# Icelandair Group hf.

## Consolidated Financial Statements for the year 2016

## USD

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

# Contents

# Endorsement and Statement by the Board of Directors and the CEO

## Operations in the year 2016

The financial statements comprise the consolidated financial statements of Icelandair Group hf. (the "Company") and its subsidiaries together referred to as the "Group". The Group operates in the airline and tourism sectors with Iceland as a cornerstone of an international route network.

Profit for the year 2016 amounted to USD 89.1 million and total comprehensive income amounted to USD 138.7 million according to the consolidated statement of comprehensive income. Total equity at year end 2016 amounted to USD 568.2 million, including share capital of USD 40.6 million, according to the consolidated statement of financial postition. Reference is made to the consolidated statement of changes in equity regarding information on changes in equity during the year.

The Board of Directors proposes a dividend payment to shareholders in 2017 of ISK 565 million, equal to USD 5.0 million, which represents 6% of profit for the year 2016.

## Share capital and Articles of Association

The nominal value of the Company's issued share capital amounted to ISK 5.0 billion at year-end, of which the Company held treasury shares of ISK 25.0 million. The share capital is divided into shares of ISK 1, each with equal rights within a single class of shares listed on the Icelandic Stock Exchange (Nasdaq OMX Iceland). Companies can aquire and hold up to 10% of the nominal value of treasury shares according to the Icelandic Company's Act.

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

The number of shareholders at year end 2016 was 2,559, an increase of 173 during the year. At year end 2016 the 10 largest shareholders were:

| Name | Shares in ISK thousand | Shares in % |
|---|---|---|
| Lífeyrissjóður verslunarmanna ................................................................ | 734.361 | 14,69 |
| Stefnir Sjóðir ............................................................................................ | 721.463 | 14,43 |
| Lífeyrissjóður starfsmanna ríkisins A deild og B deild .............................. | 466.040 | 9,32 |
| Gildi - lífeyrissjóður ................................................................................. | 369.261 | 7,39 |
| Landsbréf - Úrvalsbréf ............................................................................. | 188.237 | 3,76 |
| Birta lífeyrissjóður ................................................................................... | 184.553 | 3,69 |
| Stapi lífeyrissjóður ................................................................................... | 171.154 | 3,42 |
| Sameinaði lífeyrissjóðurinn ...................................................................... | 145.102 | 2,90 |
| Brú - Lífeyrissjóður starfsmanna sveitarfélaga ......................................... | 126.218 | 2,52 |
| Söfnunarsjóður lífeyrisréttinda ................................................................. | 102.106 | 2,04 |
| | 3.208.495 | 64,17 |
| Other shareholders ................................................................................... | 1.766.045 | 35,32 |
| Treasury shares ........................................................................................ | 25.460 | 0,51 |
| Total issued shares .................................................................................. | 5.000.000 | 100,00 |

Further information on matters related to share capital is disclosed in note 27. Additional information on shareholders is provided on the Company's website www.icelandairgroup.com.

# Endorsement and statement by the Board of Directors and the CEO, continued:

### Corporate Governance

The Group's management is of the opinion that practicing good Corporate Governance is vital for the existence of the Group and in the best interests of the shareholders, Group companies, employees and other stakeholders and will in the long run produce satisfactory returns on shareholders' investment. Corporate Governance exercised within Icelandair Group hf. ensures sound and effective control of the Company´s affairs and a high level of business ethics.

The framework for Corporate Governance practices within the Group consists of the provisions of law, the parent company's Articles of Association, general securities regulations and the Icelandic Corporate Governance guidelines issued by the Iceland Chamber of Commerce, Nasdaq OMX Iceland and the Confederations of Icelandic Employers. Corporate Governance practices ensure open and transparent relationships between the Company´s management, its Board of Directors, its shareholders and other stakeholders.

The Board of Directors has prepared a Corporate Governance Statement in compliance with the Icelandic Corporate Governance guidelines which are described in full in the Corporate Governance Statement in the consolidated financial statements. It is the opinion of the Board of Directors that Icelandair Group hf. complies with the Icelandic guidelines for Corporate Governance.

Information on matters related to financial risk management is disclosed in note 33.

### Non-Financial Reporting

The Company is a large public-interest entity. According to changes made to the Icelandic Financial Statements Act in June 2016 such companies should disclose in their management report relevant and useful information on their policies, main risks and outcomes relating to at least environmental matters, social and employee aspects, respect for human rights, anticorruption and birbery issues in addition to a short description of the Company's business model. The Company's policies and outcome of these matters are further discussed in an the Non-Financial Reporting in the consolidated finanical statements.

### Statement by the Board of Directors and the CEO

The consolidated financial statements for the year ended 31 December 2016 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional Icelandic disclosure requirements for financial statements of listed companies.

According to our best knowledge it is our opinion that the annual consolidated financial statements give a true and fair view of the consolidated financial performance of the Company for the year 2016, its assets, liabilities and consolidated financial position as at 31 December 2016 and its consolidated cash flows for the year 2016.

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

The Board of Directors and the CEO have today discussed the consolidated financial statements of Icelandair Group hf. for the year 2016 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the consolidated financial statements will be approved at the annual general meeting of Icelandair Group hf.

Reykjavík, 7 February 2017.
Board of Directors:

Sigurður Helgason, Chairman of the Board
Magnús Magnússon
Katrín Olga Jóhannesdóttir
Ásthildur Margrét Otharsdóttir
Úlfar Steindórsson

CEO:

Björgólfur Jóhannsson

# Independent Auditors' Report

To the board of directors and shareholders of Icelandair Group hf.

## Report on the audit of the Consolidated Financial Statements

### Opinion

We have audited the consolidated financial statements of Icelandair Group hf. (the Group), which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the Code of ethics for Icelandic auditors, which are based on the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have also fulfilled other ethical requirements of that rules. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

| Key audit matter | How our audit responded to the key audit matter |
|---|---|
| **Timing and accuracy of revenue recognition of passenger income**<br><br>*Reference is made to note 7 "Operating income" and 32 "Deferred income".*<br><br>Passenger ticket sale is presented as deferred income in the consolidated statement of financial position until transportation has been provided. Then the sale is recognized as revenue. Large volume of transactions flow through various computer systems from the date of sale until the revenue is recognized in the consolidated statement of profit or loss.<br><br>The recording process is complex which gives rise to an inherent risk of errors, in determining the amount and timing of the revenue recognition. Timing and accuracy in the registration of passenger income is therefore one of the key audit matters of our audit of the consolidated financial statements. | Our audit procedures were designed to challenge the accuracy of the revenue recognition. These procedures included testing of controls over the group's systems which govern the passenger ticket sale. We used the service of our IT specialists to test the appropriate controls such as access control, change management control and automated controls of the revenue systems. We also tested non-automated controls. The purpose of the testing was to assess if the design of controls was likely to ensure the accuracy and timing of the revenue recognition of passenger income and to test operating effectiveness of controls and as such evaluated the management monitoring of controls.<br><br>We analysed passenger revenue and used external and internal information to set expectations which were compared to recognized revenue.<br><br>We used substantive testing where we tested reconciliations between systems and revenue cut offs. |

# Independent Auditors' Report continued:

| Key audit matter | How our audit responded to the key audit matter |
|---|---|
| **Expected recoverable amount of intangible assets and goodwill**<br><br>*Reference is made to note 16 "Intangible assets and goodwill" and 44h "Impairment".*<br><br>The carrying value of goodwill amounted to USD 139 m. and other intangible assets were USD 35.7 m. at year end 2016 as specified in note 16.<br><br>The carrying value of intangible assets has been allocated to the applicable cash generating units within the Group. Management is required to perform an impairment test annually on goodwill and other intangible assets with indefinite useful lives. The purpose of an impairment test is to determine if goodwill and other intangible assets can be recovered through future cash flows.<br><br>The recoverable amounts of individual cash generating units are determined by discounting the expected future cash flows generated from the continuing use of the units.<br><br>The expected recoverable amount of intangible assets is one of the key audit matters due to the significance to the Group's consolidated statement of financial position, and due to inherent uncertainty involved in forecasting and discounting future cash flows which are the basis of the assessment of the recoverability of the intangible assets. | We used the service of our valuation specialists to assess the valuation models and assumptions used by management in their calculations of expected recoverable amount of each cash generating unit.<br><br>We assessed the management assumptions by comparing them to both internal and external industry information.<br><br>Our procedures included among others:<br><br>- Management forecasts for each cash generating unit for the explicit period were compared to forecasts presented to the Board, historic revenue amounts, growth rates and historic industry statistics. Forecasts from prior periods were also compared to actual results to test its accuracy.<br><br>- Assessing the reasonableness of management forecasts of the long term growth rate.<br><br>- Assessing the reasonableness of management forecasts for changes in margins, new investments, utilization and changes in pricing.<br><br>- Assessing the reasonableness of the discount rates applied by comparing them to current finance cost and market conditions for the cash generating units.<br><br>- Review of information in the notes to the financial statements to confirm that all information required by applicable accounting policies were provided. |

## Other information

The Board of Directors and CEO are responsible for other information. The other information comprises the information included in the annual report, but does not include the consolidated financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

The Annual Report is expected to be made available to us after the date of this auditor's report. In connection with our audit of the consolidated financial statements, our responsibility is to read the Annual Report when it becomes available and consider whether the other information it contains is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report such matters.

# Independent Auditors' Report continued:

**Responsibilities of the Board of Directors and the CEO for the Consolidated Financial Statements**

The Board of Directors and the CEO are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as they determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Board of Directors and the CEO are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the management either intends to liquidate the Group or cease operations, or have no realistic alternative but to do so.

The Board of Directors and CEO are responsible for overseeing the Group's financial reporting process.

**Auditors' Responsibilities for the Audit of the Consolidated Financial Statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain understanding of internal control relevant to the audit 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 Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group´s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

# Independent Auditors' Report continued:

We communicate with the Board of Directors and the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Board of Directors and the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and were applicable, related safeguards.

From the matters communicated with The Board of Directors and the Audit Committee, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor’s report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

## Report on the endorsement and statement by the Board of Directors and the CEO

Pursuant to the legal requirement under Article 104, Paragraph 2 of the Icelandic Financial Statements Act no. 3/2006, we confirm that, to the best of our knowledge, the statement by the Board of Directors and the CEO accompanying the consolidated financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the consolidated financial statements.

Alexander G. Edvardsson and Auður Thorisdottir, auditors, are responsible for the audit of the financial statements and this auditor’s report.

Reykjavik, 7 February 2017.

***KPMG ehf.***

Alexander G. Eðvardsson
Auður Þórisdóttir

# Consolidated statement of profit or loss and other comprehensive income for the year 2016

| | Notes | 2016 | 2015 *Restated |
|---|---|---|---|
| **Operating income** | | | |
| Transport revenue | 7 | 947.823 | 848.868 |
| Aircraft and aircrew lease | | 84.574 | 83.356 |
| Other operating revenue | 7 | 253.177 | 207.475 |
| | | 1.285.574 | 1.139.699 |
| **Operating expenses** | | | |
| Salaries and other personnel expenses | 8 | 354.253 | 278.015 |
| Aviation expenses | 8 | 420.250 | 401.194 |
| Other operating expenses | 8 | 291.226 | 233.824 |
| | | 1.065.729 | 913.033 |
| **Operating profit before depreciation and amortisation (EBITDA)** | | 219.845 | 226.666 |
| Depreciation and amortisation | 10 | ( 101.408) | ( 83.826) |
| **Operating profit (EBIT)** | | 118.437 | 142.840 |
| Finance income | | 6.414 | 5.134 |
| Finance costs | | ( 5.697) | ( 8.210) |
| **Net finance income (costs)** | 11 | 717 | ( 3.076) |
| Share of profit of associates | 18 | 957 | 459 |
| **Profit before tax** | | 120.111 | 140.223 |
| Income tax | 21 | ( 31.043) | ( 29.000) |
| **Profit for the year** | | 89.068 | 111.223 |
| **Other comprehensive income** | | | |
| **Items that are or may be reclassified to profit or loss** | | | |
| Currency translation differences | | 9.100 | ( 1.686) |
| Effective portion of changes in fair value of cash flow hedge, net of tax | | 40.482 | ( 118) |
| **Other comprehensive income (loss) for the year** | | 49.582 | ( 1.804) |
| **Total comprehensive income for the year** | | 138.650 | 109.419 |
| Owners of the Company | | 88.820 | 111.318 |
| Non-controlling interests | | 248 | ( 95) |
| **Profit for the year** | | 89.068 | 111.223 |
| **Total Comprehensive income attributable to:** | | | |
| Owners of the Company | | 138.367 | 109.523 |
| Non-controlling interests | | 283 | ( 104) |
| **Total comprehensive income for the year** | | 138.650 | 109.419 |
| **Earnings per share:** | | | |
| Basic earnings per share in US cent per share | 28 | 1,79 | 2,24 |
| Diluted earnings per share in US cent per share | 28 | 1,79 | 2,24 |

* See note 4

The notes on pages 13 to 51 are an integral part of these consolidated financial statements.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 9 *Amounts are in USD thousand*

# Consolidated Statement of Financial Position as at 31 December 2016

| | Notes | 2016 | 2015 |
|---|---|---|---|
| **Assets:** | | | |
| Operating assets | 13-16 | 602.615 | 419.071 |
| Intangible assets and goodwill | 17-18 | 174.704 | 172.694 |
| Investments in associates | 18 | 23.497 | 18.223 |
| Deferred cost | 19 | 63 | 118 |
| Receivables and deposits | 20 | 74.098 | 27.474 |
| Non-current assets | | 874.977 | 637.580 |
| Inventories | 22 | 23.963 | 19.205 |
| Trade and other receivables | 23 | 139.280 | 101.075 |
| Assets held for sale | 24 | 4.148 | 0 |
| Short term investments | 25 | 23.236 | 19.533 |
| Cash and cash equivalents | 26 | 226.889 | 194.586 |
| Current assets | | 417.516 | 334.399 |
| **Total assets** | | 1.292.493 | 971.979 |
| **Equity:** | | | |
| Share capital | | 40.576 | 40.576 |
| Share premium | | 154.705 | 154.705 |
| Reserves | | 114.849 | 1.400 |
| Retained earnings | | 257.696 | 259.746 |
| Equity attributable to equity holders of the Company | 27 | 567.826 | 456.427 |
| Non-controlling interests | | 387 | 104 |
| Total equity | | 568.213 | 456.531 |
| **Liabilities:** | | | |
| Loans and borrowings | 29 | 196.722 | 55.387 |
| Payables | 30 | 13.289 | 8.644 |
| Deferred tax liabilities | 21 | 58.179 | 35.485 |
| Non-current liabilities | | 268.190 | 99.516 |
| Loans and borrowings | 29 | 45.660 | 10.143 |
| Trade and other payables | 31 | 210.543 | 219.680 |
| Deferred income | 32 | 199.887 | 186.109 |
| Current liabilities | | 456.090 | 415.932 |
| Total liabilities | | 724.280 | 515.448 |
| **Total equity and liabilities** | | 1.292.493 | 971.979 |

