Icelandair Group Annual Report 2009

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Chairman's Address

Sigurdur Helgason,
Chairman of the Board

Although the year 2009 was extremely difficult for the aviation industry in general, most of the operating companies within the Icelandair Group showed a satisfactory result. Nevertheless the Group's losses over the year amounted to ISK 10.7 billion. The Company's overall revenue grew by 11% over the year amounting to slightly over ISK 80 billion. Earnings before financial items, taxes and depreciation (EBITDA) amounted to ISK 8.1 million in 2009, increasing by over 160% between years.

In other words the loss of the year did not result from poor operation of the Group's core activities, but from heavy burden of debts and misguided investments in previous years. A large part of the loss is a consequence of guarantees issued by Icelandair Group to SmartLynx in 2007 and the negative impact of Travel Service on the Group. Another decisive factor was the unsustainable leverage of the parent company, which has roots back in 2006. The conclusion is that the losses of the Company in 2009 can primarily be attributed to problems relating to extensive and unsustainable leverage of the Company in the last few years.

At the end of 2009 the Group's total assets amounted to ISK 89 billion, as compared to ISK 100 billion at year-end 2008. The difference is mainly explained by the spin-off of the Czech airline Travel Service from the Group following the sale of a 20% share in the company in the last quarter of 2009. Equity amounted to ISK 14.6 billion, and the equity ratio was 16%. The net interest-bearing debt of the Company was reduced by almost ISK two billion and amounted to ISK 41.2 billion by the end of 2009.

It has been clear since the end of 2006 that the Icelandair Group was excessively leveraged and its interest burden was far too heavy. It is therefore essential that the financial restructuring efforts that have been ongoing since late 2008 are brought to a successful conclusion in order to ensure that the operations of the Company will support its loan repayment schedule. It is my belief, and this belief is shared by other Board Members, that following the financial restructuring, the Company will find itself in a favourable position to move forward with its operation of an international airline route network and comprehensive services to travellers with Iceland as a cornerstone.

The Group's investments in foreign companies have met with a lack of success, and there is no reason to conceal this fact. It is a conservative assertion that the Company's investments in SmartLynx and Travel Service proved expensive. In 2009, ISK 4.2 billion were expensed as a result of operating losses and write-offs relating to the Latvian airline SmartLynx. In addition, expensed items relating to the Czech airline Travel Service amounted to approximately ISK 1.9 billion. Neither company forms a part of Icelandair Group's core business, and the Board of Directors of the Company has therefore decided to sell both companies when the opportunity arises.

The basic operation of the Icelandair Group of companies will rest on solid ground following the Company's financial restructuring. The restructuring will bring under control the Company's balance sheet, which was inflated beyond reason in the investment frenzy that gripped Icelandic businesses in the last few years.

In the future, Icelandair Group will be built on the old values that so many people lost sight of in recent years.

The Company's business operations will be based on diverse services to travellers, and not on risky foreign investments. There is a full consensus within the Board of Directors on this point. Concurrently with the shift in focus, Icelandair Group's business model will be simplified.

As usual external factors challenged the aviation industry in 2009. Not to mention the financial crises there were significant fluctuations in the world market price of fuel. At the beginning of the year, the cost of a single barrel of Brent oil was approximately USD 43 dollars rising to a peak of USD 80 at year-end. Although the price remained relatively low, these price fluctuations caused problems for a number of airlines.

Another external and unexpected factor was the A(H1N1) pandemic that raged the world causing hesitations among the travelling public and hence had significant consequences for the airlines. And the volcanic eruption in Eyjafjallajökull this year is another reminder of the vulnerability of our industry to forces of nature.

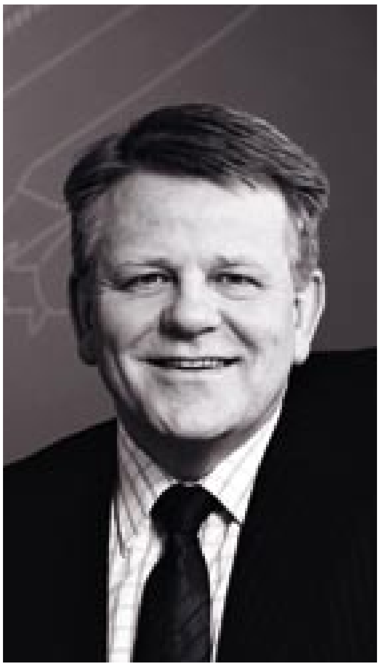
The International Air Transport Association (IATA) has estimated the total loss of the world's airlines in 2009 at a minimum of nine to ten billion US dollars. At the same time it is established that the reduction in international passenger demand was around 3.5%, and about 10% in freight carried by air. Aviation has not seen bigger reduction since World War II.

