

# **Icelandair Group hf.**

**Condensed Consolidated  
Interim Financial Statements  
1 January - 30 September 2007**

**ISK**

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

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# Endorsement and Signatures of the Board of Directors and the CEO

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The condensed consolidated interim financial statements of Icelandair Group hf. for the period from 1 January to 30 September 2007 have been prepared in accordance with International Financial Reporting Standards (IFRSs) for Interim Financial Statements (IAS 34). The interim financial statements comprise the consolidated interim financial statements of Icelandair Group hf. and its subsidiaries, which were twelve at the end of September 2007.

According to the income statement net profit for the period from 1 January to 30 September 2007 amounted to ISK 1,037 million. According to the balance sheet, equity at the end of the period amounted to ISK 25,662 million, including share capital in the amount of ISK 985 million.

On 18 September 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. Under the agreement Icelandair Group hf. will purchase 80-100% of the shares in two stages, 50% of the shares in 2007 and 30-50% during 2008. The operation of Travel Service will become part of Icelandair's Group in Q4 of 2007.

The Board of Directors and the CEO of Icelandair Group hf. hereby confirm the Company's consolidated interim financial statements for the period from 1 January to 30 September 2007 by means of their signatures.

Reykjavík, 13 November 2007.

Board of Directors:

Gunnlaugur M. Sigmundsson  
Ómar Benediktsson  
Ásgeir Baldursson  
Einar Sveinsson  
Finnur Reyr Stefánsson

CEO:

Jón Karl Ólafsson

# Independent Auditor's Review Report

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To the Board of Directors of Icelandair Group hf.

## Introduction

We have reviewed the accompanying condensed consolidated interim balance sheet of Icelandair Group hf. as of 30 September 2007 and the related statements of income, changes in equity and cash flows for the nine month period then ended and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with International Financial Reporting Standard IAS 34, *Interim Financial Reporting*. Our responsibility is to express a conclusion on this interim financial information based on our review.

We have also reviewed the pro forma interim 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 interim financial statements, which have been compiled on the basis described in note c to these consolidated interim 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 effected at the beginning of the year 2006.

## Scope of review

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

## Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying consolidated interim financial information does not give a true and fair view of the financial position of the entity as at 30 September 2007, and of its financial performance and its cash flows for the nine-month period then ended, in accordance with IAS 34, *Interim Financial Reporting*.

In our opinion, the pro forma interim financial information has been properly compiled on the basis stated in note c to these consolidated interim financial statements. Without qualifying our opinion, we draw attention to note c, which states that the pro forma interim 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, 13 November 2007.

**KPMG hf.**

Jón S. Helgason  
Sæmundur Valdimarsson

# Consolidated Income Statement

## for the period from 1 January to 30 September 2007

	Notes	2007 1.7.-30.9.	Pro forma 2006 1.7.-30.9.	2007 1.1.-30.9.	Pro forma 2006 1.1.-30.9.
<b>Operating income:</b>					
Transport revenue .....		11.994	12.480	27.995	27.648
Charter revenue .....		4.615	3.290	10.978	7.775
Other operating revenue .....		3.429	3.707	9.161	8.130
		20.038	19.477	48.134	43.553
<b>Operating expenses:</b>					
Salaries and other personnel expenses .....		4.672	4.721	14.603	13.008
Aircraft fuel .....		2.856	3.160	6.869	7.389
Aircraft and aircrew lease .....		2.832	1.460	6.684	3.588
Aircraft servicing, handling and communication .....		1.187	1.290	2.910	2.947
Aircraft maintenance expenses .....		1.239	862	3.102	2.365
Other operating expenses .....		3.531	3.563	9.004	8.536
		16.317	15.056	43.172	37.833
<b>Operating profit before depreciation and amortisation (EBITDA)</b> .....		3.721	4.421	4.962	5.720
Depreciation and amortisation .....		( 878)	( 684)	( 2.316)	( 2.000)
<b>Operating profit before net finance (costs) income (EBIT)</b> .....		2.843	3.737	2.646	3.720
Net finance (costs) income .....	2	( 372)	( 747)	( 1.573)	6
Share of profit of associates .....		48	24	175	91
<b>Profit before income tax</b> .....		2.519	3.014	1.248	3.817
Income tax .....		( 458)	( 507)	( 211)	( 652)
<b>Profit for the period</b> .....		2.061	2.507	1.037	3.165
<b>Attributable to:</b>					
Equity holders of the Company .....		2.055	2.507	1.027	3.165
Minority Interest .....		6	0	10	0
<b>Profit for the period</b> .....		2.061	2.507	1.037	3.165
<b>Earnings per share:</b>					
Basic earnings per share (ISK) .....		2,28	2,51	1,05	3,17
Diluted earnings per share (ISK) .....		2,28	2,51	1,05	3,17