The notes on pages 13 to 51 are an integral part of these consolidated financial statements.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 10 *Amounts are in USD thousand*

# Consolidated Statement of Changes in Equity for the year 2016

| | Attributable to equity holders of the Company | | | | | | |
|---|---|---|---|---|---|---|---|
| **2015** | **Share capital** | **Share premium** | **Reserves** | **Retained earnings** | **Total** | **Non-con-trolling interest** | **Total equity** |
| Balance at 1 January 2015 ................ | 40.576 | 154.705 | 3.195 | 166.371 | 364.847 | 208 | 365.055 |
| Total comprehensive income ............. | | | ( 1.795 ) | 111.318 | 109.523 | ( 104 ) | 109.419 |
| Dividend (0.38 USD cent per share) ... | | | | ( 17.943 ) | ( 17.943 ) | | ( 17.943 ) |
| Balance at 31 December 2015 .......... | 40.576 | 154.705 | 1.400 | 259.746 | 456.427 | 104 | 456.531 |
| | | | | | | | |
| **2016** | | | | | | | |
| Balance at 1 January 2016 ................ | 40.576 | 154.705 | 1.400 | 259.746 | 456.427 | 104 | 456.531 |
| Total comprehensive income ............. | | | 49.547 | 88.820 | 138.367 | 283 | 138.650 |
| Profit of subsidiaries in excess of dividend received ...................... | | | 63.902 | ( 63.902 ) | | | |
| Dividend (0.54 US cent per share) ..... | | | | ( 26.968 ) | ( 26.968 ) | | ( 26.968 ) |
| Balance at 31 December 2016 .......... | 40.576 | 154.705 | 114.849 | 257.696 | 567.826 | 387 | 568.213 |

Information on changes in other reserves is provided in note 27.

The notes on pages 13 to 51 are an integral part of these consolidated financial statements.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 11 *Amounts are in USD thousand*

# Consolidated Statement of Cash Flows for the year 2016

| | Notes | 2016 | 2015 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Profit for the year | | 89.068 | 111.223 |
| Adjustments for: | | | |
| Depreciation and amortisation | 10 | 101.408 | 83.826 |
| Other operating items | 43 | 20.325 | 16.211 |
| Working capital from operations | | 210.801 | 211.260 |
| Net change in operating assets and liabilities | 44 | ( 1.777 ) | 33.876 |
| Net cash from operating activities | | 209.024 | 245.136 |
| **Cash flows to investing activities:** | | | |
| Acquisition of operating assets | 12 | ( 231.117 ) | ( 182.574 ) |
| Proceeds from sale of operating assets | | 1.160 | 2.528 |
| Acquisition of intangible assets | 16 | ( 1.603 ) | ( 1.073 ) |
| Deferred cost, change | | ( 10.677 ) | ( 26.753 ) |
| Investment in subsidiaries and associates | | ( 5.994 ) | ( 15.552 ) |
| Non-current receivables, change | | ( 39.852 ) | ( 7.882 ) |
| Short term investments, change | | ( 3.676 ) | 11.364 |
| Net cash used in investing activities | | ( 291.759 ) | ( 219.942 ) |
| **Cash flows to financing activities:** | | | |
| Dividend paid | 27 | ( 26.968 ) | ( 17.943 ) |
| Proceeds from non-current borrowings | | 150.700 | 23.660 |
| Repayment of non-current borrowings | | ( 10.089 ) | ( 20.037 ) |
| Net cash from (used in) financing activities | | 113.643 | ( 14.320 ) |
| **Increase in cash and cash equivalents** | | 30.908 | 10.874 |
| **Effect of exchange rate fluctuations on cash held** | | 1.395 | ( 1.050 ) |
| **Cash and cash equivalents at beginning of the year** | | 194.586 | 184.762 |
| **Cash and cash equivalents at 31 December** | 26 | 226.889 | 194.586 |

Information on interest paid and received is provided in note 44.

The notes on pages 13 to 51 are an integral part of these consolidated financial statements.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 12 *Amounts are in USD thousand*

# Notes

### 1. Reporting entity

Icelandair Group hf. (the "Company") is a public limited liability company incorporated and domiciled in Iceland. The address of the Company´s registered office is at Reykjavíkurflugvöllur in Reykjavík, Iceland. The consolidated financial statements of the Company as at and for the year ended 31 December 2016 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 primarily operates in the airline and tourism industry. The Company is listed on the Nasdaq OMX Iceland.

### 2. Basis of preparation

#### a. Statement of compliance

The Group's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional Icelandic disclosure requirements for consolidated financial statements of listed companies. They were authorised for issue by the Company's board of directors on 7 February 2017.

#### b. Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except that derivative financial instruments and certain short-term investments are stated at their fair values.

Details of the Group's accounting policies, including changes during the year, are included in Note 44.

### 3. Functional and presentation currency

The Company's functional currency is U.S. dollars (USD). These Consolidated Financial Statements are presented in U.S dollars (USD), except for information in note 39 on salaries and benefits of management for their service to Group companies. Payments to management are denominated and presented in ISK.  All financial information presented in USD has been rounded to the nearest thousand, unless otherwise indicated.

### 4. Changes in presentation

*Hedge accounting*

The Group has changed it's presentation of realized currency translation difference of cash flow hedges in the Statement of comprehensive income. After the change the currency difference is presented in the Statement of Comprehensive income within the same line item as the hedged item is presented. Previously all currency differences on hedges were presented among finance income and expenses. The change had following effects on comparitive numbers:

| | 2015 Original | Change | 2015 Restated |
|---|---|---|---|
| Salaries and other personnel expenses .......................................... | 280.244 | 2.229 | 278.015 |
| Aviation expenses .......................................................................... | 406.649 | 5.455 | 401.194 |
| Net finance income (costs) ............................................................. | 4.608 | ( 7.684 ) | ( 3.076 ) |

*Consolidated Financial Statements of Icelandair Group hf. 2016* 13 *Amounts are in USD thousand*

## 5. Use of estimates and judgements

In preparing these consolidated financial statements, management has made judgements, estimates and assumptions that affect the application of the Group's accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively.

### Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ending 31 December 2016 is included in the following notes:

Note 17 - measurement of the recoverable amounts of cash-generating units;
Note 32 - deferred income;
Note 34 - provisions and valuation of financial instruments;
Note 40 - reassessment of taxes;

### Measurement of fair values

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

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

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

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

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

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

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

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

Note 25 - short term investments;
Note 32 - deferred income;
Note 34 - derivatives;
Note 34 - non-derivative financial liabilities.

## 6. Operating segments

Segment information is presented in the consolidated financial statements in respect of the Group's business segments, which are the primary basis of segment reporting. The business segment reporting format reflects the Group's management and internal reporting structure and is divided into two segments; Route network and Tourism services.

Inter-segment pricing is determined on an arm's length basis.

Segment results include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

*Route network*

The primary business strategy of the Route Network is to operate flights based on the Hub and Spoke concept between Europe and North America via Iceland, leveraging Iceland’s geographical position. Icelandair’s Hub and Spoke System is able to maximize flights to and from North America arriving in Iceland with easy connections to Scandinavia, the UK and Continental Europe. This successful strategy of combining passengers visiting and departing Iceland, with passengers travelling across the Atlantic (via Iceland) has allowed Icelandair to constantly grow and expand its route network over the last years.

Icelandair Cargo sells and markets the cargo space capacity of Icelandair's aircraft in the route network and in addition operates two dedicated freighters servicing the imports and exports market to and from Iceland. Loftleidir Icelandic leases and services aircraft to international clients. The aircraft is usually operated under the Icelandair Air Operator Certificate (AOC) and Icelandair Technical Services provides the maintenance service for Loftleidir’s clients. Air Iceland is the regional airline that operates scheduled flights within Iceland and to Greenland.

*Tourism services*

The focus of the tourist services business segment is on catering to the growing demand for universal tourist services in Iceland. The segment comprises a wide array of the tourism value chain offering a wide collection of hotel brands and a full service tour operator. Icelandair Hotels is the Company’s hotel chain offering four hotel brands through different geographies in Iceland. Iceland Travel is the Company’s tour operator and destination manager focusing on offering top quality services to individuals and companies alike.

*Shared services*

Shared services companies mainly provide services to other Group Companies and partly to third party. Services provided include accounting, HR, treasury and credit management, ground handling, cargo warehousing, insurance and legal services. Shared services also provides financing through internal treasury system and owned real estate is leased to Group Companies.

### Geographic information

The geographic information analyses the Group´s revenue as the majority of the Group’s clients are outside of Iceland. The vast majority of the Group´s non-current assets are located in Iceland. In presenting the following information the Group’s revenues have been based on geographic location of customers:

| | 2016 | 2015 |
|---|---|---|
| *Revenues* | | |
| North America | 37% | 37% |
| Iceland | 25% | 24% |
| West Continental Europe | 14% | 14% |
| Scandinavia | 8% | 9% |
| United Kingdom | 7% | 7% |
| Other | 10% | 9% |
| Total revenues | 100% | 100% |

Consolidated Financial Statements of Icelandair Group hf. 2016 15 Amounts are in USD thousand

**6.** contd.:

### Information on reportable segments

| 2016 | Route network | Tourism services | Shared services | Total |
|---|---|---|---|---|
| External revenue | 1.106.517 | 162.488 | 16.569 | 1.285.574 |
| Inter-segment revenue | 99.013 | 12.854 | 74.527 | 186.394 |
| Segment revenue | 1.205.530 | 175.342 | 91.096 | 1.471.968 |
| | | | | |
| Segment EBITDAR* | 224.921 | 22.881 | 7.158 | 254.960 |
| Operating lease expenses | ( 22.581 ) | ( 12.054 ) | ( 480 ) | ( 35.115 ) |
| Segment EBITDA | 202.340 | 10.827 | 6.678 | 219.845 |
| | | | | |
| Finance income | 15.623 | 238 | 8.818 | 24.679 |
| Finance costs | ( 4.161 ) | ( 2.950 ) | ( 16.851 ) | ( 23.962 ) |
| Depreciation and amortisation | ( 92.743 ) | ( 3.874 ) | ( 4.791 ) | ( 101.408 ) |
| Share of profit of equity accounted investees | 32 | 172 | 753 | 957 |
| | | | | |
| Reportable segment profit (loss) before tax | 121.091 | 4.413 | ( 5.393 ) | 120.111 |
| | | | | |
| Reportable segment assets | 897.597 | 53.590 | 982.181 | 1.933.368 |
| Investment in associates | 227 | 714 | 22.556 | 23.497 |
| Capital expenditure | 195.464 | 8.971 | 38.962 | 243.397 |
| Reportable segment liabilities | 549.153 | 40.424 | 401.015 | 990.592 |

| 2015 | Route network | Tourism services | Shared services | Total |
|---|---|---|---|---|
| External revenue | 1.004.344 | 125.204 | 10.151 | 1.139.699 |
| Inter-segment revenue | 89.237 | 8.679 | 53.660 | 151.576 |
| Segment revenue | 1.093.581 | 133.883 | 63.811 | 1.291.275 |
| | | | | |
| Segment EBITDAR* | 243.028 | 16.897 | 1.785 | 261.710 |
| Operating lease expenses | ( 23.934 ) | ( 10.587 ) | ( 523 ) | ( 35.044 ) |
| Segment EBITDA | 219.094 | 6.310 | 1.262 | 226.666 |
| | | | | |
| Finance income | 3.572 | 91 | 5.884 | 9.547 |
| Finance costs | ( 7.666 ) | ( 1.172 ) | ( 3.785 ) | ( 12.623 ) |
| Depreciation and amortisation | ( 79.317 ) | ( 2.777 ) | ( 1.732 ) | ( 83.826 ) |
| Share of profit of equity accounted investees | 19 | 18 | 422 | 459 |
| | | | | |
| Reportable segment profit before tax | 135.702 | 2.470 | 2.051 | 140.223 |
| | | | | |
| Reportable segment assets | 756.443 | 38.516 | 592.685 | 1.387.644 |
| Investment in associates | 167 | 466 | 17.589 | 18.222 |
| Capital expenditure | 197.534 | 8.445 | 4.421 | 210.400 |
| Reportable segment liabilities | 509.136 | 27.349 | 126.125 | 662.610 |

*EBITDAR means EBITDA before operating lease expenses.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 16 *Amounts are in USD thousand*

**6.** contd.:

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

| | 2016 | 2015 |
|---|---|---|
| **Revenue** | | |
| Total revenue for reportable segments | 1.471.968 | 1.291.275 |
| Elimination of inter-segment revenue | ( 186.394 ) | ( 151.576 ) |
| Consolidated revenue | 1.285.574 | 1.139.699 |
| **Profit or loss** | | |
| Total profit of reportable segments | 120.111 | 140.223 |
| Consolidated continuing profit before tax | 120.111 | 140.223 |
| **Assets** | | |
| Total assets for reportable segments | 1.933.368 | 1.387.644 |
| Investments in associates | 23.497 | 18.222 |
| Elimination of inter-segment assets | ( 664.372 ) | ( 433.887 ) |
| Consolidated total assets | 1.292.493 | 971.979 |
| **Liabilities** | | |
| Total liabilities for reportable segments | 990.592 | 662.610 |
| Elimination of inter-segment liabilities | ( 266.312 ) | ( 147.162 ) |
| Consolidated total liabilities | 724.280 | 515.448 |

| Other material items | Reportable segment totals | Adjust-ments | Consoli-dated totals |
|---|---|---|---|
| **2016** | | | |
| Segment EBITDAR | 254.960 | | 254.960 |
| Segment EBITDA | 219.845 | | 219.845 |
| Finance income | 24.679 | ( 18.265 ) | 6.414 |
| Finance costs | ( 23.962 ) | 18.265 | ( 5.697 ) |
| Depreciation and amortisation | ( 101.408 ) | | ( 101.408 ) |
| Share of profit of associates | 957 | | 957 |
| Capital expenditure | 243.397 | | 243.397 |
| **2015** | | | |
| Segment EBITDAR | 261.710 | | 261.710 |
| Segment EBITDA | 226.666 | | 226.666 |
| Finance income | 9.547 | ( 4.413 ) | 5.134 |
| Finance costs | ( 12.623 ) | 4.413 | ( 8.210 ) |
| Depreciation and amortisation | ( 83.826 ) | | ( 83.826 ) |
| Share of loss of associates | 459 | | 459 |
| Capital expenditure | 210.400 | | 210.400 |