IATA has expressed the opinion that demand is likely to continue its decline in the coming years. Most of the world's airlines have met reduced demand by cutting capacity in 2009. However, the most recent figures from IATA indicate that the decline may have reached the bottom, although it is still unclear what final effects of the flight restrictions as a result of the eruption in Eyjafjallajökull will be.

Tourist services are not the exclusive interest of a limited group of people. Tourism is one of the largest industries in the world and is fundamental to Iceland's economy returning about ISK 155 billion in revenues in foreign currency in 2009. This corresponds to around 20% of Iceland's total revenues in foreign currency in 2009. In comparison, industry accounted for 24% and the sale of fisheries products for 27% of foreign income. This makes tourism the third pillar of the Icelandic economy.

Looking ahead, I can only feel optimistic about Icelandair Group's future, largely because of the financial restructuring that is now being implemented and the reduced value of the Icelandic krona is playing to the advantage of Iceland's tourism industry. The current economic difficulties in Iceland and elsewhere have forced business enterprises like Icelandair Group to look inwards and scrutinise the nuts and bolts of improving operational efficiency. The result will be that Icelandair Group will emerge from the current difficulties as a stronger company, better suited to continue its vigorous business activities in coming years. I want to thank all of the Company's employees for their excellent work and important contribution and all of our customers for the business loyalty. Last but not least, I would like to thank our shareholders for their trust in the Board of Directors during the year.

CEO's Address



Björgólfur Jóhannsson,
President and CEO

The year 2009 was in many ways an extraordinary year for Icelandic business operations. The year saw the start of extensive realignment in the Icelandic economy following the collapse of the banks, and there was uncertainty in virtually all international markets. Iceland was by no means the only country affected: throughout the world fluctuations in currency and oil prices appear to have been mere precursors of the turmoil in the international markets resulting from the persistent debt problems of many of the world's largest countries. Greater stability would be a welcome respite in 2010, but unfortunately the first few months of the year have shown indications of continued unrest, at least for the time being.

Although Icelandair Group was not left untouched by the unrest, the success of the Company's core operations exceeded expectations. The Group posted a loss of ISK 10.7 billion for the year, but its underlying core operations were nevertheless sound. Icelandair, the Group's largest subsidiary by far and accounting for over 55% of total income, showed its best results in years. Also, Air Iceland showed a good operating profit; better in fact, than in many previous years. The operations of Loftleidir, Bluebird, Icelandair Shared Services and Iceland Travel showed a profit in 2009 as well, but on the whole other Icelandic subsidiaries performed on par. Losses and expenses from Travel Service and SmartLynx, on the other hand amounted to approximately ISK 6 billion, which is completely unacceptable.

The consequences of the banks' collapse in Iceland are becoming more evident by the day. Such is the destruction that the collapse can best be described as a man-made catastrophe; it is clear that it will be some time before the economy regains its former strength. The business sector has not been left unscathed by the upheaval, and it can safely be surmised that most of the time of the managers of Iceland's largest companies has been spent on financial restructuring efforts, and the work is far from over. The long and short of it is that excessive debt lies at the root of many companies' problems.

If there is anything that we can learn from history, it is the fact that the day of reckoning will dawn sooner rather than later. The operating losses of the Group last year were a direct consequence of acquisitions of foreign companies and excessive leverage of the parent company dating back to 2006. These decisions were made in circumstances when access to capital was easy and capital was cheap. Not to put too fine a point on it, the parent Company's debt became unsustainable and the current flow of net income will not, in unchanged conditions, cover payments and service of the Company's debts. The Board of Directors therefore had no alternative but to seek a partnership with its creditors on financial restructuring in order to secure the foundation of the Company's future operations.

The financial restructuring work was the most important and most extensive task of the Company's management in 2009. Negotiations with the Company's creditors were in progress throughout 2009, and we now believe that a favourable resolution may be in sight. The broad outline of the financial restructuring is that creditors will buy the Company's holdings in Travel Service and Bluebird, receive the gains of the Boeing 787 contracts, paying the acquisition price by taking over debts.

Concurrently with the sale of assets, the creditors will convert a part of their claims into shares, thereby strengthening the Company's equity base. Based on current plans, the financial restructuring should result in approximately ISK 15 billion reduction in interest-bearing debts. Following the financial restructuring, our vision is of a strong, resurgent operating company, with the Group's current creditors refinancing the Company's outstanding debt for the most part.

It is my opinion that the Company is set to become an attractive investment opportunity following the financial restructuring. However, we believe that it should first be strengthened still further through the issue of new shares. We have planned a public offering later this year to professional and private investors. In my estimation, a target of at least ISK eight billion in new shares is realistic. It is extremely important for the offering to succeed and for the Icelandic stock market to regain its footing and start out on a path of growth once more.

