59)	160
Profit before income tax		129	3,060
Income tax	11,12	128	(445)
Profit for the year		257	2,615
Attributable to:			
Equity holders of the Company		251	2,621
Minority Interest		6	(6)
Profit for the year		257	2,615
Earnings per share:			
Basic earnings per share (ISK)	29	0.25	2.62
Diluted earnings per share (ISK)	29	0.25	2.62

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

Amounts are in ISK million

Consolidated Balance Sheet

as at 31 December 2007

	Notes	2007	2006
Assets:			
Operating assets	14-17	22,832	22,935
Intangible assets	18-19	26,846	27,845
Investments in associates	20	2,335	2,058
Prepaid aircraft acquisitions	21	249	9,669
Long-term receivables and deposits	22	1,788	2,689
Total non-current assets		54,050	65,196
Inventories	23	1,301	1,131
Trade and other receivables	24	7,284	6,149
Receivables from sale of aircrafts	25	1,753	1,094
Prepayments	26	366	271
Cash and cash equivalents	27	2,006	2,776
Total current assets		12,710	11,421
Total assets		66,760	76,617
Equity:			
Share capital		981	1,000
Share premium		25,593	26,090
Reserves		(1,296)	(584)
Accumulated deficit		(293)	(544)
Total equity attributable to equity holders of the Company	28	24,985	25,962
Minority interest		48	42
Total equity		25,033	26,004
Liabilities:			
Loans and borrowings	30-33	14,040	21,607
Deferred income tax liability	34	134	360
Total non-current liabilities		14,174	21,967
Loans and borrowings	30	11,058	4,614
Loans to finance prepaid aircraft acquisition	30	0	8,545
Trade and other payables	36	12,591	12,428
Deferred income	37	3,904	3,059
Total current liabilities		27,553	28,646
Total liabilities		41,727	50,613
Total equity and liabilities		66,760	76,617

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

Amounts are in ISK million

Consolidated Statement of Changes in Equity

for the year ended 31 December 2007

		Attributable to equity holders of the Company								
				Reserves						
	Notes	Share capital	Share premium	Share option reserve	Hedging reserve	Translation reserve	Accumulated deficit	Total	Minority Interest	Total equity
1 October - 31 December 2006										
Issued and sold share capital		1,000	26,000					27,000		27,000
Foreign currency translation differences for foreign operations						(418)		(418)		(418)
Net loss on hedge of net investment in foreign operation						(7)		(7)		(7)
Effective portion of changes in fair value of cash flow hedges, net of tax					(159)			(159)		(159)
Net income and expense recognised directly in equity					(159)	(425)		(584)		(584)
Loss for the Q4 2006							(544)	(544)	(6)	(550)
Total recognised income					(159)	(425)	(544)	(1,128)	(6)	(1,134)
Issue of convertible notes, net of tax			90					90		90
Minority, change									48	48
Equity 31.12.2006		1,000	26,090	0	(159)	(425)	(544)	25,962	42	26,004
2007										
Equity 1.1.2007		1,000	26,090	0	(159)	(425)	(544)	25,962	42	26,004
Foreign currency translation differences for foreign operations						(1,019)		(1,019)		(1,019)
Net profit on hedge of net investment in foreign operation						4		4		4
Effective portion of changes in fair value of cash flow hedges, net of tax					135			135		135
Net income and expense recognised directly in equity					135	(1,015)		(880)		(880)
Profit for the year							251	251	6	257
Total recognised income (expense)					135	(1,015)	251	(629)	6	(623)
Purchase of own shares	28	(19)	(497)					(516)		(516)
Share based payments	35			168				168		168
Equity 31.12.2007		981	25,593	168	(24)	(1,440)	(293)	24,985	48	25,033

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

Amounts are in ISK million

Consolidated Statement of Cash Flows

for the year 2007

	Notes	2007	2006
Cash flows from operating activities:			
Profit for the year		257	2,615
Adjustments for:			
Depreciation and amortisation	9	3,140	2,732
Other operating items	45	(1,902)	(434)
Working capital from operations		1,495	4,913
Net change in operating assets and liabilities	46	2,394	1,455
Net cash from operating activities		3,889	6,368
Cash flows from investing activities:			
Acquisition of operating assets	14	(7,571)	(7,671)
Proceeds from the sale of operating assets		3,814	3,476
Acquisition of intangible assets	18	(455)	(232)
Acquisition of subsidiaries, net of cash acquired		0	(15,953)
Long-term receivables, increase		(1,249)	(660)
Net cash used in investing activities		(5,461)	(21,040)
Cash flows from financing activities:			
Repurchase of own shares	28	(516)	0
Proceeds from issue of share capital		0	13,600
Proceeds from long term borrowings		8,723	19,961
Repayment of long term borrowings		(7,611)	(18,186)
Proceeds from short term borrowings		257	1,945
Net cash from financing activities		853	17,320
(Decrease) increase in cash and cash equivalents		(719)	2,648
Effect of exchange rate fluctuations on cash held		(51)	128
Cash and cash equivalents at beginning of the year		2,776	0
Cash and cash equivalents at 31 December 2007	27	2,006	2,776

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

Amounts are in ISK million

Notes

1. Reporting entity

Icelandair Group hf. (the “Company”) is a limited liability company incorporated and domiciled in Iceland. The address of the Company´s registered office is at Reykjavíkurflugvöllur in Reykjavík, Iceland. The consolidated financial statements of the Company as at and for the year ended 31 December 2007 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´s operations are in the airline transportation and tourism industry. The Company is listed on the Iceland Stock Exchange.

Icelandair Group hf. was a subsidiary of FL GROUP hf. until October 2006, when it was acquired by Icelandair Group Holding hf., a company incorporated in Iceland in October 2006. The acquisition of Icelandair Group hf. was accounted for by applying the purchase method, where Icelandair Group hf. is the acquiree and Icelandair Group Holding hf. is the acquirer. After the acquisition, Icelandair Group hf. legally merged with Icelandair Group Holding hf. on 1 November 2006, with Icelandair Group hf. as the continuing company.

To provide users of the Group´s consolidated financial statements with more appropriate information of the Group’s operations and cash flows, audited pro forma figures based on audited financial statements of all subsidiaries of Icelandair Group hf. for the whole year 2006 are presented in the consolidated income statement and consolidated statement of cash flows with relevant disclosures in the notes. The basis for preparation of the pro forma figures is described further in note 2e.

2. Basis of preparation

a. *Statement of compliance*

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

The financial statements were approved by the Board of Directors on 21 February 2008.

b. *Basis of measurement*

The consolidated financial statements are prepared on the historical cost basis except that derivative financial instruments are stated at their fair value. The methods used to measure fair values are discussed further in note 4.

c. *Functional and presentation currency*

The consolidated financial statements have been prepared in Icelandic krona (ISK), which is the Company’s functional currency. All financial information presented in ISK has been rounded to the nearest million.

d. *Use of estimates and judgements*

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are: business combinations, measurement of the recoverable amounts of cash-generating units, utilisation of tax losses, accounting for an arrangement containing a lease, provisions and valuation of financial instruments.

e. *Pro forma information*

As stated in note 1, audited pro forma figures for the whole year 2006 are presented in the consolidated income statement and consolidated statement of cash flows with certain disclosures in the notes. The pro forma figures consist of the consolidated income statement and statement of cash flows of the Group for the whole year 2006, as if the acquisition of Icelandair Group hf. had been effective at the

Notes, contd.:

2e. contd.:

beginning of the year 2006. For this purpose, the consolidated pro forma income statement and statement of cash flows of the Group for the whole year 2006 have been prepared in accordance with the accounting policies disclosed in these consolidated financial statements and are based on the audited financial statements of all subsidiaries of Icelandair Group hf. for the whole year 2006, whereby depreciation and amortisation have been calculated for the whole year 2006 based on the fair values of operating and intangible assets determined as at the acquisition date in October 2006. This adjustment resulted in an increase of depreciation and amortisation in the amount of ISK 122 million and decrease in income tax expense amounting to ISK 22 million.