*Consolidated Financial Statements of Icelandair Group hf. 2016* 17 *Amounts are in USD thousand*

## 7. Operating income

Transport revenue is specified as follows:

| | 2016 | 2015 |
|---|---|---|
| Passengers | 895.614 | 806.555 |
| Cargo and mail | 52.209 | 42.313 |
| Total transport revenue | 947.823 | 848.868 |

Other operating revenue is specified as follows:

| | | |
|---|---|---|
| Sale at airports and hotels | 93.142 | 65.948 |
| Revenue from tourism | 109.980 | 91.555 |
| Aircraft and cargo handling services | 23.597 | 27.453 |
| Maintenance revenue | 2.797 | 3.439 |
| Gain on sale of operating assets | 782 | 1.529 |
| Other operating revenue | 22.879 | 17.551 |
| Total other operating revenue | 253.177 | 207.475 |

## 8. Operating expenses

Salaries and other personnel expenses are specified as follows:

| | | |
|---|---|---|
| Salaries | 232.204 | 181.566 |
| Contributions to pension funds | 33.885 | 23.492 |
| Other salary-related expenses | 28.912 | 24.731 |
| Other personnel expenses | 59.252 | 48.226 |
| Total salaries and other personnel expenses | 354.253 | 278.015 |
| Average number of full year equivalents | 3.900 | 3.384 |

Aviation expenses are specified as follows:

| | | |
|---|---|---|
| Aircraft fuel | 213.418 | 223.828 |
| Aircraft lease | 20.687 | 22.896 |
| Aircraft handling, landing and communication | 108.784 | 85.662 |
| Aircraft maintenance expenses | 77.361 | 68.808 |
| Total aviation expenses | 420.250 | 401.194 |

Other operating expenses are specified as follows:

| | | |
|---|---|---|
| Operating cost of real estates and fixtures | 26.298 | 22.140 |
| Communication | 23.135 | 18.038 |
| Advertising | 28.609 | 23.902 |
| Booking fees and commissions | 54.727 | 48.910 |
| Cost of goods sold | 27.888 | 21.092 |
| Customer services | 29.486 | 20.578 |
| Tourism expenses | 70.450 | 52.301 |
| Other operating expenses | 30.633 | 26.863 |
| Total other operating expenses | 291.226 | 233.824 |

## 9. Auditor's fee

Auditor's fee are specified as follows:

| | | |
|---|---|---|
| Audit | 421.218 | 323.727 |
| Other services | 84.778 | 103.862 |
| Total auditor´s fee | 505.996 | 427.589 |

*Consolidated Financial Statements of Icelandair Group hf. 2016* 18 *Amounts are in USD thousand*

## 10. Depreciation and amortisation

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

| | 2016 | 2015 |
|---|---|---|
| Depreciation of operating assets, see note 12 | 99.179 | 80.146 |
| Amortisation of intangible assets, see note 16 | 2.229 | 3.680 |
| Depreciation and amortisation recognised in profit or loss | 101.408 | 83.826 |

## 11. Finance income and finance costs

Finance income and finance costs are specified as follows:

| | 2016 | 2015 |
|---|---|---|
| Interest income on bank deposits | 3.157 | 2.074 |
| Other interest income | 173 | 860 |
| Net currency exchange gain | 3.084 | 2.200 |
| Finance income total | 6.414 | 5.134 |
| Interest expense on loans and borrowings | 4.798 | 7.338 |
| Other interest expenses | 899 | 872 |
| Finance costs total | 5.697 | 8.210 |
| Net finance income (costs) | 717 | ( 3.076 ) |

## 12. Operating assets

Operating assets are specified as follows:

| Cost | Aircraft and flight equipment | Buildings | Other property and equipment | Total |
|---|---|---|---|---|
| Balance at 1 January 2015 | 420.276 | 31.719 | 50.940 | 502.935 |
| Additions | 159.565 | 9.299 | 13.710 | 182.574 |
| Sales and disposals | ( 49.877 ) | ( 248 ) | ( 3.589 ) | ( 53.714 ) |
| Effects of movements in exchange rates | ( 32 ) | ( 567 ) | ( 731 ) | ( 1.330 ) |
| Balance at 31 December 2015 | 529.932 | 40.203 | 60.330 | 630.465 |
| Additions | 180.018 | 34.417 | 16.682 | 231.117 |
| Additions due to acquisition of subsidiary | 0 | 43.791 | 0 | 43.791 |
| Sales and disposals | ( 56.496 ) | 0 | ( 1.354 ) | ( 57.850 ) |
| Reclassification of assets held for sale | ( 9.878 ) | 0 | 0 | ( 9.878 ) |
| Effects of movements in exchange rates | 529 | 10.432 | 6.673 | 17.634 |
| Balance at 31 December 2016 | 644.105 | 128.843 | 82.331 | 855.279 |
| **Depreciation and impairment losses** | | | | |
| Balance at 1 January 2015 | 155.795 | 8.713 | 19.087 | 183.595 |
| Depreciation | 72.552 | 1.570 | 6.024 | 80.146 |
| Sales and disposals | ( 48.131 ) | ( 176 ) | ( 3.349 ) | ( 51.656 ) |
| Effects of movements in exchange rates | ( 13 ) | ( 191 ) | ( 487 ) | ( 691 ) |
| Balance at 31 December 2015 | 180.203 | 9.916 | 21.275 | 211.394 |
| Depreciation | 88.366 | 2.168 | 8.645 | 99.179 |
| Additions due to acquisition of subsidiary | 0 | 387 | 0 | 387 |
| Sales and disposals | ( 56.135 ) | 0 | ( 1.363 ) | ( 57.498 ) |
| Reclassification of assets held for sale | ( 5.730 ) | 0 | 0 | ( 5.730 ) |
| Effects of movements in exchange rates | 126 | 1.661 | 3.145 | 4.932 |
| Balance at 31 December 2016 | 206.830 | 14.132 | 31.702 | 252.664 |
| **Carrying amounts** | | | | |
| At 1 January 2015 | 264.481 | 23.006 | 31.853 | 319.340 |
| At 31 December 2015 | 349.729 | 30.287 | 39.055 | 419.071 |
| At 31 December 2016 | 437.275 | 114.711 | 50.629 | 602.615 |
| Depreciation ratios | 6-20% | 2-6% | 5-33% | |

*Consolidated Financial Statements of Icelandair Group hf. 2016* 19 *Amounts are in USD thousand*

**12.** contd.:

Aquisition of operating assets in 2016 amounted to USD 231.1 million. Included are five Boeing aircraft, overhaul of own engines and aircraft spare parts in the amount of USD 122.4 million.

## 13. Mortgages and commitments

The Group's operating assets, aircraft and spare parts are mortgaged to secure debt. The remaining balance of the debt amounted to USD 58.2 million at year end 2016 (2015: USD 30.9 million). The Group owns 36 aircraft, of which 31 are unencumbered, including 25 Boeing 757 and 1 Boeing 767.

## 14. Insurance value of aircraft and flight equipment

The insurance value and carrying amount of the Group's aircraft and related equipment at year-end is specified as follows:

| | Insurance value | | Carrying amounts | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Boeing - 31 / 26 aircraft ..................................................... | 638.000 | 581.000 | 346.122 | 263.311 |
| Other aircraft ..................................................................... | 58.466 | 78.300 | 42.353 | 42.187 |
| Flight equipment ................................................................ | 84.862 | 63.998 | 48.800 | 44.231 |
| Total aircraft and flight equipment ..................................... | 781.328 | 723.298 | 437.275 | 349.729 |

## 15. Insurance value of buildings and other operating assets

The principal buildings owned by the Group are the following:

| **2016** | **Maintenance hangars** | **Hotels** | **Office buildings** | **Other buildings** | **Under construction** | **Total** |
|---|---|---|---|---|---|---|
| Official assessment value ......... | 24.860 | 30.983 | 23.398 | 8.259 | 18.703 | 106.203 |
| Insurance value ......................... | 42.173 | 43.491 | 39.937 | 10.408 | 31.760 | 167.769 |
| Carrying amounts ...................... | 4.703 | 71.819 | 23.278 | 3.426 | 11.485 | 114.711 |
| Square meters ........................... | 19.135 | 24.577 | 17.850 | 8.263 | 15.343 | 85.168 |
| Vacant space (square meters) .. | | 380 | | | | 380 |
| **2015** | | | | | | |
| Official assessment value ......... | 17.654 | 2.099 | 16.624 | 4.162 | 0 | 40.539 |
| Insurance value ......................... | 36.038 | 7.130 | 34.354 | 8.504 | 0 | 86.026 |
| Carrying amounts ...................... | 4.448 | 1.910 | 21.244 | 2.685 | 0 | 30.287 |
| Square meters ........................... | 19.135 | 2.678 | 17.850 | 7.215 | 0 | 46.878 |

Official valuation of the Group's leased land for buildings at 31 December 2016 amounted to USD 12.9 million (2015: USD 8.5 million) and is not included in the statement of financial position.

The insurance value of the Group's other operating assets and equipment amounted to USD 110.0 million at year end 2016 (2015: USD 80.8 million). The carrying amount at the same time was USD 50.6 million (2015: USD 39.1 million).

*Consolidated Financial Statements of Icelandair Group hf. 2016* 20 *Amounts are in USD thousand*

## 16. Intangible assets and goodwill

Intangible assets and goodwill are specified as follows:

| Cost | Goodwill | Trademarks and slots | Customer relations | Other intangibles | Total |
|---|---|---|---|---|---|
| Balance at 1 January 2015 | 148.516 | 35.961 | 5.158 | 9.595 | 199.230 |
| Additions | 0 | 0 | 0 | 1.073 | 1.073 |
| Sales and disposals | 0 | 0 | ( 5.142 ) | ( 604 ) | ( 5.746 ) |
| Effect of movements in exchange rates | ( 615 ) | ( 5 ) | ( 16 ) | ( 76 ) | ( 712 ) |
| Balance at 31 December 2015 | 147.901 | 35.956 | 0 | 9.988 | 193.845 |
| Additions | 0 | 0 | 0 | 1.603 | 1.603 |
| Sales and disposals | 0 | 0 | 0 | ( 6.689 ) | ( 6.689 ) |
| Effect of movements in exchange rates | 2.547 | 34 | 0 | 115 | 2.696 |
| Balance at 31 December 2016 | 150.448 | 35.990 | 0 | 5.017 | 191.455 |
| **Amortisation and impairment losses** | | | | | |
| Balance at 1 January 2015 | 11.431 | 2.605 | 4.801 | 4.420 | 23.257 |
| Amortisation | 0 | 0 | 355 | 3.325 | 3.680 |
| Sales and disposals | 0 | 0 | ( 5.142 ) | ( 604 ) | ( 5.746 ) |
| Effect of movements in exchange rates | 0 | 0 | ( 14 ) | ( 26 ) | ( 40 ) |
| Balance at 31 December 2015 | 11.431 | 2.605 | 0 | 7.115 | 21.151 |
| Amortisation | 0 | 0 | 0 | 2.229 | 2.229 |
| Sales and disposals | 0 | 0 | 0 | ( 6.689 ) | ( 6.689 ) |
| Effect of movements in exchange rates | 0 | 0 | 0 | 60 | 60 |
| Balance at 31 December 2016 | 11.431 | 2.605 | 0 | 2.715 | 16.751 |
| **Carrying amounts** | | | | | |
| At 1 January 2015 | 137.085 | 33.356 | 357 | 5.175 | 175.973 |
| At 31 December 2015 | 136.470 | 33.351 | 0 | 2.873 | 172.694 |
| At 31 December 2016 | 139.017 | 33.385 | 0 | 2.302 | 174.704 |

## 17. Impairment test

Goodwill and other intangible assets that have indefinite life are tested for impairment at each reporting date. These assets were recognised at fair value on acquistion dates. Goodwill and other intangible assets with indefinite life are specified as follows:

| | 2016 | 2015 |
|---|---|---|
| Goodwill | 139.017 | 136.470 |
| Trademarks and airport slots | 33.385 | 33.351 |
| Total | 172.402 | 169.821 |

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

*Consolidated Financial Statements of Icelandair Group hf. 2016* 21 *Amounts are in USD thousand*

**17.** contd.:

For the purpose of impairment testing, goodwill is allocated to the units which represent the level within the Group at which the goodwill is monitored for internal management purposes. The aggregate carrying amounts of goodwill allocated to each cash generated unit (CGU) are as follows:

| | Goodwill | | Trademarks and slots | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Route network | 137.149 | 134.541 | 33.385 | 33.351 |
| Tourism services | 1.868 | 1.929 | 0 | 0 |
| Total goodwill | 139.017 | 136.470 | 33.385 | 33.351 |

The recoverable amounts of cash-generating units was based on their value in use and were determined by discounting the future cash flows generated from the continuing use of the CGU. Cash flows were projected based on actual operating results and a 5 - 10 year business plan. Cash flows were extrapolated for determining the residual value using a constant nominal growth rate which was consistent with the long-term average growth rate for the industry. Management believes that this forecast period was justified due to the long-term nature of the business.