The Board of Directors of the Company has laid down a new strategy based on a simplified business model. From this point on, Icelandair Group is no longer defined as an investment company; instead, the Group will serve as an operating company, focusing on the operation of an international air route network with Iceland as a hub and services to travellers. The new business model reflects the new focus of the Group and the change in direction will be signalled by the sale of the Group's shares in Travel Service, SmartLynx and Bluebird.

I welcome these changes, and I believe that they will place the Company in a better position to serve its customers. From now on we will concentrate on doing what we do best: airline operations and universal services to travellers; our new business model reflects these two supporting pillars of the Company.

Icelandair Group is the most important and largest travel service company in Iceland. Through its subsidiaries, the Company holds a leading position in international air travel, domestic air travel, the hotel market and various areas of air travel and general tourist services. We are proud of our position, but we do realise that with this position comes great responsibility, which can best be addressed through continued advances in the interests of Icelandic tourism.

This responsibility does not mean simply creating conditions for maintaining the flow of tourists to Iceland, but also providing Icelanders with the best available travel services. In spite of the challenging environment of recent months and years our basic operation has been successful, which bodes well for the future. I want to thank all of our employees for their continued commitment and professionalism.

We have shown that we are worthy of trust.

Year in Review

January
Ómar Benediktsson was appointed Managing Director of the charter airline SmartLynx in Latvia. Ómar was Vice-chairman of the Board of Directors of Icelandair Group in the two preceding years, but left the board at the Annual General Meeting in March 2009.

Notices from Icelandair Group published in connection with the posting of the Group's interim financial statements in 2008 revealed that the Group held notes amounting to ISK 2.5 billion with payment due on 23 January 2009. In co-operation with its commercial bank, Íslandsbanki, Icelandair Group has completed its refinancing of the notes for the short term.

March
The annual general meeting of Icelandair Group was held in March and the Group published its Annual Report for 2008. Icelandair, a subsidiary of Icelandair Group, introduced four direct scheduled flights a week to Seattle in the USA, starting in the summer of 2009. This destination fits with Icelandair's route network, which is based on Iceland's' geographic location between North America and Europe.

May
Íslandsbanki hf. acquired 42% of the shares in Icelandair Group hf. It was announced that the Company would continue to be listed on OMX NASDAQ and that the Bank's stake would be sold in an open and transparent sales procedure as soon as possible.

June
A share capital increase in Travel Service was carried out. Icelandair Group's co-owners Unimex Group and Roman Vik subscribed to the new shares in the company. Following the share capital increase the shareholding of Icelandair Group in Travel Service was reduced to 50.1% from the previous 66%.

July
The Board of Directors announced that a shareholder's meeting would be held on 6 August. The Board of Directors asked for shareholders' approval of authorisation to increase the share capital of the Company by up to ISK 4.000.000.000 - four billion Icelandic krónur - by means of subscriptions to new shares. The Board of Directors also announced that elections to the Board would be held at the shareholders' meeting.

August
The shareholders' meeting announced in July approved the proposals submitted at the meeting and the following candidates were elected to the Board of Directors of Icelandair Group:

Board members:
Finnur Reyr Stefánsson
Jón Ármann Gudjónsson
Katrín Olga Jóhannesdóttir
Pétur J Eiríksson
Sigurdur Helgason

Alternate board members:
Kristín Einarsdóttir
Magnús Magnússon
Tómas Kristjánsson

Following the meeting, the board of directors met and elected Sigurdur Helgason as chairman and Finnur Reyr Stefánsson as Vice-chairman.

September
Icelandair, Icelandair Group's largest subsidiary, announced the expansion of its schedule and plans to increase tourism in 2010. The Company announced plans to increase capacity by up to 10% between years, increasing the number of foreign tourists by about 20-25 thousand and creating over 400 jobs in aviation and tourism throughout the country. Brussels and Trondheim were announced as new destinations in the summer of 2010.

November
Icelandair Group signed an agreement on the sale of 20% of its share in the Czech airline Travel Service. Following the divestment Icelandair Group holds a 30% share in Travel Service. The sale had the result that Travel Service became an affiliated company instead of being a subsidiary. The effects of the sale on the income statement were negative by ISK 0.9 billion and equity decreased by ISK 1.5 billion. The Group's total assets were reduced by ISK 12 billion.


FLIGHT DISPATCH SERVICES

The Group

Icelandair

Icelandair aims to be the preferred airline to and from Iceland and an attractive choice for North Atlantic travel, committed to providing safe and efficient air travel and unique services. Icelandair has built up an international route network with Iceland, a sparsely populated island in the North Atlantic, as a hub. Instead of viewing the country's isolation as an obstacle, the company has transformed its geographical location into a business opportunity.