3. Significant accounting principles

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.

Certain comparatives amounts have been reclassified to conform with the current year's presentation.

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) 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. Associates are accounted for using the equity method and are initially recognised at cost. The Group´s investment includes goodwill identified on acquisition, net of any accumulated impairment losses. The consolidated financial statements include the Group's share of the total recognised gains and losses and equity movements 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 Group's carrying amount including any long-term investments is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has an obligations or made payments on behalf of the investee.

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

b. Foreign currency

(i) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. Foreign currency differences arising on retranslation are recognised in the income statement.

Notes, contd.:

3b. contd.:

(ii) Foreign operations and Icelandic subsidiaries with foreign functional currency

The assets and liabilities of foreign operations and Icelandic subsidiaries with functional currency other than Icelandic krona, including goodwill and fair value adjustments arising on acquisitions, are translated to Icelandic kronas at exchange rates at the reporting date. The income and expenses of foreign operations are translated to Icelandic kronas at exchange rates at the dates of the transactions. Foreign currency differences arising on retranslation are recognised directly in a separate component of equity.

(iii) Hedge of net investment in foreign operations

Foreign currency differences arising on the retranslation of a financial liability designated as a hedge of a net investment in foreign operations are recognised directly in equity, to the extent that the hedge is effective. 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 cumulative amount in equity is transferred to profit or loss as an adjustment to the profit or loss on disposal.

c. Financial instruments

(i) Non-derivative financial instruments

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Cash and cash equivalents comprise cash balances and call deposits.

Accounting for finance income and expense is discussed in note 3(o).

Other non-derivative financial instruments

Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

(ii) Derivative financial instruments

The Group holds derivative financial instruments to hedge its foreign currency, fuel price and interest rate risk exposures. Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

Cash flow hedges

Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in profit or loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in equity is transferred to profit or loss in the same period that the hedged item affects profit or loss.

Economic hedges

Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities denominated in foreign currencies. Changes in the fair value of such derivatives are recognised in profit or loss as foreign currency gains and losses.

Notes, contd.:

3c. contd.:

(iii) Compound financial instruments

Compound financial instruments issued by the Group comprise convertible notes that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

The liability component of a compound financial instrument is recognised initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognised initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instruments is measured at amortised cost using the effective interest method. The equity component of a compound financial instruments is not remeasured subsequent to initial recognition.

(iv) 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 of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, which includes directly attributable costs, 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 transferred to / from share premium.

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 asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Cost also may include transfers from equity of any gain or loss on qualifying cash flow hedges of foreign currency purchases of operating assets. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

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

Gains and losses on disposal of an item of operating assets are determined by comparing the proceeds from disposal with the carrying amount of operating assets and are recognised net within “other operating revenue” in the income statement.

(ii) Aircrafts and flight equipment

Aircrafts and flight equipment, e.g. aircraft engines and aircraft spare parts, are measured at cost less accumulated depreciation and accumulated impairment losses. When aircrafts are acquired the purchase price is divided between the aircraft itself and engines. Aircrafts are depreciated over the estimated useful life of the relevant aircraft until a residual value is met. Engines are depreciated according to flown hours. 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 there is any, is expensed in full.

(iii) Subsequent costs

The cost of replacing part of an item of operating assets is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other costs are recognised in the income statement as an expense as incurred.

Notes, contd.:

3d. contd.:

(iv) Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each item of operating assets. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. The estimated useful lives for the current and comparative periods are as follows:

	Useful life
Aircrafts and flight equipment	10-14 years
Engines	Flying hrs.
Buildings	15-50 years
Other property and equipment	3-8 years

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

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 stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment.

(ii) Other intangible assets

Other intangible assets are measured at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised in the income statement on a straight-line basis over the estimated useful lives as follows:

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

(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 is expensed as incurred.

f. Prepaid aircraft acquisitions

Prepaid aircraft acquisitions consist of pre-payments on Boeing aircrafts that are still to be delivered. Borrowing cost related to these pre-payments is capitalised based on the interest rate on the directly related financing.

g. Leased assets

All leases are operating leases and the leased assets are not recognised on the Group's balance sheet.

h. 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 in bringing them to their existing location and condition. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. Aircraft equipment is capitalised at the foreign exchange rate ruling at the date of acquisition.

Notes, contd.:

3. contd.:

i. Impairment

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

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 original effective interest rate.

Individually significant financial assets are tested for impairment on a individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost, the reversal is recognised in 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. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, recoverable amount is estimated at each reporting date.

The recoverable amount of an asset or cash-generating unit 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 post-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

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.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. 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.

j. Employee benefits

(i) Share-based payment transactions

The grant date fair value of options granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the options. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest.

The fair value of employee stock options is measured using a binomial lattice model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility based on weighted average historic volatility adjusted for changes expected due to publicly available information, weighted average expected life of the instruments based on historical experience and general option holder behaviour, expected dividends, and the risk-free interest rate based on government bonds. Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

Notes, contd.:

3j. contd.:

In January 2007 the Company granted options for 60.3 million shares at the exercise price ISK 27.5 per share. The options vest in 12 to 36 months from the grant date.

k. Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, 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.

(i) 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.

(ii) Overhaul commitments relating to aircrafts under operating lease

With respect to the Group´s operating lease agreements, where the Group has a commitment to maintain the aircraft, provision is made during the lease term for the obligation based on estimated future cost of major airframe and certain engine maintenance checks by making appropriate charges to the income statement calculated by reference to the number of hours or cycles operated during the year.

l. Deferred income

Sold unused tickets and other prepayments are presented as deferred income in the balance sheet.

m. Operating income

(i) Transport revenue

Passenger ticket sales are not recognised as revenue until transportation has been provided. Sold documents not used within nine months from the month of sale are recognised as revenue. Revenue from mail and cargo transportation is recognised in the income statement after transportation has been provided.

(ii) Aircraft and aircrew lease

Revenue from aircraft and aircrew lease is recognised in the income statement when the service has been provided at the end of each charter flight.

(iii) Other operating revenue

Revenue from other services rendered is recognised in the income statement when the service has been provided.

Gain on sale of operating assets is recognised in the income statement after the risks and rewards of ownership have been transferred to the buyer.

n. Lease payments

(i) Operating lease payments

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

o. Finance income and expenses

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 expenses 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.

Foreign currency gains and losses are reported on a net basis.

Notes, contd.:

3. contd.:

p. Income tax

Income tax on the profit or loss for the year comprises only deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date.

q. Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the year. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares.

r. Segment reporting

A segment is a distinguishable component of the Group that is engaged in providing products or services (business segments) and which is subject to risks and rewards that are different from those of other segments. The Group´s primary format for segment reporting is based on business segments. The business segments are determined based on the Group´s management and internal reporting structure. The major revenue-earning assets of the Group are the aircraft fleet, the majority of which are 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, assets and liabilities 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.

s. New standards and interpretations effective in 2007

IFRS 7 *Financial Instruments: Disclosures* and the Amendment to *IAS 1 Presentation of Financial Statements: Capital Disclosures* became mandatory for the Group's 2007 financial statements. The adoption of IFRS 7 and the amendment to IAS 1 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the Group. In accordance with the transitional requirements of the standards, the Group has provided full comparative information.