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

| | Route network | | Tourism services | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Long term growth rate | 2,5-4,0% | 2,5-4,0% | 4,0% | 4,0% |
| Revenue growth: | | | | |
| Weighted average 2016 / 2015 | 11,4% | 3,0% | 25,9% | 23,2% |
| 2016 - 2026 / 2015 - 2025 | 8,9% | 9,0% | 17,3% | 12,4% |
| Budgeted EBITDA growth | 8,4% | 4,2% | 28,1% | 28,0% |
| WACC | 9,3-14,2% | 8,2-12,8% | 9,1% | 10,9% |
| Debt leverage | 10,2-56,9% | 10,2-53,2% | 33,4% | 19,1% |
| Interest rate for debt | 5,0-7,5% | 5,1-7,8% | 3,1% | 4,4% |

The recoverable amount of the cash-generating units was estimated to be higher than its carrying amount and no impairment was required.

## 18. Investment in associates

The Group has interests in number of associates. The carrying amount and share of profit of the associates is as follows:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Investment | Operating result | Investment | Operating result |
| Lindarvatn ehf. | 16.590 | ( 5 ) | 14.457 | 0 |
| ITF 1 slhf. | 5.649 | 588 | 2.744 | 64 |
| Other investments | 1.258 | 374 | 1.022 | 395 |
| Total investments in associates | 23.497 | 957 | 18.223 | 459 |

Lindarvatn ehf. is the owner of the property and other properties located near Austurvollur. In total the properties are 15.000 square meters but the new hotel is expected to be 11.000 square meters.

ITF 1 slhf. is a fund managed by Landsbref. The fund is menat to invest in Icelandic Companies focusing on entertainment and experience for foreign tourists. The focus is on whole year projects which contributes to better utilization of the infrastructure in the Icelandic Tourism industry.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 22 *Amounts are in USD thousand*

## 19. Deferred cost

Deferred cost consists of prepaid lease on housing and amounts paid for engine overhauls and heavy maintenance of leased aircraft which will be expensed over the lease period of the aircraft. Deferred cost is specified as follows:

| | 2016 | 2015 |
|---|---|---|
| Deferred cost | 120 | 405 |
| Current portion, classified as prepayments among receivables | ( 57 ) | ( 287 ) |
| Total deferred cost | 63 | 118 |

Deferred cost will be expensed as follows:

| | | |
|---|---|---|
| Expensed in 2016 | - | 287 |
| Expensed in 2017 | 57 | 63 |
| Expensed in 2018 | 63 | 55 |
| Total deferred cost, including current maturities | 120 | 405 |

## 20. Non-current receivables and deposits

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

Non-current receivables and deposits are specified as follows:

| | | |
|---|---|---|
| Loans, effective interest rate 6% / 6% | 208 | 359 |
| Security deposits | 5.795 | 8.426 |
| Prepayments on aircraft purchases | 68.419 | 22.348 |
| | 74.422 | 31.133 |
| Current maturities | ( 324 ) | ( 3.659 ) |
| Non-current receivables and deposits total | 74.098 | 27.474 |

Contractual repayments mature as follows:

| | | |
|---|---|---|
| Maturities in 2016 | - | 3.659 |
| Maturities in 2017 | 324 | 554 |
| Maturities in 2018 | 38.098 | 12.919 |
| Maturities in 2019 | 25.988 | 7.350 |
| Maturities in 2020 | 5.514 | 2.525 |
| Maturities in 2021 | 1.527 | 1.832 |
| Subsequent | 2.971 | 2.294 |
| Total non-current receivables and deposits, including current maturities | 74.422 | 31.133 |

Non-current receivables and deposits denominated in currencies other than the functional currency comprise USD 1.5 million (2015: USD 1.1 million).

*Consolidated Financial Statements of Icelandair Group hf. 2016* 23 *Amounts are in USD thousand*

## 21. Taxes

### Tax recognised in profit or loss

| | 2016 | 2015 |
|---|---|---|
| *Current tax expense* | | |
| Current year | 14.024 | 20.368 |
| Reassessment of taxes due to prior years | 8.099 | ( 2.238 ) |
| | 22.123 | 20.368 |
| *Deferred tax expense* | | |
| Origination and reversal of temporary differences | 12.576 | 10.828 |
| Exchange rate difference | ( 3.656 ) | 42 |
| | 8.920 | 10.870 |
| Total tax expense recognised in profit or loss | 31.043 | 29.000 |

### Tax recognised in other comprehensive income

| | 2016 | 2015 |
|---|---|---|
| Effective portion of changes in fair value of cash flow hedge | ( 10.118 ) | 30 |
| Exchange rate difference | 0 | ( 6 ) |
| Total tax recognised in other comprehensive income | ( 10.118 ) | 24 |

### Reconciliation of effective tax rate

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Profit before tax | | 120.111 | | 140.223 |
| Income tax according to current tax rate | 20,0% | 24.022 | 20,0% | 28.045 |
| Non-deductible expenses | 0,5% | 547 | 0,2% | 324 |
| Reassessment of taxes due to prior years | 6,7% | 8.099 | | 0 |
| Other items | ( 1,4%) | ( 1.625 ) | 0,4% | 631 |
| Effective tax rate | 25,8% | 31.043 | 20,6% | 29.000 |

### Recognised deferred tax liabilities

Deferred tax liabilities are specified as follows:

| | 2016 | 2015 |
|---|---|---|
| Deferred tax liabilities 1 January | 35.485 | 24.681 |
| Exchange rate difference | 3.656 | ( 36 ) |
| Deferred tax recognised in profit or loss | 8.920 | 10.870 |
| Income tax recognised in other comprehensive income | 10.118 | ( 30 ) |
| Deferred tax liabilities 31 December | 58.179 | 35.485 |

*Consolidated Financial Statements of Icelandair Group hf. 2016* 24 *Amounts are in USD thousand*

**21.** contd.:

Deferred tax liabilities are attributable to the following:

| | Assets 2016 | Assets 2015 | Liabilities 2016 | Liabilities 2015 | Net 2016 | Net 2015 |
|---|---|---|---|---|---|---|
| Operating assets ....................... | 0 | 0 | ( 51.580) | ( 40.170) | ( 51.580) | ( 40.170) |
| Intangible assets ....................... | 0 | 0 | ( 955) | ( 812) | ( 955) | ( 812) |
| Derivatives ............................... | 0 | 6.015 | ( 4.103) | 0 | ( 4.103) | 6.015 |
| Trade receivables ...................... | 0 | 132 | ( 898) | 0 | ( 898) | 132 |
| | 0 | 6.147 | ( 57.536) | ( 40.982) | ( 57.536) | ( 34.835) |
| Tax loss carry-forwards ............. | 1.595 | 611 | 0 | 0 | 1.595 | 611 |
| Other items ............................... | 0 | 0 | ( 2.238) | ( 1.261) | ( 2.238) | ( 1.261) |
| Deferred income tax .................. | 1.595 | 6.758 | ( 59.774) | ( 42.243) | ( 58.179) | ( 35.485) |

### Movements in deferred tax balance during the year

| 2016 | 1 January | Recognised in profit or loss | Exchange rate difference | Recognised in other comprehensive income and equity | 31 December |
|---|---|---|---|---|---|
| Operating assets ........................................... | ( 40.170) | ( 8.302) | ( 3.108) | 0 | ( 51.580) |
| Intangible assets ........................................... | ( 812) | ( 155) | 12 | 0 | ( 955) |
| Derivatives .................................................... | 6.015 | 0 | 0 | ( 10.118) | ( 4.103) |
| Trade receivables .......................................... | 132 | ( 1.020) | ( 10) | 0 | ( 898) |
| Tax loss carry-forwards ................................. | 611 | 266 | 18 | 0 | 895 |
| Other items .................................................. | ( 1.261) | 291 | ( 568) | 0 | ( 1.538) |
| | ( 35.485) | ( 8.920) | ( 3.656) | ( 10.118) | ( 58.179) |
| **2015** | | | | | |
| Operating assets ........................................... | ( 29.810) | ( 10.403) | 43 | 0 | ( 40.170) |
| Intangible assets ........................................... | ( 1.217) | 412 | ( 7) | 0 | ( 812) |
| Derivatives .................................................... | 5.991 | 0 | ( 6) | 30 | 6.015 |
| Trade receivables .......................................... | 199 | ( 64) | ( 3) | 0 | 132 |
| Tax loss carry-forwards ................................. | 557 | 55 | ( 1) | 0 | 611 |
| Other items .................................................. | ( 401) | ( 870) | 10 | 0 | ( 1.261) |
| | ( 24.681) | ( 10.870) | 36 | 30 | ( 35.485) |

The effect of a reassessment of taxes due to prior years of USD 8,0 million is included in the tax expense of the year in profit or loss. Further information on the reassessment is provided in note 40.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 25 *Amounts are in USD thousand*

## 22. Inventories

Inventories are specified as follows:

| | 2016 | 2015 |
|---|---|---|
| Spare parts | 18.574 | 15.030 |
| Other inventories | 5.389 | 4.175 |
| Inventories total | 23.963 | 19.205 |

## 23. Trade and other receivables

Trade and other receivables are specified as follows:

| | 2016 | 2015 |
|---|---|---|
| Trade receivables | 84.065 | 66.449 |
| Prepayments | 9.096 | 3.716 |
| Restricted cash | 3.423 | 8.693 |
| Derivatives used for hedging | 20.560 | 3.104 |
| Current maturities of long term-receivables | 324 | 3.659 |
| Other receivables | 21.812 | 15.454 |
| Trade and other receivables total | 139.280 | 101.075 |

At year end trade receivables are presented net of an allowance for doubtful debts of USD 5.2 million (2015: USD 6.4 million).

Prepaid expenses which relate to subsequent periods amounted to USD 9.1 million (2015: USD 3.7 million) at year end. The prepayments consist mainly of prepaid contractual obligations, insurance premiums, software licenses and leases.

Restricted cash is held in bank accounts pledged against credit cards, derivatives and tourism guarantees.

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables is disclosed in note 33.

## 24. Assets classified as held for sale

Assets classified as held for sale at year end consist of four Fokker 50 aircraft which Air Iceland has taken out of service.

## 25. Short term investments

Short term investments at year end consist of securities listed on stock exchanges in Luxemburg and Iceland and fixed deposits. They are recognized at fair value at year end, based on market value.

## 26. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

| | 2016 | 2015 |
|---|---|---|
| Securities | 71.772 | 4.324 |
| Bank deposits | 154.785 | 189.912 |
| Cash on hand | 332 | 350 |
| Cash and cash equivalents total | 226.889 | 194.586 |

*Consolidated Financial Statements of Icelandair Group hf. 2016* 26 *Amounts are in USD thousand*

## 27. Equity

### Share capital

The Company's share capital amounts to ISK 5.0 billion according to its Articles of Association. Shareholders are entitled to receive dividends as declared from time to time and are entitled to one vote per share of one ISK.

The Company held treasury shares in the amount of ISK 25.0 million at year end 2016 (2015: ISK 25.0 million).

### 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. The balance of the share premium account can be used to offset losses not covered by other reserves or to offset stock splits.

### Reserves

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

The translation reserve comprises all currency differences arising from the translation of the financial statements of subsidiaries having functional currencies other than the Group, as well as from the translation of liabilities that hedge net investment.

According to changes made to the Icelandic Financial Statement Act in 2016, companies must present in a seperate equity account recognized share in profit of subsidiaries and associates in in excess of dividend received or declared. The effect of the new legislation is presented as other reserves in the specfication below.

Reserves are specified as follows:

| | Hedging reserve | Translation reserve | Other reserves | Total reserves |
|---|---|---|---|---|
| Balance 1 January 2015 | ( 23.941 ) | 27.136 | 0 | 3.195 |
| Currency translation differences | | ( 1.677 ) | 0 | ( 1.677 ) |
| Effective portion of changes in fair value of cash flow hedges, net of tax | ( 118 ) | | | ( 118 ) |
| Balance at 31 December 2015 | ( 24.059 ) | 25.459 | 0 | 1.400 |
| Share in profit of subsidiaries and associates | | | 108.016 | 108.016 |
| Dividend received | | | ( 44.114 ) | ( 44.114 ) |
| Currency translation differences | | 9.065 | | 9.065 |
| Effective portion of changes in far value of cash flow hedges, net of tax | 40.482 | | | 40.482 |
| Balance at 31 December 2016 | 16.423 | 34.524 | 63.902 | 114.849 |

### Dividend

The Board of Directors has approved to the following dividend policy: “The Company's goal is to declare 20-40% of annual net profit as dividend. Final decision on dividend payments will be based on the financial position of the Company, operating capital requirements and market conditions.”

Dividend amounting to USD 27.0 million was paid to shareholders in the year 2016 (2015: USD 17.9 million).

