

Icelandair Group hf.

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

ISK

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

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Endorsement and Signatures of the Board of Directors and the CEO

The condensed consolidated interim financial statements of Icelandair Group hf. for the period from 1 January to 30 June 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 June 2007.

According to the income statement net loss for the period from 1 January to 30 June 2007 amounted to ISK 1,024 million. According to the balance sheet, equity at the end of the period amounted to ISK 23,865 million, including share capital in the amount of ISK 985 million.

On 14 May the Company announced it had signed a letter of intent for 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 100% of the shares in two stages, 50% of the shares in 2007 and the remaining 50% during 2008. The signing of the final purchase agreement is planned late August 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 June 2007 by means of their signatures.

Reykjavík, 14 August 2007.

Board of Directors:

Finnur Ingólfsson
Ómar Benediktsson
Gunnlaugur M. Sigmundsson
Helgi S. Guðmundsson
Hermann S. Guðmundsson
Jóhann Magnússon
Martha Eiríksdóttir

CEO:

Jón Karl Ólafsson

Independent Auditor's Review Report

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 June 2007 and the related statements of income, changes in equity and cash flows for the six-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 June 2007, and of its financial performance and its cash flows for the six-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, 14 August 2007.

KPMG hf.

Consolidated Income Statement

for the period from 1 January to 30 June 2007

	Notes	2007 1.4.-30.6.	Pro forma 2006 1.4.-30.6.	2007 1.1.-30.6.	Pro forma 2006 1.1.-30.6.
Operating income:					
Transport revenue		9.686	9.613	16.001	15.168
Aircraft and aircrew lease		3.750	2.268	6.363	4.485
Other operating revenue		2.755	2.600	5.732	4.423
		<u>16.191</u>	<u>14.481</u>	<u>28.096</u>	<u>24.076</u>
Operating expenses:					
Salaries and other personnel expenses		5.329	4.447	9.931	8.287
Aircraft fuel		2.334	2.575	4.013	4.229
Aircraft and aircrew lease		2.416	1.253	3.852	2.128
Aircraft servicing, handling and communication		985	1.049	1.723	1.657
Aircraft maintenance expenses		836	808	1.863	1.503
Other operating expenses		2.969	2.785	5.473	4.973
		<u>14.869</u>	<u>12.917</u>	<u>26.855</u>	<u>22.777</u>
Operating profit before depreciation (EBITDA)		1.322	1.564	1.241	1.299
Depreciation and amortisation		(686)	(449)	(1.438)	(1.316)
Operating profit (loss) before net finance (costs) income (EBIT)		636	1.115	(197)	(17)
Net finance (costs) income	2	(432)	347	(1.201)	753
Share of profit of associates		66	58	127	67
Profit (loss) before income tax		270	1.520	(1.271)	803
Income tax		(65)	(274)	247	(145)
Profit (loss) for the period		<u>205</u>	<u>1.246</u>	<u>(1.024)</u>	<u>658</u>
Attributable to:					
Equity holders of the Company		202	1.246	(1.028)	658
Minority Interest		3	0	4	0
Profit (loss) for the period		<u>205</u>	<u>1.246</u>	<u>(1.024)</u>	<u>658</u>
Earnings per share:					
Basic earnings per share (ISK)		0,20	1,25	(1,03)	0,66
Diluted earnings per share (ISK)		0,20	1,25	(1,03)	0,66

Consolidated Balance Sheet

as at 30 June 2007

	Notes	30.6.2007	31.12.2006
Assets:			
Operating assets		21.478	22.935
Intangible assets		27.289	27.845
Investments in associates		2.169	2.058
Prepaid aircraft acquisitions		257	9.669
Long-term receivables and deposits		2.703	2.689
Total non-current assets		53.896	65.196
Inventories		1.130	1.131
Trade and other receivables		7.928	6.149
Receivables from sale of aircrafts	3	3.995	1.094
Prepayments		463	271
Cash and cash equivalents		4.186	2.776
Total current assets		17.702	11.421
Total assets		71.598	76.617
Equity:			
Share capital		985	1.000
Share premium		25.697	26.090
Reserves		(1.291)	(584)
Accumulated deficit		(1.572)	(544)
Total equity attributable to equity holders of the Company		23.819	25.962
Minority interest		46	42
Total equity		23.865	26.004
Liabilities:			
Loans and borrowings		16.290	21.607
Deferred income tax liability		584	360
Total non-current liabilities		16.874	21.967
Loans and borrowings		7.748	4.614
Loans to finance prepaid aircraft acquisition		2.848	8.545
Trade and other payables		12.585	12.428
Deferred income		7.678	3.059
Total current liabilities		30.859	28.646
Total liabilities		47.733	50.613
Total equity and liabilities		71.598	76.617