IFRIC 7 – 10 became mandatory for the Group's 2007 financial statements but their adoption had no impact on the Group's 2007 financial statements.

t. New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2007, and have not been applied in preparing these consolidated financial statements:

- *IFRS 8 Operating Segments* introduces the "management approach" to segment reporting. IFRS 8, which becomes mandatory for the Group's 2009 financial statements, will require the disclosure of segment information based on the internal reports. The Group has not yet determined the potential effect of IFRS 8 on the consolidated financial statements.

Notes, contd.:

3t. contd.:

- *IAS 1 Presentation of Financial Statements* (revised in 2007) replaces IAS 1 Presentation of Financial Statements (revised in 2003) as amended in 2005. IAS 1 (Revised 2007) sets the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The main change in revised IAS 1 is a requirement to present all non-owner changes in equity (changes in equity not resulting from transactions with owners in their capacity as owners) in one or two statements: either in a single statement of comprehensive income, or in an income statement plus in a statement of comprehensive income. Unlike under current IAS 1, it is not permitted to present components of comprehensive income in the statement of changes in equity. IAS 1 (revised in 2007), which becomes mandatory for the Group's 2009 financial statements if endorsed by the EU, is expected to impact the presentation of the Group's income statement and statement of changes in equity.
- Revised *IAS 23 Borrowing Costs* removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. If endorsed by the EU, the revised IAS 23 will become mandatory for the Group's 2009 financial statements and will have no effect on the Group's accounting policies.
- The amendments to *IFRS 2 Share Based Payment – Vesting Conditions and Cancellations* (January 2008) clarify the definition of vesting conditions and the accounting treatment of cancellations. If endorsed by the EU, the amendments become mandatory for the Group's 2009 financial statements, with retrospective application required. The amendments are not expected to have any effect on the consolidated financial statements of the Group
- *IFRS 3 Business Combinations (revised in 2008) and amended IAS 27 Consolidated and Separate Financial Statements* introduce changes to the accounting for business combinations and for non-controlling (minority) interest. The most significant changes from IFRS 3 (2004) and IAS 27 (2003) are the following:
  - IFRS 3 (2008) applies also to business combinations involving only mutual entities and to business combinations achieved by contract alone;
  - The definition of a business combination has been revised to focus on control;
  - The definition of a business has been amended;
  - Transaction costs incurred by the acquirer in connection with the business combination do not form part of the business combination transaction;
  - Acquisitions of additional non-controlling equity interests after the business combination are accounted for as equity transactions;
  - Disposals of equity interests while retaining control are accounted for as equity transactions;
  - New disclosures are required.
- *IFRS 3 (revised in 2008)* and amended IAS 27 will become mandatory for the Group's 2010 Financial Statements, if endorsed by the EU. The carrying amounts of any assets and liabilities that arose under business combinations prior to the application of IFRS 3 (revised in 2008) are not adjusted while most of the amendments to IAS 27 must be applied retrospectively. The Group has not yet determined the potential effect of IFRS 3 (revised in 2008) and amended IAS 27 on the consolidated financial statements.
- *IFRIC 11 IFRS 2 – Group and Treasury Share Transactions* requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments are obtained. IFRIC 11 will become mandatory for the Group's 2008 financial statements, with retrospective application required. IFRIC 11 is not expected to have any impact on the consolidated financial statements.
- *IFRIC 12 Service Concession Arrangements* provides guidance on certain recognition and measurement issues that arise in accounting for public to-private service concession arrangements. IFRIC 12, which becomes mandatory for the Group's 2008 financial statements if endorsed by the EU, will have no effect on the consolidated financial statements.

Notes, contd.:

3t. contd.:

- *IFRIC 13 Customer Loyalty Programmes* addresses the accounting by entities that operate, or otherwise participate in, customer loyalty programmes for their customers. It relates to customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. IFRIC 13 becomes mandatory for the Group's 2009 financial statements if endorsed by the EU. The Group has not yet determined potential effect of IFRIC 13 on the consolidated financial statements.
- *IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* clarifies when refunds or reductions in future contributions in relation to defined benefit assets should be regarded as available and provides guidance on the impact of minimum funding requirements (MFR) on such assets. It also addresses when a MFR might give rise to a liability. IFRIC 14 will become mandatory for the Group's 2008 financial statements if endorsed by the EU, with retrospective application required. The Group has not yet determined the potential effect of the interpretation on the consolidated financial statements.

4. Determination of fair values

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and / or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(i) Operating assets

The fair value of operating assets recognised as a result of a business combination is based on market values. The market value of aircrafts and properties is the estimated amount for which they could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of items of equipment, fixtures and fittings is based on the quoted market prices for similar items.

(ii) Intangible assets

The fair value of intangible assets acquired in a business combination is based on the discounted estimated royalty payments that have been avoided as a result of the trademark being owned. The fair value of other intangible assets is based on the discounted cash flows expected to be derived from the use and eventual sale of the assets.

(iii) Inventories

The fair value of inventories acquired in a business combination is determined based on its estimated selling price in the ordinary course of business less the estimated costs of completion and sale, and a reasonable profit margin based on the effort required to complete and sell the inventory.

(iv) Trade and other receivables

The fair value of trade and other receivables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

(v) Derivatives

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

(vi) Non-derivative financial liabilities

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date. In respect of the liability component of convertible notes, the market rate of interest is determined by reference to similar liabilities that do not have a conversion option.

Notes, contd.:

Segment reporting

5. 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 four segments, scheduled airline operations, global capacity solutions and aircraft trading, travel and tourism and shared services.

   Scheduled airline operations

   Three companies are categorised as being part of the Scheduled Airline Operation focus of the Group: Icelandair, the international full-service airline with a hub in Iceland; Icelandair Cargo, a full-service air-freight company and Icelandair Ground Services, which handles airlines and passenger services at Keflavik Airport. These companies work closely together and have long historical ties.

   Global capacity solutions and aircraft trading

   The five companies forming this part of Icelandair Group hf. are Loftleiðir-Icelandic, a capacity provider for the international airline and tour operator industry, Bluebird Cargo, a transportation service provider, Icelease, which handles the buying, selling and leasing of aircrafts using IG Invest as its holding company and Lerox a company holding 50% of the stake in Travel Services which was acquired in September 2007. These five companies are grouped together to emphasise Icelandair Group's increased focus on international expansion in this field. Their role is to capitalise on internal know-how by offering aircraft operation services to third parties and taking advantage of trading opportunities in a fast-growing world market, as well as looking for opportunities for mergers and acquisitions.

   Travel and tourism

   Three companies; Iceland Travel, a tour operator and travel agency in in-coming tourism, Icelandair Hotels, which markets and operates two hotel chains, Icelandair Hotels and Edda Hotels, and Air Iceland a scheduled domestic carrier which also offers regular flights to Greenland and the Faeroe Islands form the travel and tourism part of the Group. These companies all provide strategic support to the international scheduled operations, their main focus is on profitable operations.

   Shared services

   This segment comprises IceCap Guernsey and Icelandair Shared Services besides operations of the Parent Company. Icelandair Shared Services handles accounting, reporting and salary processing for the companies within Icelandair Group. IceCap underwrites a part of Icelandair Group's insurance risk.