The Board of Directors proposes a dividend payment to shareholders in 2017 of ISK 565 million, equal to USD 5.0 million, which represents 6% of profit for the year 2016.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 27 *Amounts are in USD thousand*

## 28. Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to equity holders of the Parent by the weighted average number of outstanding shares during the year. The calculation of diluted earnings per share is identical to basic earnings per share as no convertible notes or stock options have been issued.

| | 2016 | 2015 |
|---|---|---|
| **Basic earnings per share:** | | |
| Profit for the year attributable to equity holders of the parent company | 88.820 | 111.318 |
| Weighted average number of shares for the year | 4.974.540 | 4.974.540 |
| Basic earnings per share in US cent per share | 1,79 | 2,24 |
| Diluted earnings per share in US cent per share | 1,79 | 2,24 |

## 29. Loans and borrowings

This note provides information on the contractual terms of the Group´s interest-bearing loans and borrowings, which are measured at amortised cost. For more information on the Group´s exposure to interest rate, foreign currency and liquidity risk, see note 33.

| | | |
|---|---|---|
| Loans and borrowings are specified as follows: | | |
| Secured bank loans | 58.195 | 30.852 |
| Unsecured bonds | 184.187 | 34.678 |
| Total loans and borrowings | 242.382 | 65.530 |
| Current maturities | ( 45.660 ) | ( 10.143 ) |
| Total non-current loans and borrowings | 196.722 | 55.387 |

**Current loans and borrowings are specified as follows:**

| | | |
|---|---|---|
| Current maturities of non-current liabilities | 45.660 | 10.143 |
| Total loans and borrowings | 242.382 | 65.530 |

**Terms and debt repayment schedule:**

| | Currency | Nominal interest rates year end 2016 | Year of maturity | Total remaining balance 2016 | 2015 |
|---|---|---|---|---|---|
| Secured bank loans | USD | 4,4% | 2017-2022 | 21.082 | 29.256 |
| Secured bank loans | ISK | | | 0 | 870 |
| Secured bank loans, indexed | ISK | 4,3% | 2025 | 1.728 | 726 |
| Unsecured bond issue | USD | 4,6% | 2020-2021 | 172.527 | 23.596 |
| Unsecured bond issue, indexed | ISK | 5,7% | 2023 | 11.660 | 11.082 |
| Secured bank loans - short term | ISK | 6,6% | 2017 | 35.385 | 0 |
| Total interest bearing liabilities | | | | 242.382 | 65.530 |

| | | |
|---|---|---|
| Repayments of loans and borrowings are specified as follows: | | |
| Repayments in 2016 | - | 10.143 |
| Repayments in 2017 | 45.660 | 10.189 |
| Repayments in 2018 | 5.585 | 5.524 |
| Repayments in 2019 | 2.390 | 2.332 |
| Repayments in 2020 | 26.175 | 26.118 |
| Repayments in 2021 | 152.661 | 2.567 |
| Subsequent repayments | 9.911 | 8.657 |
| Total loans and borrowings | 242.382 | 65.530 |

*Consolidated Financial Statements of Icelandair Group hf. 2016* 28 *Amounts are in USD thousand*

## 30. Non-current payables

Non-current payables correspond to accrued engine overhaul cost of leased aircraft and security deposits from lease contracts to be realized after 2017. Non-current obligations are specified as follows:

| | 2016 | 2015 |
|---|---|---|
| Non-current payables | 16.573 | 19.334 |
| Current portion, classified in trade and other payables | ( 3.284 ) | ( 10.690 ) |
| Total non-current payables | 13.289 | 8.644 |
| Non-current payables will be repaid as follows: | | |
| Repayments in 2016 | - | 10.690 |
| Repayments in 2017 | 3.284 | 3.255 |
| Repayments in 2018 | 5.852 | 2.454 |
| Repayments in 2019 | 3.487 | 1.199 |
| Repayments in 2020 | 976 | 736 |
| Repayments in 2021 | 2.974 | 1.000 |
| Total non-current payables, including current maturities | 16.573 | 19.334 |

## 31. Trade and other payables

Trade and other payables are specified as follows:

| | 2016 | 2015 |
|---|---|---|
| Trade payables | 55.977 | 41.569 |
| Current portion of engine overhauls and security deposits from lease contracts | 3.284 | 10.690 |
| Derivatives used for hedging | 436 | 33.075 |
| Income tax payable | 14.048 | 20.368 |
| Other payables | 136.798 | 113.978 |
| Total trade and other payables | 210.543 | 219.680 |

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 33.

## 32. Deferred income

Sold unused tickets, fair value of unutilized frequent flyer points and other prepayments are presented as deferred income in the statement of financial position.

| Deferred income is specified as follows: | 2016 | 2015 |
|---|---|---|
| Sold unused tickets | 164.580 | 158.958 |
| Frequent flyer points | 18.800 | 16.660 |
| Other prepayments | 16.507 | 10.491 |
| Total deferred income | 199.887 | 186.109 |

The amount allocated to frequent flyer points is estimated by reference to the fair value of the discounted services for which they could be redeemed, since the fair value of the points themselves is not directly observable. The fair value of the discounted services for which the points, granted through a customer loyalty programme, can be redeemed takes into account the expected redemption rate and the timing of such expected redemptions. That amount is recognised as deferred income.

Consolidated Financial Statements of Icelandair Group hf. 2016 29 Amounts are in USD thousand

## 33. Financial risk management

### Overview

The Group has exposure to the following financial risks:

- credit risk
- liquidity risk
- market risk

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

*Risk management framework*

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Company's Risk Management Commitee 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 which undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

### Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers.

*Exposure to credit risk*

The carrying amounts of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was as follows:

| | | Carrying amount | |
|---|---|---|---|
| | **Note** | **2016** | **2015** |
| Non-current receivables and deposits ...................................................... | 20 | 74.098 | 27.474 |
| Trade and other receivables ..................................................................... | 23 | 130.184 | 97.359 |
| Short term investments ............................................................................ | 25 | 23.236 | 19.533 |
| Cash and cash equivalents ...................................................................... | 26 | 226.889 | 194.586 |
| | | 454.407 | 338.952 |

Consolidated Financial Statements of Icelandair Group hf. 2016 30 Amounts are in USD thousand

**33.** contd.:

*Trade and other receivables*

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

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

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

At year end 2016, the maximum exposure to credit risk for trade and other receivables by type of counterparty was as follows:

| | 2016 | 2015 |
|---|---|---|
| Credit cards | 51.609 | 45.835 |
| Trade receivables | 21.197 | 20.614 |
| | 72.806 | 66.449 |
| Other receivables | 66.474 | 34.626 |
| | 139.280 | 101.075 |

*Impairment losses*

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

| | Gross 2016 | Allowance for Impairment 2016 | Gross 2015 | Allowance for Impairment 2015 |
|---|---|---|---|---|
| Not past due | 65.172 | ( 510) | 47.888 | ( 397) |
| Past due 1-30 days | 12.010 | ( 53) | 14.224 | ( 102) |
| Past due 31-120 days | 6.540 | ( 899) | 4.360 | ( 586) |
| Past due 121-365 days | 1.248 | ( 450) | 1.370 | ( 627) |
| More than one year | 4.248 | ( 3.241) | 4.964 | ( 4.645) |
| Total | 89.218 | ( 5.153) | 72.806 | ( 6.357) |

Changes in the allowance for impairment in respect of trade receivables during the year were as follows:

| | 2016 | 2015 |
|---|---|---|
| Balance at 1 January | 6.357 | 5.390 |
| Impairment loss allowance, increase (decrease) | 811 | 1.785 |
| Amounts written off | ( 2.048) | ( 781) |
| Exchange rate difference | 31 | ( 37) |
| Balance at 31 December | 5.151 | 6.357 |

Based on historical default rates, the management believes that minimal impairment allowance is necessary in respect of trade receivables not past due or past due by 30 days; a significant part of the balance relates to customers that have a good track record with the Group.

The allowance account in respect of trade receivables is used to record impairment losses. If the Group believes that no recovery is possible the financial asset is written off directly.

Consolidated Financial Statements of Icelandair Group hf. 2016 31 Amounts are in USD thousand

**33.** contd.:

*Guarantees*
The Group's policy is to provide financial guarantees only to wholly-owned subsidiaries.

**Liquidity risk**
Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group aims to maintain the level of its cash and cash equivalents and other highly marketable debt investments at an amount of three months operating cost on average where 30% can be in the form of unused lines of credit.

The Company's management monitors its cash flow requirements by using rolling forecast and the liquidity management is based on projected cash flow in different currencies.

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

| **31 December 2016** | **Carrying amount** | **Contractual cash flows** | **Within 12 months** | **1-2 years** | **2-5 years** | **More than 5 years** |
|---|---|---|---|---|---|---|
| **Non-derivative financial liabilities** | | | | | | |
| Unsecured bank loans ............. | 184.187 | 232.639 | 13.065 | 10.415 | 205.026 | 4.133 |
| Secured loans .......................... | 58.195 | 61.395 | 46.015 | 4.701 | 4.872 | 5.807 |
| Payables & prepayments .......... | 223.832 | 223.832 | 210.543 | 5.852 | 7.437 | 0 |
| Exposure to liquidity risk ........... | 466.214 | 517.866 | 269.623 | 20.968 | 217.335 | 9.940 |
| **Derivative financial liabilities** | | | | | | |
| Commodity derivatives ............. | 11.788 | 12.171 | 12.259 | ( 88) | 0 | 0 |
| Forward exchange contracts ..... | 8.415 | 12.338 | 12.338 | 0 | 0 | 0 |
| Interest rate swaps .................... | ( 79) | ( 64) | ( 170) | ( 192) | 298 | 0 |
| Exposure to liquidity risk ........... | 20.124 | 24.445 | 24.427 | ( 280) | 298 | 0 |
| **31 December 2015** | | | | | | |
| **Non-derivative financial liabilities** | | | | | | |
| Unsecured bond issue ............. | 34.678 | 42.294 | 3.272 | 2.769 | 30.962 | 5.291 |
| Secured loans .......................... | 30.852 | 35.649 | 10.923 | 9.584 | 7.999 | 7.143 |
| Payables & prepayments .......... | 228.324 | 228.324 | 219.680 | 3.255 | 4.389 | 1.000 |
| Exposure to liquidity risk ........... | 293.854 | 306.267 | 233.875 | 15.608 | 43.350 | 13.434 |
| **Derivative financial liabilities** | | | | | | |
| Commodity derivatives ............. | ( 33.075) | ( 33.215) | ( 33.215) | 0 | 0 | 0 |
| Forward exchange contracts ..... | 3.333 | 5.183 | 5.183 | 0 | 0 | 0 |
| Exposure to liquidity risk ........... | ( 29.742) | ( 28.032) | ( 28.032) | 0 | 0 | 0 |

Unused unsecured credit lines at year end 2016 amounted to USD 74.4 million (2015: USD 73.9 million).

In addition to the liquidity exposure presented in the balance sheet the Group is exposed to off balance sheet liabilities. Further information on these liabilities is provided in note 35 and 38.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 32 *Amounts are in USD thousand*

**33.** contd.:

### Market risk

Market risk emerges from changes in market prices, such as foreign exchange rates, interest rates, carbon prices and fuel prices, as those changes will affect the Group's cash flows or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

The Group uses spot and forward trading, swaps and options in order to manage market risks. All such transactions are carried out within the guidelines set by the Board of Directors. The Group seeks to apply hedge accounting in order to manage volatility in profit or loss.

### Fuel risk

The Group is exposed to fuel price risk. The Group´s fuel price risk managment strategy aims to provide the airline with protection against sudden and significant increases in oil prices while ensuring that the airline is not competitively disadvantaged in the event of a substantial fall in the price of fuel. The current Group strategy as reflected in the policy is to hedge between 40% and 60% of fuel consumption 12 months forward and upto 20% from 13-18 months forward. In implementing the strategy, the hedge programme allows for a number of derivatives with approved counterparties and within approved limits. At year end the 60% of an estimated 12 months exposure of 325 k M.tonnes was hedged with swaps.

*Sensitivity analysis*

The following table demonstrates the sensitivity of the financial instruments in place at year end to a reasonably possible change in fuel prices, with all other variables held constant, on profit before tax and equtiy:

| | Effect on equity | | Effect on profit before tax | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Increase in fuel prices by 10% .......................................... | 11.963 | 7.126 | 0 | 0 |
| Decrease in fuel prices by 10% ......................................... | ( 11.963) | ( 7.126) | 0 | 0 |

### Currency risk

The Group is exposed to currency risk on sales, purchases, trade and other receivables, short term investments, cash and cash equivalents, secured bank loans and trade payables 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 currency mismatch in the cashflow by netting receipts and payments in each individual currency and by internal trading within the Group. The shortfall of USD and ISK are financed by a surplus of European currencies, most importantly EUR and Scandinavian currencies but also GBP and CAD. The exposure is hedged 50-80% 9-12 months forward with spot and forward contracts.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 33 *Amounts are in USD thousand*

**33.** contd.:

*Exposure to currency risk*

The Group's exposure to currency risk in it's major currencies is as follows:

| **2016** | **ISK** | **EUR** | **GBP** | **DKK** | **SEK** | **CAD** |
|---|---|---|---|---|---|---|
| Receivables / payables, net ...... | ( 42.193) | ( 24.156) | ( 12.718) | ( 3.468) | ( 3.203) | ( 11.252) |
| Cash and cash equivalents ....... | 23.325 | 20.534 | 7.530 | 3.186 | 3.662 | 5.468 |
| Secured bank loans ................. | ( 11.660) | 0 | 0 | 0 | 0 | 0 |
| Forward exchange contracts ..... | 118.302 | ( 27.954) | ( 19.780) | ( 17.024) | ( 22.239) | ( 26.104) |
| Net statement of financial position exposure ...... | 87.774 | ( 31.576) | ( 24.968) | ( 17.306) | ( 21.780) | ( 31.888) |
| Next 12 months forecast sales .......................... | 286.721 | 310.523 | 71.745 | 26.879 | 30.077 | 84.236 |
| Next 12 months forecast purchases ................. | ( 551.029) | ( 256.163) | ( 26.571) | ( 11.038) | ( 3.405) | ( 15.931) |
| Net 12 months currency exposure ................... | ( 176.534) | 22.784 | 20.206 | ( 1.465) | 4.892 | 36.417 |

| **2015** | **ISK** | **EUR** | **GBP** | **DKK** | **SEK** | **CAD** |
|---|---|---|---|---|---|---|
| Receivables / payables, net ...... | ( 68.709) | ( 25.218) | ( 14.926) | ( 3.396) | ( 4.512) | ( 10.057) |
| Cash and cash equivalents ....... | 16.339 | 19.487 | 9.337 | 1.449 | 5.990 | 14.637 |
| Secured bank loans ................. | ( 11.082) | 0 | 0 | 0 | 0 | 0 |
| Forward exchange contracts ..... | 54.054 | ( 45.748) | ( 14.820) | 0 | ( 11.862) | ( 14.040) |
| Net statement of financial position exposure ...... | ( 9.398) | ( 51.479) | ( 20.409) | ( 1.947) | ( 10.384) | ( 9.460) |
| Next 12 months forecast sales .......................... | 273.482 | 221.278 | 82.080 | 18.793 | 40.847 | 27.688 |
| Next 12 months forecast purchases ................. | ( 358.773) | ( 122.137) | ( 3.317) | ( 10.094) | ( 5.954) | ( 19.443) |
| Net 12 months currency exposure ................... | ( 94.689) | 47.662 | 58.354 | 6.752 | 24.509 | ( 1.215) |

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

| | **Average rate** | | **Year-end spot rate** | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| ISK ........................................................................ | 0,0083 | 0,0076 | 0,0088 | 0,0077 |
| EUR ........................................................................ | 1,11 | 1,11 | 1,05 | 1,09 |
| GBP ........................................................................ | 1,36 | 1,53 | 1,24 | 1,48 |
| CAD ........................................................................ | 0,76 | 0,78 | 0,75 | 0,72 |
| DKK ........................................................................ | 0,15 | 0,15 | 0,14 | 0,15 |
| SEK ........................................................................ | 0,12 | 0,12 | 0,11 | 0,12 |

*Consolidated Financial Statements of Icelandair Group hf. 2016* 34 *Amounts are in USD thousand*

**33.** contd.:

*Sensitivity analysis*

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

| **2016** | **Equity** | **Profit or loss** |
|---|---|---|
| ISK | (7.022) | 2.442 |
| EUR | 2.526 | 290 |
| GBP | 1.997 | 415 |
| DKK | 1.384 | (1.339) |
| SEK | 1.742 | (37) |
| CAD | 2.551 | 463 |
| **2015** | | |
| ISK | 752 | 5.076 |
| EUR | 4.118 | 458 |
| GBP | 1.633 | 447 |
| DKK | 156 | 156 |
| SEK | 831 | (118) |
| CAD | 757 | (366) |

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

**Interest rate risk**

The fair value of a fixed rate instrument will fluctuate because of changes in market interest rates. The cash flow of variable rate instruments will also fluctuate with changes in market interest rates. The Group follows a policy of hedging 40-80% of the net interest rate cash flow exposure of long-term financing with up to a 5-year horizon. This is achieved by using fixed rate loans and fixed for floating swap contracts.