# Consolidated Balance Sheet

## as at 30 September 2007

	Notes	30.9.2007	31.12.2006
<b>Assets:</b>			
Operating assets .....		22.353	22.935
Intangible assets .....		27.171	27.845
Investments in associates .....		1.933	2.058
Prepaid aircraft acquisitions .....		243	9.669
Long-term receivables and deposits .....		2.590	2.689
Total non-current assets		54.290	65.196
Inventories .....		1.181	1.131
Trade and other receivables .....		7.571	6.149
Receivables from sale of aircrafts .....	3	1.538	1.094
Operating assets held for sale .....		1.121	0
Prepayments .....		397	271
Cash and cash equivalents .....		3.762	2.776
Total current assets		15.570	11.421
<b>Total assets</b>		69.860	76.617
<b>Equity:</b>			
Share capital .....		985	1.000
Share premium .....		25.697	26.090
Reserves .....		( 1.555 )	( 584 )
Retained earnings (accumulated deficit) .....		483	( 544 )
Total equity attributable to equity holders of the Company		25.610	25.962
Minority interest .....		52	42
Total equity		25.662	26.004
<b>Liabilities:</b>			
Loans and borrowings .....		14.525	21.607
Deferred income tax liability .....		923	360
Total non-current liabilities		15.448	21.967
Loans and borrowings .....		9.810	4.614
Loans to finance prepaid aircraft acquisition .....		1.572	8.545
Trade and other payables .....		13.022	12.428
Deferred income .....		4.346	3.059
Total current liabilities		28.750	28.646
Total liabilities		44.198	50.613
<b>Total equity and liabilities</b>		69.860	76.617

# Consolidated Statement of Changes in Equity for the period from 1 January to 30 September 2007

## Attributable to equity holders of the Company

	Share capital	Share premium	Reserves			Retained earnings (accumulated deficit)	Total	Minority Interest	Total equity
			Share option reserve	Hedging reserve	Translation reserve				
Equity 1.1.2007 .....	1.000	26.090	0	( 159 )	( 425 )	( 544 )	25.962	42	26.004
Foreign currency translation differences for foreign operations .....					( 1.290 )		( 1.290 )		( 1.290 )
Net profit on hedge of net investment in foreign operation .....					10		10		10
Effective portion of changes in fair value of cash flow hedges, net of tax .....				161			161		161
Net income and expense recognised directly in equity .....				161	( 1.280 )	0	( 1.119 )	0	( 1.119 )
Profit for the period .....						1.027	1.027	10	1.037
Total recognised income (expense) .....				161	( 1.280 )	1.027	( 92 )	10	( 82 )
Own shares, change .....	( 15 )	( 393 )					( 408 )		( 408 )
Stock option expense .....			148				148		148
Equity 30.9.2007 .....	985	25.697	148	2	( 1.705 )	483	25.610	52	25.662