Notes, contd.:

5. contd.:

Business segments

2007

	Scheduled airline operations	Global capacity and aircraft trading	Travel and tourism	Shared services	Eliminations	Consolidated
External revenue	38,579	15,646	9,144	108		63,477
Inter-segment revenue	12,940	24	152	643	(13,759)	
Total segment revenue	51,519	15,670	9,296	751	(13,759)	63,477
Segment EBITDA	2,739	2,165	1,108	(535)		5,477
Segment results	928	1,744	582	(917)		2,337
Net finance expense	(240)	(477)	(178)	(1,254)		(2,149)
Share of loss of associates	0	(59)	0	0		(59)
Income tax	(159)	(282)	(74)	643		128
Profit (loss) for the year	529	926	330	(1,528)		257
Segment assets	28,084	11,696	5,093	45,024	(25,472)	64,425
Investments in associates	3	2,253	76	3		2,335
Total assets	28,087	13,949	5,169	45,027	(25,472)	66,760
Segment liabilities	22,549	10,703	4,163	19,195	(14,883)	41,727
Capital expenditure	3,675	3,757	559	35		8,026
Depreciation	1,670	408	504	5		2,587
Amortisation of intangible assets	238	269	34	12		553

Amounts are in ISK million

Notes, contd.:

5. contd.:

Business segments

Pro forma 2006

	Scheduled airline operations	Global capacity and aircraft trading	Travel and tourism	Shared services	Eliminations	Consolidated
External revenue	36,759	10,658	8,626	100		56,143
Inter-segment revenue	14,337	46	130	514	(15,027)	0
Total segment revenue	51,096	10,704	8,756	614	(15,027)	56,143
Segment EBITDA	3,482	1,590	1,085	(99)		6,058
Segment results	1,948	1,296	636	(554)		3,326
Net finance expense	468	(205)	(319)	(370)		(426)
Share of profit of associates	0	160	0	0		160
Income tax	(410)	(158)	(56)	179		(445)
Profit (loss) for the year	2,006	1,093	261	(745)		2,615
Segment assets	33,997	19,965	5,232	48,539	(33,174)	74,559
Investments in associates	0	2,058	0	0		2,058
Total assets	33,997	22,023	5,232	48,539	(33,174)	76,617
Segment liabilities	27,750	19,682	4,202	21,882	(22,903)	50,613
Capital expenditure	2,029	4,805	1,048	21		7,903
Depreciation	1,471	268	433	5		2,177
Amortisation of intangible assets	206	317	25	7		555

Business combination

6. On 18 September 2007 the Company signed a purchase agreement for the acquisition of the Czech airline Travel Service, the largest private airline in the Czech Republic. Travel Service operates charter flights to and from Prague and Budapest and also owns and operates the low cost airline Smart Wings. According to the agreement Icelandair Group hf. will purchase the shares in two stages, 50% of the shares in 2007 and 50% during 2008. According to the purchase agreement the sellers have option to buy 20% of the shares at the completion date in 2008. The sellers have to give notice to the buyer on or before 31 May 2008 if they are going to buy back the 20% share.

The 50% share in Travel Service acquired in 2007 was acquired through the holding company, Lerox CZ s.r.o. which was 100% owned by Icelandair Group hf. at year-end 2007. The 50% share of Travel Service is accounted for using the equity method within Lerox CZ s.r.o. for the two last months of the year. The acquisition date of Lerox CZ s.r.o. was determined as 1 November 2008. Travel Service is not consolidated with Lerox CZ s.r.o. in the year 2007 since control was not in place at year-end 2007. The acquisition price for Lerox CZ s.r.o. amounted to ISK 960 million including transaction cost of ISK 104 million.

Business combination in 2006

During 2007 the purchase price allocation for 2006 business combination was finalised. Some minor adjustments were made to the provisional purchase price allocation in 2006.

Amounts are in ISK million

Notes, contd.:

Operating expenses

7. Salaries and other personnel expenses are specified as follows:

	2007	Pro forma 2006
Salaries	13,552	11,937
Equity-settled share based payment transactions	168	0
Salary-related expenses	3,045	2,746
Other personnel expenses	3,243	3,078
Total salaries and other personnel expenses	20,008	17,761

Auditors' fees

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

Audit of financial statements	30	29
Review of interim accounts	8	10
Other services	16	16
Total auditors' fees	54	55

The abovementioned figures include fees to the auditors of all companies within the Group. Fees to auditors, other than the auditors of the Parent Company amounted to ISK 5 million during the year 2007.

Depreciation and amortisation

9. The depreciation and amortisation charge in the income statement is specified as follows:

Depreciation of operating assets, see note 14	2,587	2,177
Amortisation of intangible assets, see note 18	553	555
Depreciation and amortisation recognised in the income statement	3,140	2,732

Finance income and finance expenses

10. Finance income and finance expenses are specified as follows:

Interest income on bank deposits	194	688
Other interest income	145	398
Net foreign exchange gain	57	513
Finance income total	396	1,599
Interest expense on loans and borrowings	2,413	1,014
Other interest expenses	132	1,011
Finance expenses total	2,545	2,025
Net finance expense	(2,149)	(426)

Amounts are in ISK million

Notes, contd.:

Income tax

11. Income tax recognised in the income statement is specified as follows:

Deferred tax expense	2007	Pro forma 2006
Origination and reversal of temporary differences	(128)	445
Total income tax in income statement	(128)	445

12. Reconciliation of effective tax rate:

		2007		Pro forma 2006
Profit before tax		129		3,060
Income tax according to current tax rate	18.0%	23	18.0%	551
Tax exempt revenues	(38.8%)	(50)	(0.3%)	(9)
Non-deductible expenses	36.4%	47	0.2%	6
Foreign currency subsidiaries	(117.1%)	(151)	(2.8%)	(87)
Other items	2.3%	3	(0.5%)	(16)
Effective tax rate	(99.1%)	(128)	14.5%	445

13. Income tax recognised directly in equity:

	2007	2006
Derivatives	30	(35)
Convertible notes	0	20
Total income tax recognised directly in equity	30	(15)

Operating assets

14. Operating assets are specified as follows:

Gross carrying amounts	Aircrafts and flight equipment	Buildings	Other property and equipment	Total
Additions through business combinations	16,998	2,063	1,491	20,552
Additions during the period	3,023	363	363	3,749
Sales and disposals during the period	(983)	0	(237)	(1,220)
Exchange rate difference	273	0	4	277
Balance at 31 December 2006	19,311	2,426	1,621	23,358
Sales and disposals during the year	(3,583)	(8)	(38)	(3,629)
Additions during the year	6,229	590	752	7,571
Exchange rate difference	(1,600)	0	(28)	(1,628)
Balance at 31 December 2007	20,357	3,008	2,307	25,672

Amounts are in ISK million

Notes, contd.:

14. contd.:

Depreciation and impairment losses	Aircrafts and flight equipment	Buildings	Other property and equipment	Total
Depreciation	438	29	106	573
Sales and disposals during the period	(106)	0	(47)	(153)
Exchange rate difference	3	0	0	3
Balance at 31 December 2006	335	29	59	423
Depreciation for the year	2,083	121	383	2,587
Sales and disposals during the year	(202)	(5)	(32)	(239)
Exchange rate difference	79	0	(10)	69
Balance at 31 December 2007	2,295	145	400	2,417
Carrying amounts				
At 1 October 2006	16,998	2,063	1,491	20,552
At 31 December 2006	18,976	2,397	1,562	22,935
At 31 December 2007	18,062	2,863	1,907	22,832

Mortgages and commitments

15. The Group's operating assets are mortgaged to secure debt. The remaining balance of the debt amounted to ISK 14,776 million at the end of the year 2007 (2006: ISK 26,034 million).