Icelandair operates under an Air Operators Certificate issued by the Icelandic Civil Aviation Authority and is, as such EASA compliant. Icelandair is an Icelandic carrier and has route rights in accordance with this status. Icelandair Technical Services provides maintenance and technical services for the Icelandair fleet, with the majority of the work performed at the Service Centre at Keflavik International Airport.

The Icelandair business strategy is based on the position of Iceland on the flight route between northern Europe and North America. Icelandair divides its marketing activities into three main categories: travel from Iceland, travel to Iceland and travel via Iceland – that is to say flights between Europe and North America with a stopover in Iceland. By linking these three markets using the same aircraft and the same route network the company has succeeded in sustaining and strengthening this business over a long period of time.

Icelandair connects 15-20 European cities to 5-8 North American cities through the hub in Iceland. The network is based on a 24 hour rotation with aircraft departing Iceland early morning for Europe, returning in the late afternoon and then leaving for Canada and USA in the early evening. These then arrive back in Iceland early the following morning and the process is repeated. In 2009 Icelandair introduced Stavanger and Seattle into the network and has announced services to Brussels, Belgium and Trondheim, Norway as of spring 2010. Icelandair is increasing capacity in its network by 13% in 2010 from the year before, carrying an expected 1.6 million passengers.

What Icelandair's international expansion has accomplished for Icelanders, apart from an increase in the number of tourists and the business activities that have developed around the tourist industry throughout the country, is a system of outstanding flight services between Iceland and other countries. By linking the Icelandic "micromarket" with the international airline route network, Icelandair has been able to offer greater frequency, more destinations and better efficiency and services than would otherwise be possible.

Birkir Hólm Gudnason is the CEO of Icelandair.

Air Iceland

Air Iceland is a dynamic company operated with the objective of offering a strong but flexible airline service for the West Nordic countries. The company runs scheduled domestic flights within Iceland, as well as routes from Iceland to Greenland and the Faeroe Islands.

Air Iceland offers flights to seven destinations within Iceland, covering all major urban centres as well as a number of smaller towns. From Reykjavík, Air Iceland flies to Akureyri, Egilsstadir, Ísafjördur and the Vestmanna Islands. From Akureyri, in cooperation with other carriers, Air Iceland flies to Grímsey, Thórshöfn and Vopnafjördur. Air Iceland offers flights to five destinations in Greenland. All year round Air Iceland flies to Kulusuk, and to Nerlerit Inaat, both on the east cost of Greenland. Over the summer Air Iceland offers flights to Narsarsuaq, Ilulissat and Nuuk, the capital of Greenland.

Air Iceland offers year-round flights to the Faeroe Islands in partnership with Atlantic Airways. In 2009, Air Iceland carried 376,000 passengers, including 22,000 passengers on international flights.

Air Iceland's fleet consists of six Fokker 50 aircraft and two DASH 8-100 aircraft.

Air Iceland holds a solid position in the Icelandic domestic air transport market. Demand has been strong on the company's main routes and is expected to remain strong. The busiest routes are from Reykjavík to Egilsstadir and Akureyri.

Árni Gunnarsson is the Managing Director of Air Iceland.

Icelandair Cargo

The company bases its business on scheduled services between Iceland, Europe and North America, supported by charters and wet leases (ACMI). In addition to marketing and selling space on its own freighters, Icelandair Cargo sells cargo hold space on Icelandair's passenger aircraft. Icelandair Cargo operates a fleet of five Boeing 757-200 freighters. The company uses two cargo aircraft for its scheduled flights and three cargo aircraft for its ACMI products. The Icelandair Cargo network includes 30 destinations serviced by its freighter aircraft and the Icelandair passenger route network. Icelandair Cargo has 53 employees, in Iceland, the United States and Belgium.

The company offers its customers competitive and quick global services through extensive interline and special pro-rate agreements with other airlines. The operation is supported by a trucking network in Europe and in the USA. Sales are made by Icelandair Cargo staff in Iceland and in New York, which serves as the centre of sales for all the Americas.

70% of the Company's revenues are generated by its cargo operations. The rest, 30%, is generated by the ACMI operations. Export is the company's most important resource, accounting for almost 38% of its income. About ninety per cent of the exports consist of fresh seafood, while imports include produce, high-tech products and spare parts. For a number of years Icelandair Cargo has carried express freight to and from Iceland for the courier companies TNT, DHL and FedEx.

Gunnar Már Sigurfinnsson is the Managing Director of Icelandair Cargo.