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

| | **Carrying amount** | |
|---|---|---|
| | **2016** | **2015** |
| *Fixed rate instruments* | | |
| Financial assets | 3.230 | 2.945 |
| | 3.230 | 2.945 |
| Effect of derivatives | 20.124 | (29.742) |
| | 23.354 | (26.797) |
| *Variable rate instruments* | | |
| Financial assets | 246.563 | 210.824 |
| Financial liabilities | (165.209) | (22.005) |
| | 81.354 | 188.819 |

*Consolidated Financial Statements of Icelandair Group hf. 2016* 35 *Amounts are in USD thousand*

**33.** contd.:

*Fair value sensitivity analysis for fixed rate instruments*

The Group designates derivatives for the purpose of fuel, fx and interest rate hedging as hedging instruments under a fair value hedge accounting model. Interest rate changes affect the fixed rate instruments carrying amount through equity.

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

| | 100 bp | 100 bp |
|---|---|---|
| **31 December 2016** | **increase** | **decrease** |
| Fixed rate instruments | ( 63) | 66 |
| Effects of derivatives | ( 81) | 82 |
| Fair value sensitivity (net) | ( 144) | 148 |
| | | |
| **31 December 2015** | | |
| Fixed rate instruments | ( 58) | 60 |
| Effects of derivatives | 118 | ( 120) |
| Fair value sensitivity (net) | 61 | ( 60) |

*Cash flow sensitivity analysis for variable rate instruments*

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

| | 100 bp | 100 bp |
|---|---|---|
| **31 December 2016** | **increase** | **decrease** |
| Variable rate instruments | 651 | ( 651) |
| Cash flow sensitivity (net) | 651 | ( 651) |
| | | |
| **31 December 2015** | | |
| Variable rate instruments | 1.511 | ( 1.511) |
| Cash flow sensitivity (net) | 1.511 | ( 1.511) |

### Capital management

The Board's policy is to maintain a strong capital base for the benefit of investor, creditor and market confidence and to sustain future development of the business. The policy is to hold in cash and other highly liquid assets the equivilant of three months operating cost of which 30% of the benchmark can be in the form of unused lines of credit. Furthermore according to the policy the equity ratio shall not be less than 35%.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 36 *Amounts are in USD thousand*

## 34. Financial instruments and fair values

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

| | Carrying amount 2016 | Fair value 2016 | Carrying amount 2015 | Fair value 2015 |
|---|---|---|---|---|
| Derivatives, included in loans and receivables | 20.560 | 20.560 | 3.104 | 3.104 |
| Short term investments | 23.236 | 23.236 | 19.533 | 19.533 |
| Unsecured bond issue | ( 184.187) | ( 189.963) | ( 34.678) | ( 33.438) |
| Secured loans | ( 58.195) | ( 58.138) | ( 30.852) | ( 30.769) |
| Derivatives, included in payables and prepayments | ( 436) | ( 436) | ( 33.075) | ( 33.075) |
| Total | ( 199.022) | ( 204.741) | ( 75.968) | ( 74.645) |

### Fair value hierarchy:

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

| 31 December 2016 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Derivatives, included in loans and receivables | | 20.560 | | 20.560 |
| Short term investments | 23.236 | | | 23.236 |
| Unsecured bond issue | | | ( 189.963) | ( 189.963) |
| Secured loans | | | ( 58.138) | ( 58.138) |
| Derivatives, included in payables and prepayments | | ( 436) | | ( 436) |
| Total | 23.236 | 20.124 | ( 248.101) | ( 204.741) |

| 31 December 2015 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Derivatives, included in loans and receivables | | 3.104 | | 3.104 |
| Short term investments | 19.533 | | | 19.533 |
| Unsecured bond issue | | | ( 33.438) | ( 33.438) |
| Secured loans | | | ( 30.769) | ( 30.769) |
| Derivatives, included in payables and prepayments | | ( 33.075) | | ( 33.075) |
| Total | 19.533 | ( 29.971) | ( 64.207) | ( 74.645) |

The basis for determining the levels is disclosed in note 5.

### Non-derivative financial liabilities

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

### Derivatives

The fair value of forward exchange contracts is based on their quoted price, if available. If a quoted price is not available, then fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate based on government bonds.

The fair value of interest rate swaps is based on broker quotes. If not available the fair value is based on the discounted cashflow difference of the contratual fixed interest payment and the floating interest receivable.

Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group entities and counterparties when appropriate.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 37 *Amounts are in USD thousand*

## 35. Off-balance sheet items

### Leases as lessee

As a lessee the Group has in place operating leases for storage facilities, hotels, equipment and fixtures for its operations, the longest until the year 2041. The Group has also in place operating leases for aircraft with duration from 1,4 years to 6,25 years. During the year USD 35.1 million was recognised as an expense in profit or loss in respect of operating leases (2015: USD 35.0 million). At year end 2016 the leases are payable as follows in nominal amounts for each year:

| 2016 | Real estate | Aircraft | Other | Total |
|---|---|---|---|---|
| In the year 2017 | 13.281 | 16.761 | 10.067 | 40.109 |
| In the year 2018 | 16.794 | 15.225 | 3.049 | 35.068 |
| In the year 2019 | 19.922 | 9.024 | 3.333 | 32.279 |
| In the year 2020 | 19.694 | 7.624 | 3.003 | 30.321 |
| In the year 2021 | 18.961 | 2.994 | 2.440 | 24.395 |
| Subsequent | 231.271 | 1.830 | 33.165 | 266.266 |
| Total | 319.923 | 53.458 | 55.057 | 428.438 |

| 2015 | | | | |
|---|---|---|---|---|
| In the year 2016 | 14.813 | 19.688 | 6.111 | 40.612 |
| In the year 2017 | 16.522 | 15.663 | 1.968 | 34.153 |
| In the year 2018 | 21.017 | 13.761 | 2.249 | 37.027 |
| In the year 2019 | 20.778 | 7.560 | 2.242 | 30.580 |
| In the year 2020 | 20.871 | 6.160 | 2.298 | 29.329 |
| Subsequent | 277.594 | 1.530 | 33.520 | 312.644 |
| Total | 371.595 | 64.362 | 48.388 | 484.345 |

The aircraft lease payments consist of regular lease payments excluding maintenance reserves.

## 36. Leases as lessor

As a lessor the Company leases aircraft on wet, dry and various other terms, both on short and long term leases. Lease income for the year amounted to USD 84.6 million (2015; USD 83.4 million). Contracted leases at year end were as follows:

| | 2016 | 2015 |
|---|---|---|
| In the year 2016 | - | 63.274 |
| In the year 2017 | 72.138 | 51.619 |
| In the year 2018 | 77.036 | 51.511 |
| In the year 2019 | 33.231 | 19.777 |
| In the year 2020 | 29.146 | 13.559 |
| In the year 2021 | 11.142 | 5.152 |
| Total | 222.693 | 204.892 |

## 37. Guarantees

IG Invest, a former subsidiary of the Company, had an agreement with Boeing for the purchase of one Boeing 787 Dreamliner aircraft to be delivered in 2017. Despite the disposal of IG Invest, Icelandair Group was a guarantor for the capital commitments. In 2016 the Company reached an agreement with Boeing where the aircraft is scheduled to be sold to a third party and the Company is relieved of its commitments.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 38 *Amounts are in USD thousand*

## 38. Capital commitments

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

The delivery plan is as follows:

| | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|
| Boeing 737 MAX8 | 3 | 3 | 2 | 1 |
| Boeing 737 MAX9 | | 3 | 3 | 1 |
| Total | 3 | 6 | 5 | 2 |

## 39. Related parties

### Identity of related parties

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

### Transactions with management and key personnel

Salaries and benefits of management for their service to Group companies and the number of shares in the Company held by management are specified below. Salaries and benefits are presented in ISK, rounded to nearest thousand.

| Board of Directors: | 2016 Salaries and benefits ISK | Number of shares held at year-end 2016 in thousands | 2015 Salaries and benefits ISK | Number of shares held at year-end 2015 in thousands |
|---|---|---|---|---|
| Sigurður Helgason, Chairman of the Board | 8.750 | 14.000 | 8.100 | 14.000 |
| Ásthildur Margrét Otharsdóttir | 4.850 | | 4.500 | |
| Katrín Olga Jóhannesdóttir | 6.500 | 13 | 6.000 | 413 |
| Magnús Magnússon | 4.080 | | 4.500 | |
| Úlfar Steindórsson | 6.625 | | 6.150 | |
| **Key employees:** | | | | |
| Björgólfur Jóhannsson CEO of Icelandair Group hf. | 54.002 | 1.400 | 53.619 | 1.300 |
| Eight MD's of Group companies and CFO of Group | 297.950 | 1.111 | 273.181 | 6.111 |

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

### Transaction with associates

During the year 2016 the Group purchased services from associates for USD 0.1 million (2015: USD 0.1 million). The Group's revenues were USD 0.1 million from associates (2015: USD 0.1 million). Transactions with associates are priced on an arm's length basis.

### Transaction with shareholders

There are no shareholders with significant influence at year end 2016. Companies which members of the Board and key employees control have been identified as being thirteen. These companies have been identified as related. Transactions with them consist of purchase and sale of services in the ordinary course of business on an arm's length basis. Total purchases in 2016 from these entities amounted to USD 0.1 million (2015: USD 0.1 million). Total sales amounted to USD 0.1 million (2015: USD 0.1 million).

### 40. Reassessment of taxes

In 2015 the Internal Revenue Board issued a ruling disallowing the Company to recognize for tax purposes certain interest expenses on loans that were transferred to the Company in a reverse acquisition in 2006. In 2016 the management decided not to appeal the ruling and the effect, USD 8.0 million, has been recognized and is included in the income tax expense for the year.

### 41. Litigations and claims

The Icelandic Competition Authority (ICA) is investigating Icelandair's alleged predatory pricing in 2012-13 which could be considered as a breach of Article 11 of the Icelandic Competition Act. If the investigation will conclude that Icelandair had a dominant position in the market, and abused its position by predatory pricing, the ICA could lay an administrative fine on Icelandair for the alleged breach of the Competition Act. The ICA's decision may be appealed to the Icelandic Competition Appeals Committee. The Company's management is of the opinion that Icelandair's pricing in 2012-13 was fully compliant with the Competition Act.

### 42. Group entities

The Company held twelve subsidiaries at year end 2016 which are all included in the consolidated financial statements. They are as follows:

| | **Ownership interest** | |
|---|---|---|
| | **2016** | **2015** |
| Route network: | | |
| A320 ehf. | 100% | 100% |
| Air Iceland ehf. | 100% | 100% |
| Feria ehf. | 100% | 100% |
| Icelandair ehf. | 100% | 100% |
| Icelandair Cargo ehf. | 100% | 100% |
| Loftleiðir - Icelandic ehf. | 100% | 100% |
| Tourism services: | | |
| Iceland Travel ehf. | 100% | 100% |
| Icelandair Hotels ehf. | 100% | 100% |
| Shared services: | | |
| Fjárvakur - Icelandair Shared Services ehf. | 100% | 100% |
| IceCap Ltd., Guernsey | 100% | 100% |
| Iceeignir ehf. | 100% | 100% |
| IGS ehf. | 100% | 100% |

The subsidiaries further own fourteen subsidiaries that are also included in the consolidated financial statements. Four of those have non-controlling shareholders.

*Consolidated Financial Statements of Icelandair Group hf. 2016* 40 *Amounts are in USD thousand*

## 43. Statement of cash flows

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

| | 2016 | 2015 |
|---|---|---|
| Expensed deferred cost | 8.418 | 6.874 |
| Exchange rate difference and indexation of liabilities and assets | 4.820 | 455 |
| Gain on the sale of operating assets | ( 782 ) | ( 1.529 ) |
| Gain on sale of investments | ( 94 ) | 0 |
| Share in profit of associates | ( 957 ) | ( 459 ) |
| Income tax | 8.920 | 10.870 |
| Total other operating items in the statement of cash flows | 20.325 | 16.211 |

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

| | 2016 | 2015 |
|---|---|---|
| Inventories, (increase) decrease | ( 3.800 ) | 3.639 |
| Trade and other receivables, increase | ( 9.573 ) | ( 3.948 ) |
| Trade and other payables, (decrease) increase | ( 2.219 ) | 22.762 |
| Deferred income, increase | 13.815 | 11.423 |
| Net change in operating assets and liabilities in the statement of cash flows | ( 1.777 ) | 33.876 |

Additional cash flow information:

| | 2016 | 2015 |
|---|---|---|
| Interest paid | 5.267 | 7.947 |
| Interest received | 3.298 | 2.849 |
| Taxes paid | 30.139 | 8.880 |

## 45. Ratios

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

| | 2016 | 2015 |
|---|---|---|
| Current ratio | 0,92 | 0,80 |
| Equity ratio | 0,44 | 0,47 |
| Intrinsic value of share capital | 13,99 | 11,24 |

*Consolidated Financial Statements of Icelandair Group hf. 2016* 41 *Amounts are in USD thousand*

### 46 Significant accounting policies

The accounting policies set out in this note have been applied consistently to all periods presented in these consolidated financial statements and have been applied consistently by Group entities.