Insurance value of aircrafts and flight equipment

16. The insurance value and book value of aircrafts and related equipment of the Company at year-end 2007 are specified as follows:

	Insurance value	Carrying amount
Boeing - 8 aircrafts	21,040	10,922
Other aircrafts	4,333	1,459
Flight equipment	3,453	5,681
Total aircrafts and flight equipment	28,826	18,062

Amounts are in ISK million

Notes, contd.:

Insurance value of other operating assets

17. The principal buildings owned by the Group at 31 December 2007 are the following:

	Official assessment	Insurance	Carrying amount
Maintenance hangar, Keflavík Airport	1,514	2,175	733
Freight building, Keflavík Airport	406	577	380
Office building, Reykjavík Airport	863	883	304
Service building, Keflavík Airport	390	578	246
Hangar 4 and other buildings, Reykjavík Airport	653	765	258
Buildings in Latvia	513	420	461
Other buildings	400	803	481
Buildings total	4,739	6,201	2,863

Official valuation of the Group's leased land for buildings at 31 December 2007 amounted to ISK 663 million and is not included in the Balance Sheet.

The insurance value of the Group's other operating assets and equipment amounted to ISK 3,216 million at the end of the year 2007. The carrying amount at the same time was ISK 1,907 million.

Intangible assets

18. Intangible assets are specified as follows:

Gross carrying amounts	Goodwill	Trademarks and slots	Customer relations	Other intangibles	Total
Additions through business combinations	21,447	4,637	1,137	1,037	28,258
Additions during the period	0	0	0	87	87
Exchange rate difference	(333)	(50)	11	32	(340)
Balance at 31 December 2006	21,114	4,587	1,148	1,156	28,005
Adjustments to provisional purchase price allocation	(351)	461	0	(110)	0
Additions during the year	37	0	0	418	455
Exchange rate difference	(657)	(128)	(65)	(52)	(902)
Balance at 31 December 2007	20,143	4,920	1,083	1,412	27,558
Amortisation and impairment losses					
Amortisation	0	0	31	128	159
Exchange rate difference	0	0	1	0	1
Balance at 31 December 2006	0	0	32	128	160
Amortisation for the year	0	0	122	431	553
Exchange rate difference	0	0	(1)	0	(1)
Balance at 31 December 2007	0	0	153	559	712

Amounts are in ISK million

Notes, contd.:

18. contd.:

Carrying amounts	Goodwill	Trademarks and slots	Customer relations	Other intangibles	Total
At 1 October 2006	21,447	4,637	1,137	1,037	28,258
At 31 December 2006	21,114	4,587	1,116	1,028	27,845
At 31 December 2007	20,143	4,920	930	853	26,846

Impairment test

19. Goodwill and other intangible assets that have indefinite live are tested for impairment at each reporting date. These assets were recognised at fair value when Icelandair Group Holding hf. acquired the Company in October 2006. Goodwill and other intangible assets with indefinite live are specified as follows:

Goodwill	20,143
Trademarks and slots	4,920
Total	25,063

These assets were tested for impairment by comparing their carrying amounts to their fair value less cost to sell. Trademarks are tested by using the royalty relief method. The main assumption consist of royalty rate 0.7 -1.5% and the discount rate 13.5 -15.2%.

For the purpose of impairment testing on goodwill, goodwill is allocated to the Group´s segments which represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. The aggregate carrying amount of goodwill allocated to each unit are as follows:

Scheduled airline operations	10,625
Global capacity and aircraft trading	5,723
Travel and tourism	2,801
Shared services	994
Total goodwill	20,143

For the purpose of impairment testing on goodwill, fair value less cost to sell is determined by discounting the future cash flows generated from the continuing use of each unit and was based on the following key assumptions:

Cash flows were projected based on actual operating results and a 4-year business plan. Cash flows were extrapolated for determining the residual value using a constant 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 anticipated annual revenue growth included in the cash flow projections was 3.5 - 16.0% for the years 2008 to 2011. A post-tax discount rate of 11.5 - 13.2% was applied in determining the recoverable amount of the units. The discount rate was estimated based on an industry average weighted average cost of capital, which was based on a possible range of debt leveraging of 31-57% percent at a market interest rate of 7.5 - 9.4%.

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

Amounts are in ISK million

Notes, contd.:

Equity accounted investees

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

	Ownership 2007	2006
Barkham Associates SA	49%	49%
China Ice No 1 ehf.	40%	40%
China Ice No 1 slf.	40%	40%
China Ice No 2 ehf.	40%	40%
China Ice No 2 slf.	40%	40%
China Ice No 3 ehf.	40%	40%
China Ice No 4 ehf.	40%	40%
China Ice No 5 ehf.	40%	40%
China Ice No 5 slf.	40%	40%
China Ice No 6 ehf.	40%	40%
China Ice No 6 slf.	40%	40%
Icesing ehf.	49%	49%
Siglo FIJ Ltd.	49%	49%
Siglo FIR Ltd.	49%	49%
Siglo FIU Ltd.	49%	49%
Travel Service CZ s.r.o.	50%	-
Assets	21,808	29,774
Liabilities	18,319	25,261
Revenues	4,970	2,259
Expenses	5,016	1,909
Net (loss) profit	(46)	350
Share of (loss) profit of associates	(59)	160

During the year the Group acquired a 50% share in the Czech airline Travel Service. Icelandair Group hf. will purchase additional 30-50% share during 2008. All other associates are structured around ownership of aircrafts.

Prepaid aircraft acquisitions

21. Prepaid aircraft acquisitions in the balance sheet is for the purchase of four Boeing 787 Dreamliner aircrafts to be delivered in the year 2010 and 2012. The Company has capitalised borrowing cost amounting to ISK 30 million related to these prepayments based on the average interest rate which was 6.3% at year-end. The Company also has an option to purchase three additional 787 Dreamliner aircrafts with delivery after the year 2012.

Amounts are in ISK million

Notes, contd.:

Long-term receivables and deposits

	2007	2006
22. Long-term receivables and deposits are specified as follows:		
Loans, effective interest rate 7.6% / 7.6%	775	1,012
Deposits	653	757
Other long-term receivables	1,016	943
	2,444	2,712
Current maturities of long-term receivables	(656)	(23)
Long-term receivables and deposits total	1,788	2,689
Long-term receivables contractual repayments are specified as follows:		
Repayments in 2007	-	23
Repayments in 2008	656	23
Repayments in 2009	23	24
Repayments in 2010	21	25
Repayments in 2011	18	26
Repayments in 2012	11	27
Subsequent	46	864
Total loans, including current maturities	775	1,012

Inventories

23. Inventories are specified as follows:

Spare parts	960	872
Other inventories	341	259
Inventories total	1,301	1,131

In 2007 the write-down of inventories to net realisable value amounted to ISK 35 million (2006: 34 million). The write-down is included in other operating expenses.

Trade and other receivables

24. Trade and other receivables are specified as follows:

Trade receivables	5,158	5,009
Derivatives	0	215
Current maturities of long term-receivables	656	23
Other receivables	1,470	902
Trade and other receivables total	7,284	6,149

At 31 December 2007 trade receivables are shown net of an allowance for doubtful debts of ISK 241 million (2006: ISK 262 million) arising from the likely bankruptcy of a significant customer.