# Consolidated Statement of Cash Flows for the Nine Months Ended 30 September 2007

	Notes	2007 1.1.-30.9.	2006 1.1.-30.9.
<b>Cash flows from operating activities:</b>			
Profit for the period .....		1.037	3.165
Adjustments for:			
Depreciation and amortisation .....		2.316	2.000
Other operating items .....	6	( 1.299 )	( 50 )
Working capital from operations		2.054	5.115
Net change in operating assets and liabilities .....		1.870	1.278
Net cash from operating activities		3.924	6.393
<b>Cash flows from investing activities:</b>			
Acquisition of operating assets .....		( 5.024 )	( 4.247 )
Proceeds from the sale of operating assets .....		3.234	1.896
Acquisition of intangible assets .....		( 349 )	( 145 )
Acquisition of subsidiaries, net of cash acquired .....		0	4.571
Long-term receivables, increase .....		( 230 )	( 372 )
Net cash (used in) from investing activities		( 2.369 )	1.703
<b>Cash flows from financing activities:</b>			
Acquisition of own shares .....		( 409 )	0
Proceeds from borrowings .....		8.440	4.046
Repayment of long term borrowings .....		( 7.544 )	( 7.190 )
Repayment of short term borrowings .....		( 950 )	0
Net cash used in financing activities		( 463 )	( 3.144 )
<b>Increase in cash and cash equivalents .....</b>		1.092	4.952
<b>Effect of exchange rate fluctuations on cash held .....</b>		( 106 )	24
<b>Cash and cash equivalents at 1 January .....</b>		2.776	0
<b>Cash and cash equivalents at 30 September .....</b>		3.762	4.976
<b>Investment and financing without cash flow effect:</b>			
Receivables from sale of operating assets .....	3	1.538	0
Operating assets held for sale .....		1.121	0

# Notes

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## Significant accounting policies

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 Reykjavíkflugvöllur in Reykjavík, Iceland. The consolidated interim financial statements of the Company as at and for the nine-month period ended 30 September 2007 comprise the Company and its subsidiaries (together referred to as the "Group") and the Group's interests in associates. The Group's operations are in the airline transportation and tourism industry. The interim financial statements were authorised for issue by the board of directors on 13 November 2007.

### a. *Statement of compliance*

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standard IAS 34, *Interim Financial Reporting*. They do not include all of the information required for a complete set of consolidated annual financial statements, and should be read in conjunction with the consolidated financial statements of the Company as at and for the year ended 31 December 2006.

### b. *Basis of preparation*

The accounting policies and methods of computation applied by the Company in these condensed interim consolidated financial statements are the same as those applied by the Company in its consolidated financial statements as at and for the year ended 31 December 2006. The consolidated financial statements for the year ended 31 December 2006 are available at the Company's office and website, [www.icelandairgroup.is](http://www.icelandairgroup.is) and at The Icelandic Stock Exchange website, [www.omxgroup.com](http://www.omxgroup.com).

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

### c. *Pro forma information*

Compiled pro forma figures for the first nine months of the year 2006 are presented in the income statement and statement of cash flows. The pro forma figures consist of the consolidated interim income statement and statement of cash flows of the Group for the first nine months of the year 2006, as if the acquisition of Icelandair Group hf. had been effected at the beginning of the year 2006. For this purpose, the consolidated interim pro forma income statement and statement of cash flows of the Group for the first nine months of the year 2006 have been prepared in accordance with the accounting policies disclosed in these consolidated interim financial statements and are based on the compiled financial statements of all subsidiaries of Icelandair Group hf. for the first nine months of the year 2006.

### d. *Equity settled share-based payment transactions*

The Company issued share options to employees at the beginning of the year and adopted IFRS 2, Share-based Payment.

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.

## Notes, contd.:

### d. Contd.:

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.