Icelandair Hotels

Icelandair Hotels remains the market leader as a provider of reliable quality hotel accommodation in Iceland, featuring both international brand Hilton Reykjavík, and its well-established domestic Icelandair Hotels and Edda Hotels.

Icelandair hotels run the Hilton Reykjavík Nordica, seven Icelandair hotels and thirteen Edda hotels. All the hotels, apart from five outside Reykjavik, are operated by Icelandair Hotels under franchise agreements which permit the hotels to use the Icelandair Hotels trade mark. The Edda Hotels form a chain of summer hotels, all sitting at the doorstep of some of the country's best known natural wonders and historic sites. Most of the Edda hotel properties serve as boarding schools during the winter. Icelandair Hotels leases all the real estate that it uses for its operations. Icelandair Hotels has more than doubled its capacity in the last five years.

Magnea Thórey Hjálmarsdóttir is the Managing Director of Icelandair Hotels.

Icelandair Ground Services

Icelandair Ground Services (IGS) is an international airline service company offering universal services for airlines and passengers passing through Keflavik International Airport.

IGS provides aircraft ground handling services for all types of aircraft, a first-class flight kitchen and bonded stores, a state-of-the-art cargo centre and a restaurant division in the Leifur Eiriksson Air Terminal. All these units are organised and operated as profit units with independent accounts. IGS enables airlines and other customers to obtain all the services they require through a single provider. IGS competes with two other suppliers of ground handling services at Keflavík Airport. Icelandair is by far the largest client of IGS, but the company has also contracted with other airlines, such as SAS and LTU.

Gunnar S. Olsen is the Managing Director of Icelandair Ground Services.

Iceland Travel/VITA

Iceland Travel produces, markets, distributes and sells package tours to foreign tourists in Iceland. It specializes in advanced services and works with almost all the licensed vendors operating in the tourist industry in Iceland - from car rentals to hotels and accommodation providers, professional guides, touring companies and numerous other service providers. Iceland Travel's well-educated, experienced and creative team is the key to its high standard of service and successful operation. The aim is to offer high quality service at competitive prices at all times. Iceland Travel provides travel and Meeting Incentive Conference Event (MICE) services in Iceland. The focus is on profitable packages with increasing attention to Internet sales channels. About 75% of Iceland Travel's customers are contracted customers, foreign travel wholesalers and Icelandic companies and organisations. Iceland Travel also operates VITA, which offers a wide selection of leisure tours. VITA's mission is to offer a variety of leisure tours to Icelanders travelling abroad, offering high quality service at a competitive price. VITA takes advantage of opportunities that arise through the company's partnership with Icelandair, thereby offering a secure and attractive option for Icelanders seeking services and assistance in organising group and individual tours, such as vacation tours, golf and ski trips and city breaks.

Helgi Eysteinsson is the Managing Director of Iceland Travel/VITA.

Loftleidir-Icelandic

Loftleidir–Icelandic is a capacity solution company for the international passenger airlines and tour operator industries. The company has developed from being a marketing vehicle operating in the international ACMI (Aircraft Crew Maintenance and Insurance) and charter markets, to become a capacity solution provider, thus expanding its horizon above the aircraft types traditionally operated under the Icelandair Air Operator's Certificate (AOC).

Loftleidir-Icelandic had eleven aircraft in operation in 2009: four B767-300ER and seven B757-200. Loftleidir Icelandic has remained a strong performer during turbulent marketing times. The main focus in 2009 continued to be on Aircraft & Maintenance (AM) products. At year-end 2009, there were three aircraft on an AM contract with Yakutia Air Company in the Republic of Sakha in Russia and the foreseen duration of the cooperation until at least 2014.

Air Niugini in Papua, New Guinea, has one B767-300ER and one B757-200 under an AM contract with the company and cooperation is foreseen until at least 2011.

In spring 2010 Santa Barbara Airlines (SBA) in Venezuela started a lease of two B767-300ER. The two aircraft are operated by Smartlynx under an ACMI contract.

Loftleidir Icelandic's co-operation with SBA has now been ongoing for four successive years.

Gudni Hreinsson is the Managing Director of Loftleidir-Icelandic.

Bluebird Cargo

Bluebird Cargo is a transportation service provider, operating a fleet of narrow-body freighter aircraft, an air cargo sales agency and related peripheral services.

In addition to air freight services to and from Iceland, Bluebird Cargo operates aircraft on a wet-lease basis in the service of three key customers: UPS, TNT, and DHL. The wet-lease part of the operation accounts for close to 80% of the company's total revenue, with the remaining 20% generated by the carriage of general cargo to and from Iceland. The main general cargo clients of Bluebird Cargo are Icelandic freight forwarders, most of the major international freight forwarders and many large Icelandic exporters.