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

Attributable to equity holders of the Company

	Reserves						Total	Minority Interest	Total equity
	Share capital	Share premium	Share option reserve	Hedging reserve	Translation reserve	Accumulated deficit			
Equity 1.1.2007	1.000	26.090	0	(159)	(425)	(544)	25.962	42	26.004
Foreign currency translation differences for foreign operations					(1.215)		(1.215)		(1.215)
Net profit on hedge of net investment in foreign operation					15		15		15
Effective portion of changes in fair value of cash flow hedges, net of tax				394			394		394
Net income and expense recognised directly in equity				394	(1.200)		(806)	0	(806)
Loss for the period						(1.028)	(1.028)	4	(1.024)
Total recognised income (expense)				394	(1.200)	(1.028)	(1.834)	4	(1.830)
Own shares, change	(15)	(393)					(408)		(408)
Stock option expense			99				99		99
Equity 30.6.2007	985	25.697	99	235	(1.625)	(1.572)	23.819	46	23.865

Consolidated Statement of Cash Flows for the Six Months Ended 30 June 2007

	Notes	2007 1.1.-30.6.	2006 1.1.-30.6.
Cash flows from operating activities:			
(Loss) profit for the period .....	(	1.024)	724
Adjustments for:			
Depreciation		1.438	1.316
Other operating items	6	(2.095)	(662)
Working capital (used in) from operations		(1.681)	1.378
Net change in operating assets and liabilities		5.266	2.479
Net cash from operating activities		3.585	3.857
Cash flows from investing activities:			
Acquisition of operating assets .....	(	3.591)	(1.931)
Proceeds from the sale of operating assets		2.972	1.906
Acquisition of intangible assets .....	(	344)	(67)
Acquisition of subsidiaries, net of cash acquired		0	5.023
Long-term receivables, increase .....	(	307)	(276)
Net cash (used in) from investing activities		(1.270)	4.655
Cash flows from financing activities:			
Acquisition of own shares .....	(	409)	0
Proceeds from borrowings		8.440	0
Repayment of long term borrowings .....	(	6.887)	(1.284)
Repayment of short term borrowings .....	(	1.945)	0
Net cash used in financing activities		(801)	(1.284)
Increase in cash and cash equivalents		1.514	7.228
Effect of exchange rate fluctuations on cash held .....	(	104)	178
Cash and cash equivalents at 1 January		2.776	0
Cash and cash equivalents at 30 June		4.186	7.406
Investment and financing without cash flow effect:			
Receivables from sale of operating assets	3	3.995	0

Notes

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 Reykjavíkurlugvöllur in Reykjavík, Iceland. The consolidated interim financial statements of the Company as at and for the six-month period ended 30 June 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 14 August 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 and at The Icelandic Stock Exchange website, 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 six 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 six 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 six 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 six 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 June 2007:

	Scheduled airline operations	Global capacity and aircraft trading	Travel and tourism infrastructure	Shared services	Eliminations	Consolidated
Segment revenue	19.639	6.663	3.937	334	(2.477)	28.096
Segment EBITDAR	1.772	1.675	459	(255)		3.651
Segment EBITDA	252	1.025	219	(255)		1.241
Segment results	(574)	872	(26)	(469)		(197)
Net finance costs	(400)	(190)	22	(633)		(1.201)
Share of profit of						
associates	0	127	0	0		127
Income tax	174	(145)	0	218		247
(Loss) profit for the period	(800)	664	(4)	(884)		(1.024)
Segment assets	31.197	12.452	5.899	42.652	(22.771)	69.429
Investments in						
associates	3	2.149	17			2.169
Total assets	31.200	14.601	5.916	42.652	(22.771)	71.598
Segment liabilities	26.861	12.286	5.237	18.088	(14.739)	47.733
Capital expenditure	2.218	1.353	341	23		3.935
Depreciation	756	147	227	4		1.134
Amortisation of intangible assets	127	148	26	3		304

Notes, contd.:

Finance income and finance expense

	2007	Pro forma 2006
	1.1.-30.6.	1.1.-30.6.
2. Finance income and finance expense are specified as follows:		
Interest income on bank deposits	61	261
Other interest income	61	90
Net foreign exchange gain	0	1.112
Finance income total	<u>122</u>	<u>1.463</u>
Interest expense on loans and borrowings	1.220	683
Other interest expenses	77	27
Net foreign exchange loss	26	0
Finance expense total	<u>1.323</u>	<u>710</u>
Net finance (costs) income	<u>(1.201)</u>	<u>753</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 3,995 million at 30 June 2007 and will be paid during the year.

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.:

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 June 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.-30.6.	1.1.-30.6.
6. Other operating items in the statement of cash flows are specified as follows:		
Gain on the sale of assets	(1.260)	(458)
Exchange rate difference and indexation of liabilities and assets	(1.002)	(327)
Share of profit of associates	(127)	(67)
Income tax	(247)	159
Other items	541	31
Total other operating items in the statement of cash flows	<u>(2.095)</u>	<u>(662)</u>

Notes, contd.:

Ratios

	30.6.2007	31.12.2006
7. The Group's primary ratios are specified as follows:		
Working capital ratio	0,57	0,40
Equity ratio	0,33	0,34
Intrinsic value of share capital	24,23	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.
Nothing new has taken place regarding the penalty on Icelandair Ground Services ehf. disclosed in the financial statement for 2006.