#### a. Basis of consolidation

##### (i) Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has right to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated statements from the date on which control commences until the date on which control ceases. When the Group looses control over subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related NCI and other compnonents of equity. Any resulting gain or loss is recognised in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

##### (ii) Investments in associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Interests in associates are accounted for using the equity method. They are initially recognised at cost, which includes transaction costs. Subsequent to initial recognition, the consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of associates, until the date on which significant influence ceases.

##### (iii) Transactions eliminated on consolidation

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

#### b. Currency exchange

##### (i) Currency transactions

Transactions in currencies other than functional currencies (foreign currencies) are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in currencies at the reporting date are translated to the functional currency at the exchange rate at that date. The currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortised cost in currency translated at the exchange rate at the end of the year.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Non-monetary items in a foreign currency that are measured based on historical cost are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on a financial liability designated as a hedge of the net investment in a foreign operation to the extent that the hedge is effective (see (iii) below), or qualifying cash flow hedges to the extent the hedge is effective, which are recognised in other comprehensive income.

##### (ii) Subsidiaries with other functional currency

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

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

**46** contd.:

**c. Financial instruments**

(i) **Non-derivative financial assets**

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

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

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to offset the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

The Group classifies non-derivative financial assets into the following categories: financial assets at fair value through profit or loss and loans and receivables.

**Financial assets at fair value through profit or loss**

A financial asset is classified at fair value through profit or loss if it is classified as held-for-trading or is designated as such on initial recognition. Financial assets are designated as at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group’s documented risk management or investment strategy. Attributable transaction costs are recognised in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value and changes therein which takes into account any dividend income, are recognised in profit or loss.

Financial assets classified as held-for-trading comprise marketable securities actively managed by the Group’s treasury department to address short-term liquidity needs.

**Loans and receivables**

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses.

Loans and receivables comprise restricted cash and cash equivalents and trade and other receivables.

**Cash and cash equivalents**

Cash and cash equivalents comprise cash balances and call deposits and marketable securities with original maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments.

**46** contd.:

(ii) **Non-derivative financial liabilities**

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

The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

The Group classifies non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognised initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost using the effective interest method. Other financial liabilities comprise loans and borrowings and trade and other payables.

(iii) **Share capital**

*Ordinary shares*

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognised as a deduction from equity, net of any tax effects.

*Repurchase and reissue of share capital*

When share capital recognised as equity is repurchased, the amount of the consideration paid, which includes directly attributable costs, net of any tax effects, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognised as an increase in equity, and the resulting surplus or deficit on the transaction is presented in share premium.

(iv) **Derivative financial instruments, including hedge accounting**

The Group holds derivative financial instruments to hedge its foreign currency, fuel price and interest rate risk exposures (see note 34). Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss as incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below. The Group holds no trading derivatives.

On initial designation of the derivative as a hedging instrument, the Group formally documents the relationship between the hedging instrument and hedged item, including the risk management objectives and strategy in undertaking the hedge transaction and the hedged risk, together with the methods that will be used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80-125 percent. For a cash flow hedge of a forecast transaction, the transaction should be highly probable to occur and should present an exposure to variations in cash flows that ultimately could affect reported profit or loss.

*Cash flow hedges*

When a derivative is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction that could affect profit or loss, the effective portion of changes in the fair value of the derivative is recognised in other comprehensive income and presented in the hedging reserve in equity. Any ineffective portion of changes in the fair value of the derivative is recognised immediately in profit or loss.

When the hedged item is a non-financial asset, the amount accumulated in equity is included in the carrying amount of the asset when the asset is recognised. In other cases the amount accumulated in equity is reclassified to profit or loss in the same period during which the hedged item affects profit or loss. If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, or the designation is revoked, then hedge accounting is discontinued prospectively. If the forecast transaction is no longer expected to occur, then the balance in equity is reclassified in profit or loss.

**46** contd.:

*Other non-trading derivatives*
When a derivative financial instrument is not designated in a hedge relationship that qualifies for hedge accounting, all changes in its fair value are recognised immediately in profit or loss.

**d. Operating assets**

(i) **Recognition and measurement**

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

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

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

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

(ii) **Aircraft and flight equipment**

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

(iii) **Subsequent expenditure**

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

(iv) **Depreciation**

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

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

| | **Useful life** |
|---|---|
| Aircraft and flight equipment | 3-17 years |
| Engines | Cycles flown |
| Buildings | 17-50 years |
| Other property and equipment | 3-20 years |

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

**46** contd.:

**e. Intangible assets and goodwill**

(i) **Goodwill and other intangible assets with indefinite useful lives**

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries. In respect of business acquisitions goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

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

Negative goodwill arising on an acquisition is recognised directly in profit or loss.

Goodwill, trademarks and airport slots with indefinite useful lives are stated at cost less accumulated impairment losses.

(ii) **Other intangible assets**

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

| | Useful life |
|---|---|
| Software | 3 years |
| Other intangible assets | 6-10 years |

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

(iii) **Subsequent expenditure**

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

**f. Leased assets**

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

**g. Inventories**

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

**46** contd.:

### h. Impairment

#### (i) Non-derivative financial assets

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

Objective evidence that financial assets are impaired includes:
Default or delinquency by a debtor;
Restructuring of an amount due to the Group on terms that the Group would not consider otherwise;
Indications that a debtor or issuer will enter bankruptcy;
Adverse changes in the payment status of borrowers or issuers;
The disappearance of an active market for a security because of financial difficulties; or
Observable data indicating that there is a measurable decrease in the expected cash flows from a group of financial assets.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognised. When an event occurring after the impairment recognised causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

#### (ii) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Goodwill and indefinite-lived intangibles assets are tested annually for impairment. An impairment loss is recognised if the carrying amount of an asset or cash-generating unit (CGU) exceeds its recoverable amount.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGUs. Subject to an operating segment ceiling test, for the purposes of goodwill impairment testing, CGUs to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination.

Impairment losses are recognised in profit or loss. Impairment losses recognised in respet of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU (group of CGUs), and then to reduce the carrying amounts of other assets in the CGU (group of CGUs) on a pro rata basis.

An impairment loss is recognised if the carrying amount of an asset or 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 other assets in the unit (group of units) on a pro rata basis.

The Group's corporate assets do not generate separate cash inflows and are utilised by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

**46** contd.:

An impairment loss in respect of goodwill is not reversed. For other assets, an impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

**j. Provisions**

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

**Overhaul commitments relating to aircraft under operating lease**

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

Provisions are entered into the statement of financial position among non-current and current payables, as applicable.

**i. Deferred income**

Sold unused tickets, fair value of unutilized frequent flyer points and other prepayments are presented as deferred income in the statement of financial position.

**Icelandair's frequent flyer program**

Frequent flyer points earned or sold are accounted for as a liability on a fair value basis of the services that can be purchased for the points. The points are recognized as revenue when they are utilized or when they expire.

**k. Operating income**

**(i) Transport revenue**

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

**(ii) Customer loyalty programmes**

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

**(iii) Aircraft and aircrew lease**

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

**46** contd.:

(iv) **Other operating revenue**

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

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

**l. Employee benefits**

(i) **Short-term employee benefits**

Short-term employee benefits are expensed when the related service is provided. A liability is recognised for the amount expected to be paid if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(ii) **Defined contribution plans**

Obligations for contributions to defined contribution plans are epensed when the related service is provided.

**m. Lease payments**

**Operating lease payments**

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

**n. Finance income and finance costs**

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

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

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

**o. Income tax**

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

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

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

**46** contd.:

A deferred tax asset is recognized for unused tax losses and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

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

**p. Earnings per share**

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

**q. Segment reporting**

An operating segment is a component of the Group that engages in business activities from which it may earn revenue and incur expenses, including revenue and expenses that relate to transactions with any of the Group’s other components. An operating segment’s operating results are reviewed regularly by the CEO to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available. The major revenue-earning assets of the Group is the aircraft fleet, the majority of which is registered in Iceland. Since the Group's aircraft fleet is employed flexibly across its route network, there is no suitable basis of allocating such assets and related liabilities to geographical segments.

Inter-segment pricing is determined on an arm's length basis.

Segment results, reported to the CEO include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly investments and related revenue, loans and borrowings and related expenses, corporate assets and head office expenses, and income tax assets and liabilities.

## 47 Standards issued but not yet effective

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2017 and earlier application is permitted; however, the Group has not early applied the following new or amended standards in preparing these consolidated fiancial statements.

IFRS 9, published in July 2014, replaces the existing guidance in IAS 39 *Financial Instruments: Recognition and Measurement.* IFRS 9 includes revised guidance on the classification and measurement of financial instruments, a new expected credit loss model for calculating impairment on financial assets, and new general hedge accounting requirements. It also carries forward the guidance on recognition and drecognition of financial instruments from IAS 39. IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted.

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces exisiting revenue recognition guidance, including IAS 18 *Revenue* , IAS 11 *Construction Contracts* and IFRIC 13 *Customer Loyalty Programmes* . IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adotpion permitted.

In January 2016, the IASB issued IFRS 16 Leases - realising its long-standing goal of bringing leases on-balance sheet for lessees. The new standard takes effect in January 2019. Early adoption is permitted if IFRS 15 Revenue from Contracts with Customers is also adopted. IFRS 16 will have substantial effect on the Group´s balance sheet as all leasing commitments exceeding 12 months will be recognized in the balance sheet at a discounted value.

The Group is assessing the potentioal impact on its consolidated financial statements resulting from the application of IFRS 9, IFRS 15 and IFRS 16.

In addition a number of new or amended standards are effective for annual periods beginning after 1 January 2017 but are not expected to have a significant impact on the Group´s consolidated financial statements.

# Corporate Governance Statement

### The framework

The guidelines on Corporate Governance issued by the Iceland Chamber of Commerce, NASDAQ OMX Iceland and the Confederation of Icelandic Employers, along with the Company's Articles of Association, and rules for Issuers of Securities listed on the NASDAQ OMX Iceland, make up the framework for Icelandair Group's Corporate Governance practices. The Company's Articles of Association are on the Company's website and the guidelines and the rules for Issuers are on the website of NASDAQ OMX Iceland.

The Company complies in all main respect to the rules mentioned above. The Company however does not have a Nomination Committee as the Board of Directors has not seen the need for it. No government organization has found the Company to be in breach with any rule or regulation regarding corporate governance.

In 2012 The Iceland Chamber of Commerce, the Confederation for Icelandic Employers and Nasdaq OMX Iceland hf. granted the Company a recognition for "Exemplary in corporate governance". The aim with the recognition is to increase credibility and transparency of Icelandic companies' corporate governance with respect to shareholders and interested parties.

### Internal audit and risk management

The Group's Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group's Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee. The committee shall oversee the annual accounts of the Company and the Group's consolidated accounts. The committee is responsible for evaluation of the independence and the eligibility of both the Company´s auditor and auditing firm. The committee shall make suggestions to the Board of Directors regarding the selection of the Company´s auditor. The Audit Committee held ten meetings in 2016.

Audit Commitee:
Katrín Olga Jóhannesdóttir, Chairman
Ásthildur Margrét Otharsdóttir
Magnús Magnússon

### Values and code of ethics and corporate responsibility

The company's values are:
WE CARE for our customers, employees, environment and shareholders.
WE THINK CLIENTS through consistency, reliability, clear product alternatives and friendly service.
WE DRIVE RESULTS via teamwork, shared information and values, accountability and profitability.

On 25 May 2009 the Board of Directors approved a Code of Ethics that was amended on 5 January 2011. The Code of Ethics is accessible to all Company's employees through the Company's intranet, MyWork.

### Compensation Committee

The purpose of the Compensation Committee is to avoid placing the Company's management in control of their own remuneration and, furthermore, to ensure that the management's remuneration is structured so as to serve the long-term interests of shareholders. The main tasks of the Compensation Committee are policy making with respect to the management's performance related bonuses, including stock options. The Committee conducts evaluations of management remuneration and monitors the management's acquisition of stock in the Company. The Compensation Committee meets on average four times a year.

Compensation Committee
Sigurður Helgason, Chairman
Úlfar Steindórsson

## The Board of Directors and Executive Committee

### *Board of Directors*

*Sigurður Helgason, Chairman*

Sigurður Helgason was born in 1946. He was President & CEO of Flugleidir/FL-Group/Icelandair 1985 - 2005. He was Director of Cash Management 1974-1980, Senior Vice-President of Finance 1980-1983 and General Manager of The Americas 1983-1985 for Flugleidir/Icelandair. He was Chairman of the Board of The Icelandic International Development Fund 2005-2008. He is the Chairman of the Icelandair Special Children Travel Fund since 2005. He was a member of the IATA board of Govenors 2004/2005. He graduated with a MBA degree from The University of North Carolina, Chapel Hill, USA in 1973 and a Cand. Oecon. degree from the University of Iceland in 1971. He joined the Board on 6 August 2009.

*Úlfar Steindórsson, Deputy Chairman*

Úlfar Steindórsson was born in 1956 and is CEO and Chairman of Toyota in Iceland ehf. and Jú ehf. He was CEO of Primex ehf in Siglufjordur from 2002-2004, and CEO of the New Business Venture Fund from 1999-2002. Úlfar is chairman of the board of Eignarhaldsfélagið Bifreiðar ehf., Bifreiðainnflutningur ehf., Bílaútleigan ehf., Okkar bílaleiga ehf., and TK bílar ehf. He is a Board member of Toyota á Íslandi ehf, Krókasslóð ehf, TMH Iceland ehf, AB 257 ehf, UK fjárfestingar ehf, Johan Rönning hf, S.Guðjónsson ehf., Skorri ehf., My Car ehf. and UK fjárfestingar ehf. Úlfar holds a Cand. Oecon degree from the University of Iceland and an MBA from Virginia Commonwealth University. He joined the Board on 15 September 2010.

*Ásthildur Margrét Otharsdóttir*

Ásthildur was born in 1968 and is an independent management consultant with prior business experience as Global Director of Treasury and Corporate Development at Össur hf., Senior Account Manager at Kaupthing Bank hf. and Management Consultant at Accenture in Copenhagen. She is Chairman of the Board of Directors of Marel hf. and Frumtak 2 Venture Fund. Ásthildur is a member of the Council of the University of Iceland and the Court of Arbitration of the Icelandic Chamber of Commerce. Ásthildur has an MBA degree from the Rotterdam School of Management, Erasmus University and a Cand. Oecon degree from the University of Iceland. She joined the Board on 23 March 2012.