Bluebird Cargo has carved out a niche operating short-haul freighter flights in time-sensitive markets within Europe. As such, the company enjoys a fairly favourable market position. The target customer group consists of express service companies, post offices and airlines operating their own overnight networks within Europe. The air cargo sales-agency arm of Bluebird Cargo in Iceland dates back to 1994, providing local sales and marketing representation for airlines such as Cargolux Airlines, UPS Air Cargo, LTU, Luxair and others. Through these companies, Bluebird Cargo has access to the world-wide air cargo networks of some of the world's leading air freight companies, which enables the company to offer the Icelandic market reliable and fast access to almost any major destination in the world.

Skúli Skúlason is the Managing Director of Bluebird Cargo.

Travel Service

Travel Service is the largest private airline company in the Czech Republic and, at the same time, one of the most dynamically expanding charter carriers in Central Europe. The company has an Air Operators Certificate issued by the Czech Civil Aviation Authority (CCAA). The Czech Republic is a member of the European Union (EU) and the CCAA is a full member of the European Aviation Safety Agency (EASA). As a result, Travel Service has full traffic rights within the EU.

TravelService provides charter flights, scheduled low-cost flights under the Smart Wings brand, ACMI leases and private flights. Travel Service Airline flies to more than 230 airports worldwide throughout the year, mostly for Czech tour operators and travel agencies. In November Icelandair Group sold 20% of its shares in Travel Service, and now holds 30% of the shares. The sale had the result that Travel Service became an affiliated company and is no longer an Icelandair Group subsidiary. Travel Service is an asset held for sale and is therefore categorized as a discontinued business as of 2010.

Roman Vik is the Managing Director of Travel Service.


SUID-AFRIKAANSE LUGDIENS
LOFTLEIÐIR
Lufthansa

SmartLynx

SmartLynx is a charter company based in Riga, Latvia. The company has an Air Operators Certificate issued by the Latvian Civil Aviation Authority (LCAA). Latvia is a member of the European Union (EU) and the LCAA is a full member of the European Aviation Safety Agency (EASA). As a result, SmartLynx has full traffic rights within the EU. SmartLynx offers three lines of service: air charter services for tour operators in the domestic market in Latvia, wet-lease projects in Europe and Africa and dry-lease projects, including maintenance, in Israel, Greece and France. SmartLynx is an asset held for sale and is therefore categorized as a discontinued business as of 2010.

Ómar Benediktsson is the Managing Director of Smart Lynx.

Icelease

Icelease is an aircraft trading arrangement company which ties together and utilizes the knowledge, experience and business contacts within Icelandair Group in the business of buying, selling and leasing aircraft. Aircraft leasing is a large-scale worldwide branch of financial services. Over the past 25 years, the number of aircraft owned by leasing companies has been on the rise. Both the world fleet of aircraft and the proportion of the fleet owned by leasing companies have increased in size. Today, about 35% of the world's commercial fleet is owned by leasing companies.

Kári Kárason is the Managing Director of Icelease.

Fjárvakur

Fjárvakur, Icelandair Shared Services, specialises in supervising work processes pertaining to company finances rather than core business. The company was established on the foundations of the finance division of Icelandair Group and its subsidiaries. Customers can choose between outsourcing their entire financial processes or specific components. Fjárvakur's services are divided into financial services, personnel services and ticketing services. Fjárvakur has one subsidiary company, Airline Services Estonia (ASE). ASE is based in Tallin, Estonia, and supervises income accounting for Fjárvakur's European customers.

Magnús Kr. Ingason is the Managing Director of Fjárvakur.

Financials

Results in 2009

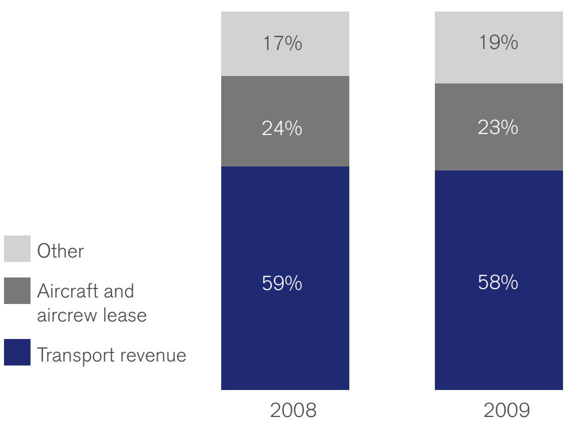
- *Total turnover was ISK 80.3 billion, increasing by 11% between years.*
- *EBITDA was ISK 8.1 billion, as compared to ISK 3.1 billion in the preceding year.*
- *EBIT was ISK 1.5 billion, as compared to a negative result of ISK 7.4 billion in the preceding year. Depreciation amounted to ISK 6.7 billion, down by ISK 3.7 billion from the preceding year.*
- *Financial costs amounted to ISK 6.0 billion, as compared to ISK 1.9 billion in the preceding year.*
- *Loss resulting from discontinued operations amounted to ISK 6.7 billion of which loss relating to Smart Lynx and Travel Service amounted to ISK 6.3 billion.*
- *Loss resulting from continued operations amounted to ISK 4 billion.*
- *Losses after taxes came to ISK 10.7 billion, as compared to ISK 7.5 billion in the year before.*
- *Cash at the end of the year amounted to ISK 1.9 billion, as compared to ISK 4.1 billion at the same time last year.*
- *Total assets amounted to ISK 89.1 billion at year-end 2009, and the equity ratio was 16.4% at the end of 2009, as compared to 20.1% at the end of 2008.*