Amounts are in ISK million

Notes, contd.:

24. contd.:

Receivables denominated in currencies other than the functional currency comprise ISK 2,609 million (2006: ISK 2,616 million) of trade receivables.

Receivables from sale of aircrafts

25. At year end 2006 the Group had made prepayments on six Boeing 737-800 aircrafts to be delivered in 2007. During the first quarter of 2007 the Group sold all these aircrafts. The Group also sold three other aircrafts during the first quarter and one during fourth quarter, two of them on a sale and leaseback contracts for 5 and 6 years. Of these aircrafts two were purchased during the first quarter and one was bought during third quarter.

Total sale price amounted to ISK 11,850 million and capital gain on sale amounted to ISK 1,196 million. Receivables from sale of aircraft amount to ISK 1,753 million at 31 December 2007 and was paid in January 2008.

Prepayments

26. Prepaid expenses which relates to subsequent periods amounted to ISK 366 million (2006: ISK 271 million) at year end. The prepayments consist mainly of insurance expenses and prepaid rental expenses.

Cash and cash equivalents

	2007	2006
27. Cash and cash equivalents are specified as follows:		
Bank deposits	1,989	2,757
Cash on hand	17	19
Cash and cash equivalents total	2,006	2,776

Equity

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

On a shareholders meeting 29 December 2006 the Board of Directors received authority to purchase own shares of maximum 10% of the total nominal value of the ordinary shares for a 18 month period. Furthermore the meeting agreed upon authorisation to the Board of Directors to increase the share capital by 6% for issue against share option plan to employees. Early January 2007 the Board of Directors granted options to key employees amounting to ISK 51 millions with the exercise price ISK 27.5 per share. The Company bought own shares at a nominal value of ISK 19 million during the year for ISK 516 million.

Share capital and share premium

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

Share option reserve

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

Amounts are in ISK million

Notes, contd.:

28. contd.:

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

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

Earnings per share

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

		Pro forma
	2007	2006
Profit attributable to ordinary equity holders of the parent company:		
Profit for the year attributable to equity holders of the Parent	251	2,621
Weighted average number of ordinary shares		
in million shares		
Issued ordinary shares at beginning of year	1,000	1,000
Effect of bought own shares	(9)	0
Weighted average number of ordinary shares at 31 December	991	1,000
Weighted average number of ordinary shares (diluted)		
in million shares		
Weighted average number of ordinary shares (basic)	991	1,000
Effect of share options	(1)	0
Weighted average number of ordinary shares (diluted) at 31 December	990	1,000
Earnings per share:		
Basic earnings per share (ISK)	0.25	2.62
Diluted earnings per share (ISK)	0.25	2.62

Notes, contd.:

Loans and borrowings

30. This note provides information about 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 38.

	2007	2006
Non-current loans and borrowings are specified as follows:		
Secured bank loans	14,851	22,416
Convertible notes	1,889	1,860
Current maturities	(2,700)	(2,669)
Total non-current loans and borrowings	14,040	21,607
Current loans and borrowings are specified as follows:		
Current maturities of non-current liabilities	2,700	2,669
Short term notes	6,174	0
Short-term loans from credit institutions	2,184	1,945
Total current loans and borrowings	11,058	4,614
Loans to finance prepaid aircraft acquisition	0	8,545
Total loans and borrowings	25,098	34,766

31. Secured bank loans are specified as follows:

	Average interest rates	Total remaining balance 2007	Average interest rates	Total remaining balance 2006
Debt in USD	5.6%	12,230	6.1%	15,885
Debt in EUR	6.9%	1,629	6.3%	2,623
Debt in GBP	7.9%	19	8.6%	353
Debt in NOK		0	7.2%	167
Debt in JPY	2.2%	16	3.7%	124
		13,894		19,152
Debt in ISK indexed	6.5%	957	6.5%	781
Debt in ISK not indexed		0	17.5%	2,483
Total secured bank loans		14,851		22,416

Amounts are in ISK million

Notes, contd.:

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

	2007	2006
Repayments in 2007	-	15,019
Repayments in 2008	11,058	3,526
Repayments in 2009	1,202	2,025
Repayments in 2010	1,845	7,211
Repayments in 2011	1,754	3,394
Repayments in 2012	5,345	836
Subsequent repayments	3,894	2,755
Total non-current borrowings	25,098	34,766

Convertible notes

33. Convertible notes are specified as follows:

Proceeds from issue of convertible notes - nominal amount	2,000	2,000
Transaction cost	(39)	(39)
Net proceeds	1,961	1,961
Amount classified as equity	(110)	(110)
Expensed transaction cost	38	9
Carrying amount of liability	1,889	1,860

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

Deferred income tax liability

34. The deferred income tax liability is specified as follows:

Deferred income tax liability 1.1.	360	0
Additions through business combination	0	604
Exchange rate difference	(128)	(22)
Income tax recognised in income statement	(128)	(207)
Income tax recognised in equity	30	(15)
Deferred income tax liability 31.12.	134	360

Amounts are in ISK million

Notes, contd.:

34. contd.:

Deferred tax assets and liabilities is attributable to the following:

	Assets		Liabilities		Net	
	2007	2006	2007	2006	2007	2006
Operating assets	1,453	427	0	0	1,453	427
Intangible assets	91	30	0	0	91	30
Derivatives	0	0	5	35	(5)	(35)
Convertible notes	0	20	0	0	0	20
Trade receivables	34	104	0	0	34	104
	1,578	581	5	35	1,573	546
Tax loss carry-forwards	0	0	1,339	265	(1,339)	(265)
Other items	0	79	100	0	(100)	79
Deferred income tax	1,578	660	1,444	300	134	360

	1 January 2007	Recognised in income statement	Exchange rate difference	Recognised in equity	31 December 2007
Operating assets	427	1,154	(128)		1,453
Intangible assets	30	61			91
Derivatives	(35)	0		30	(5)
Convertible notes	20	(20)			0
Trade receivables	104	(70)			34
Tax loss carry-forwards	(265)	(1,074)			(1,339)
Other items	79	(179)			(100)
	360	(128)	(128)	30	134

Share-based payments

35. The terms and conditions of grants are as follows:

Grant date / employees entitled	Number of instruments in thousands	Vesting conditions	Contractual life of option
Options granted 2007	60,340	2/24/36 months service	3 years
Total	60,340		

All options are to be settled by physical delivery of shares. Options vesting in 12 months can be exercised three times during the contractual life, at the end of each 12 month period. Accordingly 24 month options can be exercised two times and the 36 month options only once at the end of the 36 month period.

Amounts are in ISK million

Notes, contd.:

35. contd.:

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

	Weighted average exercise price 2007	Number of options 2007
Granted during the year	27.5	60,340
Forfeited during the year	27.5	(9,070)
Outstanding at 31 December	27.5	51,270
Exercisable at 31 December		0

The fair value of services received in return for share options granted based on the fair value of share options granted, measuring using a Black-Scholes model, with the following inputs:

	Granted 2007
Fair value at grant date, average 12, 24, and 36 months options, average	5.85
Share price	27.5
Exercise price	27.5
Expected volatility (weighted average volatility)	29.0%
Option life (expected weighted average life)	2 years
Expected dividends per share	ISK 1
Risk-free interest rate (based on government bonds)	11.7%

Total recognised expenses for the year arising from share-based payment transactions amounted to ISK 168 million (2006: ISK 0 million) including forfeited options during the year and accrued social security expenses related to share-based payments

Trade and other payables

36. Trade and other payables are specified as follows:

	2007	2006
Trade payables	4,546	5,009
Derivatives used for hedging	143	409
Other payables	7,902	7,010
Total trade and other payables	12,591	12,428

Deferred income

37. Sold unused tickets and other prepayments are presented as deferred income in the balance sheet.

Notes, contd.:

Financial risk management

38. Overview

The Group has exposure to the following risks from its use of financial instruments:
– credit risk
– liquidity risk
– market risk

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

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.