*Katrín Olga Jóhannesdóttir*

Katrín Olga Jóhannesdóttir was born in 1962 and is the former Chief Strategy Officer of Skipti hf. and the current Chairman and shareholder of Já hf. Before that she was VP for sales and marketing and VP for residential markets at Síminn hf. Prior to that she held a position as the Managing Director of Navision Iceland and was a management consultant at VSO. Katrín Olga currently serves on the Boards of Directors of Ölgerðin hf., the Iceland Chamber of Commerce and Njála ehf. Having previously served on the Boards of the Central Bank of Iceland., Sirius IT and SkjáMiðlar. She holds a Cand. Oecon degree from the University of Iceland and an M.Sc. in Business Economics from Odense University. She joined the Board on 6 August 2009.

*Magnús Magnússon*

Magnús has been employed as a division manager at LBI hf. since early 2009, having previously worked for Búnadarbankinn and the financing company Lýsing following a period of self-employment from 2003 to year-end 2008. Magnús currently serves on the Boards of Directors of Lýsi hf. and the manufacturing and contracting company Loftorka in Borgarnes, as well as several subsidiaries of LBI hf. Magnús holds a degree in business economics from the University of Iceland and a Masters Degree in international business from Norges Handelshøyskole. Magnús has been a reserve member of Icelandair Group‘s Board of Directors since 2009 and a member of the Board since fall 2014.

***Executive committee***

*Björgólfur Jóhannsson, president and CEO*

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

*Bogi Nils Bogason, CFO*
*Birkir Hólm Guðnason, CEO of Icelandair*
*Magnea Þórey Hjálmarsdóttir, Managing Director of Icelandair Hotels*

***Board of Directors***

The Company's Board of Directors exercises the supreme authority in the Company's affairs between shareholders' meetings, and it is entrusted with the task of ensuring that the organisation and activities of the Company's operation are at all times in correct and proper order.

The Board of Directors is instructed in the Company's Articles of Association to appoint a President and CEO for the Company and decide the terms of his or her employment. The Board of Directors and President and CEO are responsible for the management of the Company.

The Company's Board of Directors must at all times ensure that there is adequate supervision of the Company's accounts and the safeguarding of its assets and shall adopt working procedures in compliance with the Companies Act. Only the Board of Directors may assign powers of procuration on behalf of the Company. The signatures of the majority of the members of the Board are required to bind the Company. The President and CEO has charge of the day-to-day operation of the Company and is required in his work to observe the policy and instructions set out by the Company's Board of Directors. Day-to-day operation does not include measures which are unusual or extraordinary. Such measures can only be taken by the President and CEO with the specific authorization of the Board of Directors, unless it is impossible to await the decision of the Board without seriously disadvantaging the operation of the Company. In such instances, the President and CEO is required to consult with the Chairman of the Board, if possible, after which the Board of Directors must immediately be notified of the measures. The President and CEO shall ensure that the accounts and finances of the Company conform to the law and accepted practices and that all assets belonging to the Company are securely safeguarded. The President and CEO is required to provide the members of the Board of Directors and Company auditors with any information pertaining to the operation of the Company which they may request, as required by law.

The Company's Board of Directors consists of five members elected at the annual general meeting for a term of one year. Those who intend to stand for election to the Board of Directors must inform the Board in writing of their intention at least five days before the annual general meeting, or extraordinary shareholders' meeting at which elections are scheduled. Only those who have informed the Board of their candidacy are eligible.

The Board of Directors elects a Chairman and Deputy Chairman from its members, and otherwise allocates its obligations among its members as needed. The Chairman calls Board meetings. A meeting must also be held if requested by a member of the Board of Directors or the President and CEO. Meetings of the Board are valid if attended by a majority of its members. However, important decisions shall not be taken unless all members of the Board have had an opportunity to discuss the matter, if possible. The outcome of issues is decided by force of vote, and in the event of an equality of votes, the issue is regarded as rejected. The President and CEO attends meetings of the Board of Directors, even if he or she is not a member of the Board, and has the right to participate in discussions and submit proposals unless otherwise decided by the Board in individual cases. A book of minutes is kept of proceedings at meetings and must be signed by participants in the meeting. A Board member who disagrees with a decision made by the Board of Directors is entitled to have his or her dissenting opinion entered in the book of minutes. The same applies to the President and CEO. The Chairman is responsible for the Board's relations with the shareholders and he shall inform the Board on the views of the shareholders.

On 12 September 2007 the Board of Directors approved Rules on Working Procedures for the Board of Directors that was emended on 10 August 2012. The Rules on Working Procedures are accessible to the Board of Directors and the management through the Board's intranet, Coredata. In accordance with article 14 of the Rules on Working Procedures the Board of Directors must annually evaluate its work, size, composition and practices, and must also evaluate the performance of the CEO and others responsible for the day-to-day management of the Company and its development. The annual performance assessment is intended to improve working methods and increase the efficiency of the Board. The assessment entails e.g. evaluation of the strengths and weaknesses of the Board's work and practices and takes into consideration the work components which the Board believes may be improved.

The Board of Directors elects the members of the two sub-committees; the Compensation Committee and the Audit Committee. The sub-committees adhere to the Rules on Working Procedures. The Board of Directors convened eighteen times in the year and all Board Members attended almost all meetings. All the Members of the Board of Directors are independent from the Company, except Ásthildur Margrét Otharsdóttir. All Board members were independent of the Company's major shareholders in 2015.

# Non-Financial Reporting

## About Icelandair Group ehf.

Icelandair Group operates in the international airline and tourism sectors, with Iceland as the focal point of its international Route Network. Icelandair Group‘s business concept is built on Icelandair‘s Route Network and on marketing Iceland as a year-round destination. In addition to the international passenger flights operated by Icelandair, the Group has extensive interests in most other parts of Icelandic tourism and aviation, including hotel chains, travel agencies, regional airline and cargo, support services and ground handling and technical services, in addition to its leasing and charter operations.

## Icelandair Group and Society

The implementation of a sustainability policy is most likely to be successful if the policy is directly linked to the Company’s business strategy. That is how we contribute best to our society.

Icelandair Group is a part of the Icelandic society. Icelandair Group is proud of its role in the Icelandic community and continues to seek new opportunities to expand its ties to society at large. That is how the Group energises the power of the Icelandic tourism industry for the benefit of Iceland as a nation.

The Company focuses on creating sustainable value for its stakeholders by integrating into its business model a wide range of efforts to ensure social responsibility.

### Environment

Minimize our impact on the environment by setting measurable targets, raising awareness and benchmarking our performance to do better than before.

### Employees

Commitment to our employees with extensive programmes for human resource development.

### Society

Co-operate with society and ensure that the impact of our operations is beneficial through direct contributions and positive engagement with society at large.

## Environment

Icelandair Group is an environmentally conscious company, committed to addressing its environmental responsibilities. We are dedicated to minimising the environmental impact of our operations, both globally and locally, by reducing emissions, conserving natural resources and optimising the use of sustainable energy and materials.

Icelandair Group’s environmental impact is not limited to flight operations. It also involves ground facilities, offices and maintenance areas. Our goal is to maximise the use of green energy and minimise waste in all operations by embracing sustainable solutions. In order to achieve this goal, Icelandair Group is completing the implementation of Environmental Management Systems for all Icelandair Group companies.

Icelandair Group’s Environmental Policy describes our approaches to protecting and preserving the environment. All Company employees are responsible for ensuring compliance with Company policy. Management at all Company subsidiaries and entities are adopting guidelines and procedures to comply with the Company’s environmental policy. Minimising the environmental impact of our operations is an important element of Icelandair Group‘s business plan. We are focused on keeping Icelandair Group green by means of sustainable practices and optimal use of the resources at our disposal. Icelandair Group is committed to minimising its impact on the environment by continuous improvement of the Company’s environmental policies, sustainable material use and disposal, conduct of business with environmentally friendly suppliers and adherence to environmental protection principles.

We recognise that even though the operations of our subsidiaries may vary, we share important principles. In addition to compliance with applicable laws and regulations, we show our continuing commitment by:

- Minimising our carbon footprint and raising awareness
- Reducing waste by increasing recycling
- Promoting responsible use of resources n Increasing the use of environment

We are committed to supporting continuous improvement by setting measurable targets, raising awareness and benchmarking our performance.

### Employees

Icelandair Group seeks to attract talented and qualified personnel who can help the Company meet the challenges of the future while at the same time fitting into the existing corporate culture. We provide access for our employees to further development and training so that we can always select the best person for every job. We make every effort to improve the well-being of our employees, maintaining an attractive, yet challenging and demanding workplace, and enabling them to flourish and achieve their highest potential. Our HR strategy emphasises equality and non-discrimination and embraces diversity. We also train our employees in observing safety and security standards and we have in place detailed action plans designed to achieve our goals. We make sure that our employees are given equal opportunities to further their careers. Above all, we endeavour to make sure that all our employees feel they are part of a team. We regularly carry out work audit surveys among Icelandair Group employees, where we try to measure various indicators of how well our HR strategy is working. We regularly score high in job satisfaction and employee engagement, and in the latest survey, conducted this autumn, these factors showed higher scores than ever before.

### Society

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

### Anti-corruption and bribery policy

Our Anti-corruption and bribery policy establishes Icelandair Group‘s and all it‘s subsidiaries global standards regarding the prevention of corruption and bribery. It is our policy to conduct all our business in an honest and ethical manner and the integrity of each and every member of our staff serves to maintain the good reputation and trust of Icelandair Group. Our policy addresses bribery and corruption, facilitation payments, extortion and whistle-blowing.

The policy applies to the entire Icelandair Group workforce at all levels and grades (whether permanent, fixed-term or temporary), and all operations, subsidiaries and affiliates in all countries that we operate.

All persons, representing or performing services for or on behalf of Icelandair Group must comply with applicable anti-bribery and anti-corruption legislation and policies and Icelandair Group‘s Code of Conduct. Those who work for or on behalf of Icelandair Group will not be penalised in any way for business advantage lost due to adherence to this policy. Deviations or non compliance, including attempts to circumvent or manipulate this policy,may result in disciplinary action, including termination.

### Responsibility

Further information about Icelandair Group´s Corporate Social Responsibility is published in the Company´s Annual Report as well as on the Company´s website, www.icelandairgroup.is.

# Quarterly statements (unaudited)

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

| | Q1 | Q2 | Q3 | Q4 | Total |
|---|---|---|---|---|---|
| **Year 2016** | | | | | |
| Operating income | 211.837 | 331.355 | 485.910 | 256.472 | 1.285.574 |
| Operating expenses excluding depreciation | (210.083) | (277.467) | (324.160) | (254.019) | (1.065.729) |
| Operating profit bef. depr. (EBITDA) | 1.754 | 53.888 | 161.750 | 2.453 | 219.845 |
| Depreciation | (21.768) | (23.198) | (29.622) | (26.820) | (101.408) |
| Operating (loss) profit (EBIT) | (20.014) | 30.690 | 132.128 | (24.367) | 118.437 |
| Net finance (expense) income | (1.325) | 2.132 | (1.666) | 1.576 | 717 |
| Share of profit (loss) of associates | 55 | (58) | 363 | 597 | 957 |
| (Loss) profit before income tax | (21.284) | 32.764 | 130.825 | (22.194) | 120.111 |
| Income tax | 4.288 | (6.595) | (28.060) | (676) | (31.043) |
| **(Loss) profit** | (16.996) | 26.169 | 102.765 | (22.870) | 89.068 |
| Other comprehensive profit | 9.175 | 22.647 | 9.562 | 8.198 | 49.582 |
| **Total comprehensive (loss) income** | (7.821) | 48.816 | 112.327 | (14.672) | 138.650 |
| | | | | | |
| Working capital from (used in) operations | 3.023 | 57.310 | 161.169 | (10.701) | 210.801 |
| Net cash from (used in) operating activities | 148.792 | 119.636 | (19.933) | (39.471) | 209.024 |
| Net cash used in investing activities | (99.801) | (58.277) | (63.695) | (69.986) | (291.759) |
| Net cash (used in) from financing activities | (3.295) | (28.500) | (2.289) | 147.727 | 113.643 |
| | | | | | |
| **Year 2015** | | | | | |
| Operating income | 186.075 | 294.212 | 429.446 | 229.966 | 1.139.699 |
| Operating expenses excluding depreciation | (188.083) | (244.100) | (273.826) | (207.024) | (913.033) |
| Operating (loss) profit bef. depr. (EBITDA) | (2.008) | 50.112 | 155.620 | 22.942 | 226.666 |
| Depreciation | (17.011) | (21.872) | (23.869) | (21.074) | (83.826) |
| Operating (loss) profit (EBIT) | (19.019) | 28.240 | 131.751 | 1.868 | 142.840 |
| Net finance income (expense) | 625 | (317) | (1.378) | (2.006) | (3.076) |
| Share of profit (loss) of associates | 90 | 0 | 381 | (12) | 459 |
| (Loss) profit before income tax | (18.304) | 27.923 | 130.754 | (150) | 140.223 |
| Income tax | 3.752 | (5.558) | (27.611) | 417 | (29.000) |
| **(Loss) profit** | (14.552) | 22.365 | 103.143 | 267 | 111.223 |
| Other comprehensive profit (loss) | 3.056 | 15.206 | (4.695) | (15.371) | (1.804) |
| **Total comprehensive (loss) income** | (11.496) | 37.571 | 98.448 | (15.104) | 109.419 |
| | | | | | |
| Working capital from operations | 1.164 | 49.611 | 157.406 | 3.079 | 211.260 |
| Net cash from operating activities | 117.687 | 86.724 | 4.085 | 36.640 | 245.136 |
| Net cash used in investing activities | (37.611) | (34.559) | (60.265) | (87.507) | (219.942) |
| Net cash from (used in) financing activities | 19.880 | (20.716) | (2.868) | (10.616) | (14.320) |

*Consolidated Financial Statements of Icelandair Group hf. 2016* 58 *Amounts are in USD thousand*