At the end of second quarter 2009 the share capital in the subsidiary Travel Service was increased. The non-controlling shareholders in the company subscribed for the new shares following the share capital increase. As a result Icelandair Group's share in the company decreased from 66.0% to 50.1% at the end of the fourth quarter 2009. Icelandair Group sold 20.1% of its shares in Travel Service in November 2009, therefore the Company's balance sheet is not a part of the consolidated financial statements at year end 2009. Similarly, SmartLynx is categorized as an asset held for sale and is therefore not reflected in the 2009 balance sheet in the same manner as in 2008. Operations of Travel Service and SmartLynx are classified as discontinued operations in the Income Statement.

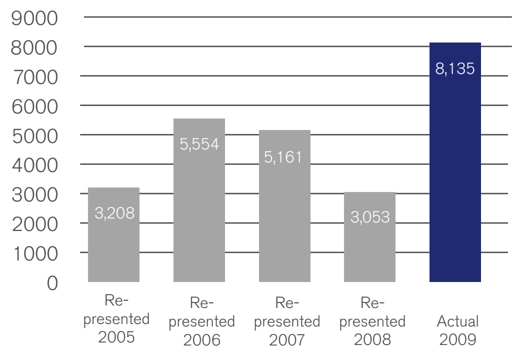
Income Statement

The net loss of ISK 10.7 billion does not fully reflect performance, as the Group's loss mainly stems from parent company guarantees for SmartLynx dating from 2007, losses from fuel hedges relating to Travel Service, and losses resulting from excessive leverage of the parent company dating back to 2006. Although it is clear that 2009 was a challenging year in international aviation, the operations of Icelandair and Air Iceland were profitable, and both companies are reporting their best annual results in years. In addition, Loftleidir, Bluebird, Fjárvakur and Iceland Travel reported a good profit in 2009.

Revenue Distribution



EBITDA – ISK million



EBITDA was ISK 8.1 billion, as compared to ISK 3.1 billion in the year before. The EBITDA growth shows the inherent capabilities of the Company to improve margins in a challenging environment. EBIT was ISK 1.5 billion, as compared to a negative result of ISK 7.4 billion in the year before. Losses after taxes over the year amounted to ISK 10.7 billion, as compared to ISK 7.5 billion in 2008. EBITDAR amounted to ISK 16.3 billion, as compared to ISK 8.8 billion in 2008.

The Company was significantly affected by the challenging market conditions that prevailed in 2009, and the Company met these conditions with cost-cutting measures and by realigning capacity on offer.

Icelandair Group's foreign investments have caused great difficulties for the Group. In 2009 ISK 4.2 billion were expensed as a result of the Latvian airline SmartLynx. In addition, expensed items relating to the Czech airline Travel Service amounted to approximately ISK 2.1 billion. Neither company forms a part of Icelandair Group's core business, and the board of directors of the company has therefore resolved to sell both companies.

Income

Total revenue for 2009 was ISK 80.3 billion, representing an increase of 11% from 2009. Transport revenue in 2009 was ISK 47.1 billion, up by 13% from last year. Growth in aircraft and aircraft lease revenue was 15% and amounted to ISK 19.4 billion in 2009, as compared to ISK 17.0 billion in 2008. Other revenue amounted to ISK 13.8 billion, growing by 3% since last year.

Operating Expenses

Operating expenses in 2009 amounted to ISK 72.2 billion, as compared to ISK 69.1 billion in 2008.

Salaries and personnel expenses fell by ISK 1.6 billion, or 8%, as compared to 2008. The average number of full-time equivalent positions fell by 10.5%, down to 2,182 positions, as compared to 2,437 at the same time last year. Fuel costs fell by ISK 2.5 billion, which represents a reduction of 15.6% from the preceding year. The average world price of fuel in 2009 was USD 571 per ton, as compared to USD 1,008 in 2008; this corresponds to a decrease of 43% between years.