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 both investment of liquid assets, the management of those assets and agreements with financial institutions related to financial operations, e.g. hedging. 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 is committed to only trade derivatives with trusted parties. The counterparty risk that arises from trading derivatives, used in risk management, is therefore minimised.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables and investments. 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.

Notes, contd.:

38. contd.:

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:

	Notes	2007	2006
Long-term receivables and deposits	22	1,788	2,689
Trade and other receivables	24	7,284	6,149
Receivables from sale of aircrafts	25	1,753	1,094
Cash and cash equivalents	27	2,006	2,776
		12,831	12,708

Impairment losses

The aging of trade receivables at the reporting date was:

	Gross 2007	Impairment 2007	Gross 2006	Impairment 2006
Not past due	4,643	0	4,333	0
Past due 0-30 days	266	0	484	0
Past due 31-120 days	40	(10)	61	(14)
More than one year	450	(231)	393	(248)
	5,399	(241)	5,271	(262)

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

Balance at January	262	200
Impairment loss (reversed) recognised	(21)	62
Balance at 31 December	241	262

Based on historical default rates, the Group believes that no 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 not be able to meet its financial obligations as they fall due. 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 two classes depending on duration and match them against the Group's liquidity preferences laid out by the management on annual basis. Tier one includes the estimated minimum of accessible funds for operational liquidity. Tier two includes assets of longer duration for strategic liquidity, such as shorter term investments. The amounts in each class of assets are targeted once a year with reference to a number of economic indicators such as the estimated turnover, the annual amount of fixed costs and the interest rate levels. In addition to limit its risk, the Group maintains lines of credit amounting to ISK 250 million at year end.

Amounts are in ISK million

Notes, contd.:

38. contd.:

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

2007	Carrying amount	Contractual cash flows	Within 12 months	1-2 years	2-5 years	After 5 years
Non-dervative financial liabilities						
Unsecured bond issue	8,358	(8,383)	(8,383)	0	0	0
Secured bank loans	14,851	(17,895)	(3,501)	(1,836)	(8,247)	(4,311)
Convertible notes	1,889	(3,411)	(304)	(336)	(2,771)	0
Trade and other payables	12,591	(12,591)	(12,591)	0	0	0
Operating lease payments	0	(26,053)	(6,272)	(5,951)	(12,612)	(1,218)
Pre delivery payments	0	(12,712)	(2,943)	(3,156)	(6,613)	0
	37,689	(81,045)	(33,994)	(11,279)	(30,243)	(5,529)
2006						
Non-dervative financial liabilities						
Unsecured bond issue	1,945	(1,955)	(1,955)	0	0	0
Secured bank loans	30,961	(37,633)	(5,556)	(6,212)	(20,609)	(5,256)
Convertible notes	1,860	(3,435)	(350)	(294)	(2,791)	0
Trade and other payables	12,428	(12,428)	(12,428)	0	0	0
Operating lease payments	0	(24,308)	(4,979)	(4,709)	(11,019)	(3,601)
Pre delivery payments	0	(14,486)	0	(3,354)	(11,132)	0
	47,194	(94,245)	(25,268)	(14,569)	(45,551)	(8,857)

Market risk

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

The Group uses derivatives in order to manage market risks. All such transactions are carried out within the guidelines set by the Board of Directors. Generally 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 as possible. Nevertheless, the USD cash inflow falls short of USD outflow due to fuel costs, lease and capital related payments which are to a large extent denominated in USD. This shortage is financed by a surplus of European currencies, most importantly EUR and Scandinavian currencies. The Group follows a hedging policy of 40-80% of net exposure with a 12 month horizon and uses a portfolio of instruments, mainly forwards and collar options.

Amounts are in ISK million

Notes, contd.:

38. contd.:

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

2007	USD	EUR	DKK	SEK	NOK
Net balance sheet exposure	1.046	(2.404)	192	169	133
Estimated forecast revenue	16.210	6.450	1.830	1.857	1.769
Estimated forecast purchases	(23.991)	(4.296)	(1.195)	(277)	(326)
Forward FX contracts	2.969	(2.969)	0	0	0
Net currency exposure	(3.766)	(3.219)	827	1.749	1.576
2006					
Net balance sheet exposure	2.876	(1.695)	211	197	(48)
Estimated forecast revenue	19.699	7.813	2.025	1.952	1.558
Estimated forecast purchases	(28.727)	(4.114)	(1.184)	(305)	(304)
Forward FX contracts	4.380	(4.380)	0	0	0
Net currency exposure	(1.772)	(2.376)	1.052	1.844	1.206

The following significant exchange rates applied during the year:

	Average rate		Reporting date spot rate	
	2007	2006	2007	2006
USD	64.21	70.02	62.62	71.36
EUR	87.85	89.00	92.20	93.79
DKK	11.76	11.76	12.36	12.57
SEK	9.47	9.48	9.74	10.37
NOK	10.94	10.90	11.57	11.38

Sensitivity analysis
A 10% strengthening of the ISK against the following currencies at 31 December would have increased (decreased) post-tax equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. This analysis is performed on the same basis for 2006.

2007	Equity	Profit or loss
USD	137	309
EUR	212	264
DKK	(68)	(68)
SEK	(143)	(143)
NOK	(129)	(129)

Amounts are in ISK million

Notes, contd.:

38. contd.:

2006	Equity	Profit or loss
USD	(9)	145
EUR	179	195
DKK	(86)	(86)
SEK	(151)	(151)
NOK	(99)	(99)

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

Interest rate risk

The largest share of outstanding long term loans, carrying 3-6 months floating interest rates are directly related to aircraft financing and denominated in USD. That is a consequence of the fact that the most liquid market for commercial aircraft denominates prices in USD. The Group follows a policy of hedging 40-80% of interest rate exposure. Swap contracts are mainly used to exchange floating rates for fixed up to 5 years ahead, which currently amounting to USD 107 million and carry on average 4% interest rates. In recent years the contracts have proved favourable as the floating rates have exceeded the fixed rates.

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

	Carrying amount 2007	2006
Fixed rate instruments		
Financial assets	1,525	1,769
Financial liabilities	(10,325)	(6,808)
	(8,800)	(5,039)
Variable rate instruments		
Financial liabilities	(14,773)	(26,013)

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 he reporting date would not affect profit or loss.

A change of 100 basis points in interest rates would have increased or decreased equity by 255 million (2006: 306 million).

Fair value sensitivity analysis for variable rate instruments

A change of 100 basis points in interest rates at the reporting date would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. The analysis is performed on the same basis for 2006.

Amounts are in ISK million

Notes, contd.:

38. contd.:

	Equity 100 bp increase	Equity 100 bp decrease
2007		
Variable rate instruments	130	(125)
Total	130	(125)
2006		
Variable rate instruments	150	(156)
Total	150	(156)

Fuel price risk

The jet fuel price has a lot of influence on cost of operations. Price development for the past five years has been characterized by a steep upward trend, generated by excessive world demand and periodic cycles which have added to the price volatility. In 2007 the monthly average of jet fuel prices reached a record level of 920 USD/t in November, having continuously rallied from 550 USD/t in January. Since November prices have maintained their achieved levels. The Group maintains a policy of hedging fuel price exposure by a ratio of 40-80% by using swaps and options. The average hedge ratio in 2007 was roughly 55-60%. Although prices did exceed the budgeted levels considerably towards the end of the year, the realized total fuel costs were close to budget due to the seasonality of fuel consumption and hedging activities.