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

## Segment reporting

### 1. Business segments for the period from 1 January to 30 September 2007:

	Scheduled airline operations	Global capacity and aircraft trading	Travel and tourism infrastructure	Shared services	Eliminations	Consolidated
Segment revenue .....	33.089	10.897	7.594	531	( 3.977 )	48.134
Segment EBITDAR .....	5.105	2.643	1.528	( 337 )		8.939
Segment EBITDA .....	2.719	1.429	1.151	( 337 )		4.962
Segment results .....	1.379	1.165	769	( 667 )		2.646
Net finance costs .....	( 315 )	( 250 )	( 46 )	( 962 )		( 1.573 )
Share of profit of associates .....	0	175	0	0		175
Income tax .....	( 176 )	( 237 )	( 131 )	333		( 211 )
Profit (loss) for the period .....	888	853	592	( 1.296 )		1.037
Segment assets .....	29.223	12.261	6.340	45.780	( 25.677 )	67.927
Investments in associates .....	3	1.913	17			1.933
Total assets .....	29.226	14.174	6.357	45.780	( 25.677 )	69.860
Segment liabilities .....	23.344	11.691	5.081	19.364	( 15.282 )	44.198
Capital expenditure .....	3.084	1.792	464	34		5.374
Depreciation .....	1.233	255	362	8		1.858
Amortisation of intangible assets .....	181	241	31	5		458

## Notes, contd.:

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### Finance income and finance expense

	2007	<b>Pro forma</b>
	1.1.-30.9.	1.1.-30.9.
2. Finance income and finance expense are specified as follows:		
Interest income on bank deposits .....	119	362
Other interest income .....	104	117
Net foreign exchange gain .....	26	596
Finance income total .....	<u>249</u>	<u>1.075</u>
Interest expense on loans and borrowings .....	1.720	1.011
Other interest expenses .....	102	58
Finance expense total .....	<u>1.822</u>	<u>1.069</u>
Net finance (costs) income .....	<u>( 1.573)</u>	<u>6</u>

### Receivables from sale of aircrafts

3. 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, two of them on a sale and leaseback contracts to 5 and 6 years. Those two aircrafts were purchased during the first 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 1,538 million at 30 September 2007 and will be paid before year end 2007.

### Equity

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

#### *Share premium*

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

#### *Share option reserve*

The reserve includes the accrued part of the fair value of share options. This reserve is reversed if share options are exercised or forfeited.

#### *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.

## Notes, contd.:

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### 4. Contd.:

#### *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.

## Group entities

5. The Company holds twelve subsidiaries at the end of the September 2007, but they were fourteen at year end 2006. On 1 January 2007, Icelandair Technical Services ehf. merged into Icelandair ehf. and Blue Cargo ehf. merged into Bluebird Cargo ehf. The subsidiaries, which are all included in the consolidated interim financial statements, are:

	Share
Scheduled airline operations:	
Icelandair ehf. ....	100%
Icelandair Cargo ehf. ....	100%
Icelandair Ground Services ehf. (IGS) ....	100%
Global capacity solutions and aircraft trading:	
Bluebird Cargo ehf. ....	100%
IceLease ehf. ....	100%
IG Invest ehf. ....	100%
Loftleiðir - Icelandic ehf. ....	100%
Travel and tourism infrastructure:	
Air Iceland ehf. ....	100%
Iceland Travel ehf. ....	100%
Icelandair Hotels ehf. ....	100%
Shared services:	
IceCap Ltd., Guernsey ....	100%
Icelandair Shared Services ehf. ....	100%

The subsidiaries own 19 subsidiaries that are all included in the consolidated interim financial statements.

## Statement of cash flows

	2007	2006
	1.1.-30.9.	1.1.-30.9.
6. Other operating items in the statement of cash flows are specified as follows:		
Gain on the sale of assets .....	( 1.193)	( 524)
Exchange rate difference and indexation of liabilities and assets .....	( 959)	( 134)
Share of profit of associates .....	( 175)	( 91)
Income tax .....	211	652
Stock option .....	148	0
Other items .....	669	47
Total other operating items in the statement of cash flows .....	<u>( 1.299)</u>	<u>( 50)</u>

## Notes, contd.:

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### Ratios

	30.9.2007	31.12.2006
7. The Group's primary ratios are specified as follows:		
Working capital ratio .....	0,54	0,40
Equity ratio .....	0,37	0,34
Intrinsic value of share capital .....	26,05	26,00

### Other

8. 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 entered in the interim financial statements.

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 company considers it more likely than not that the fine will be withdrawn.