Capital management

The Board's policy is to maintain a strong capital base so as to sustain future development of the business.

The Board's target is that managers of the Group hold the Company's ordinary shares. The Board has entered into share option agreements with managers for that purpose. At year-end 2007 the managers of the Group hold ISK 21.5 million of the shares and have entered into share option agreements for ISK 34.6 million as disclosed in note 43.

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

Financial instruments and fair values

39. The fair values of financial assets and liabilities, together with the carrying amounts shown in the balance sheet, are as follows:

	2007		2006	
	Carrying amount	Fair value	Carrying amount	Fair value
Loans and receivables	10,825	10,825	9,932	9,932
Cash and cash equivalents	2,006	2,006	2,776	2,776
Unsecured bond issue	(8,358)	(8,354)	0	0
Secured bond loans	(14,851)	(14,755)	(22,416)	(22,316)
Convertible notes	(1,889)	(1,946)	(1,860)	(1,860)
Trade and other payables	(12,591)	(12,591)	(12,428)	(12,428)
Total	(24,858)	(24,815)	(23,996)	(23,896)

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

Amounts are in ISK million

Notes, contd.:

Off-balance sheet items

40. As a lessee the Company has in place operating leases for 30 aircrafts at the end of December 2007. The leases are for sixteen Boeing 757 aircrafts, four Boeing 767 aircrafts, three Boeing 737 and seven Airbus A730 aircrafts. The Company also has in place operating leases for storage facilities, accommodations, equipment and fixtures for its operations, the longest until the year 2014. At the end of the year 2007 the leases are payable as follows:

	Real estate	Aircrafts	Other	Total
In the year 2008	686	5.475	111	6.272
In the year 2009	643	5.199	109	5.951
In the year 2010	604	4.534	58	5.196
In the year 2011	589	3.712	0	4.301
In the year 2012	557	2.558	0	3.115
Subsequent	700	518	0	1.218
Total	3.779	21.996	278	26.053

Capital commitments

41. The Group has agreements with Boeing regarding the purchase of four Boeing 787 Dreamliner aircrafts two to be delivered in the year 2010 and two in 2012. The Group also has an option to purchase three additional 787 Dreamliner aircrafts with delivery after the year 2012.

42. During the first half of 2007 the Competition Authorities fined the subsidiary, Icelandair ehf., due to an alleged breach of the competition law. The penalty amounts to ISK 130 million after it was lowered by 30% after the decision was appealed. Icelandair Group hf. has decided to take this case to court and considers it more likely than not that the fine will be withdrawn in full. Nothing has been expensed in the income statement on this case.

    The penalty on Icelandair Ground Services ehf. disclosed in the financial statement for 2006, amounting to ISK 60 million, will be taken to the Supreme Court this year. The Group still considers that this case will end up in favour of the Group but to be precautious the amount has been expensed in the income statement.

Related parties

Identity of related parties

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

    Transaction with associates

    During the year 2007 the Group purchased services from associates amounting to ISK 375 million (2006: ISK 410 million), but the Group did not sell them any services. The Group has granted loans to its associates. The balance at year end amounted to ISK 952 million and is included in the item long-term receivables and deposits in the balance sheet. Interest income amounting to ISK 51 million is recognised in the income statement. Transactions with associates are priced on an arm's length basis.

    Transactions with management and key personnel

    Salaries and benefits of management paid for their work for Group companies during the year 2007, share option agreements and shares in the Company are specified as follows:

Amounts are in ISK million

Notes, contd.:

43. contd.:

	Salaries and benefits	Share options	Shares held at year-end 2007	Share held by related parties
Board of Directors:				
Gunnlaugur M. Sigmundsson, chairman of the board	3.4			392.1
Ómar Benediktsson	5.6			61.2
Ásgeir Baldurs	0.7			
Einar Sveinsson	2.8			392.1
Finnur Reyr Stefánsson	0.0			38.2
Jón Benediktsson, alternative board member	1.4		0.4	
Martha Eiríksdóttir, alternative board member	0.4		0.1	
Sigurður Atli Jónsson, alternative board member	0.0			
Finnur Ingólfsson, former board member	5.4			
Hermann S. Guðmundsson, former board member	2.7			
Helgi S. Guðmundsson, former board member	1.7			
Jóhann Magnússon, former board member	1.7			
CEO:				
Jón Karl Ólafsson, former CEO of Icelandair Group hf.	34.6		0.1	18.6

Post employee benefits related to former CEO amounted to ISK 60 million, is included in the income statement and will be paid in 2008.

Managing directors:				
Hlynur Elísson, CFO of Icelandair Group hf.	25.1	2.9	0.1	2.2
Sigþór Einarsson, COO of Icelandair Group hf.	25.2	2.9	0.1	3.7
Thirteen MD of subsidiaries	275.1	29.8	2.4	13.0

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

Group entities

44. The Company holds thirteen subsidiaries which are all included in the consolidated financial statements. They are:

	Ownership interest 2007	2006
Scheduled airline operations:		
Icelandair ehf.	100%	100%
Icelandair Cargo ehf.	100%	100%
Icelandair Technical Services ehf. (ITS)	-	100%
Icelandair Ground Services ehf. (IGS)	100%	100%

Amounts are in ISK million

Notes, contd.:

44. contd.:

	Ownership interest 2007	2006
Global capacity solutions and aircraft trading:		
Blue Cargo ehf.	-	100%
Bluebird Cargo ehf.	100%	100%
IceLease ehf.	100%	100%
IG Invest ehf.	100%	100%
Loftleiðir - Icelandic ehf.	100%	100%
Lerox CZ s.r.o.	100%	-
Travel and tourism:		
Air Iceland ehf.	100%	100%
Iceland Travel ehf.	100%	100%
Icelandair Hotels ehf.	100%	100%
Shared services:		
IceCap Ltd., Guernsey	100%	100%
Icelandair Shared Services ehf.	100%	100%

The subsidiaries own 18 subsidiaries that are also included in the consolidated financial statements

In the beginning of the year, Icelandair Technical Services ehf. was merged with Icelandair ehf. and Blue Cargo ehf. was merged with Bluebird Cargo ehf.

Statement of cash flows

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

	2007	Pro forma 2006
Gain on the sale of operating assets	(1.793)	(995)
Exchange rate difference and indexation of liabilities and assets	(40)	276
Share of loss (profit) of associates	59	(160)
Income tax	(128)	445
Total other operating items in the statement of cash flows	(1.902)	(434)

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

Inventories, increase	(170)	(267)
Trade and other receivables, decrease (increase)	1,076	(900)
Trade and other payables, increase	643	2,126
Prepaid income, increase	845	496
Net change in operating assets and liabilities in the statement of cash flows	2,394	1,455

Amounts are in ISK million

Notes, contd.:

	2007	Pro forma 2006
47. Additional cash flow information:		
Interests paid	2,365	1,421
Interests received	352	1,011
Income tax paid	17	0

Ratios

48. The Group's primary ratios at year end 2007 are specified as follows:		
Working capital ratio	0.46	0.40
Equity ratio	0.37	0.34
Intrinsic value of share capital	25.52	26.00

Amounts are in ISK million