Aircraft and aircraft lease cost increased by 43% and amounted to ISK 12.8 billion in 2009. The increase is largely attributable to Loftleidir as its aircraft lease cost increased by approximately ISK 2.8 billion in 2008. Aircraft servicing and handling costs were ISK 5.9 billion, as compared to ISK 5.1 billion in 2008, representing an increase of 16% year-on-year. Aircraft maintenance was ISK 6.8 billion in 2009, as compared to ISK 5.5 billion in 2008. Other expenses amounted to ISK 14.8 billion, increasing by 8% from the preceding year.

Depreciation and Amortisation

Depreciation and amortization amounted to ISK 6.6 billion in 2009. Of this figure, impairments on continued operations amounted to ISK 1.5 billion, while impairments on discontinued operations amounted to ISK 0.8 billion. Total impairments amounted to ISK 2.3 billion in 2009.

Financial Income and Expenses

Net finance cost in 2009 amounted to ISK 6.7 billion, as compared to ISK 1.9 billion in 2008. The biggest contributing factor was an ISK 2 billion foreign exchange loss in 2009; conversely, 2008 returned an ISK 1.4 billion net foreign exchange gain. Interest expenses increased by ISK 0.5 billion from 2008 to 2009 and amounted to ISK 4.2 billion in 2009. Tighter liquidity arising from a very difficult international economic environment remained a challenge for the Company.

Balance Sheet

Assets

Icelandair Group's total assets as at 31 December 2009 amounted to ISK 89.1 billion, as compared to ISK 99.9 billion at the end of 2008, which is largely because, at year end 2009 Travel Service no longer forms a part of Icelandair Group. Operating assets mainly consist of aircraft and flight equipment and totalled ISK 27 billion, down from ISK 36.8 billion in 2008. Intangible assets decreased by ISK 5.7 billion from year-end 2008 and amounted to ISK 23.6 billion at year-end 2009. Long-term receivables amounted to ISK 3.4 billion, decreasing by ISK 0.4 billion from the preceding year. Assets held for sale amounted to ISK 17.5 billion; this is explained by the reclassification of SmartLynx, Travel Service and Bluebird in the balance sheet. Other assets amounted to ISK 12.6 billion, as compared to ISK 18.7 billion at year-end 2008.

Liabilities

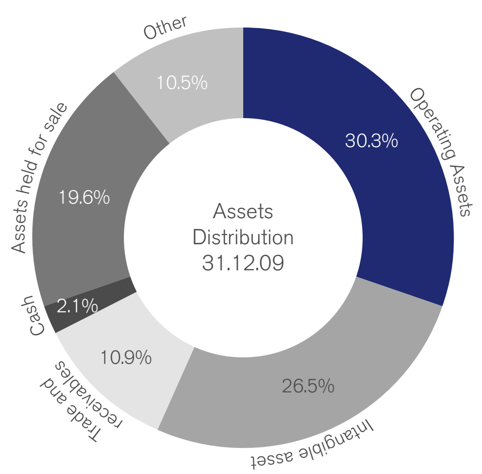
Icelandair Group's total current liabilities as at 31 December 2009 amounted to ISK 54.9 billion, as compared to ISK 52.7 billion at year-end 2008. Liabilities held for sale amounted to ISK 10.6 billion; these are largely attributable to SmartLynx, Travel Service and Bluebird. Total non-current liabilities were ISK 19.6 billion at year-end 2009, as compared to ISK 27.1 billion in the preceding year.

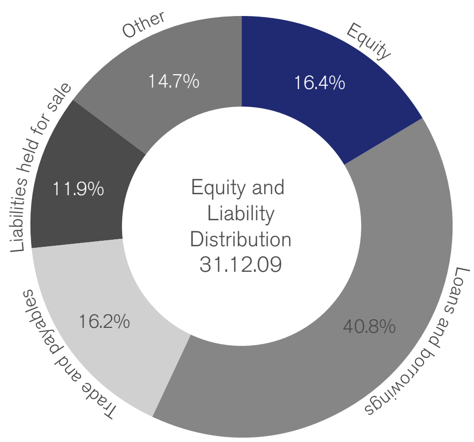
Equity

The Group's total equity amounted to ISK 14.6 billion, as compared to ISK 20.1 billion at year-end 2008. The equity ratio of the Group was 16.4% on 31 December 2009, as compared to 20.1% at the end of the preceding year. The number of shareholders at the end of 2009 was 833; shareholders were 850 at the beginning of the year. Two shareholders owned over 10% of the share capital at year-end 2009: Islandsbanki hf. with 47% and Landsbanki Islands hf. with 23.8%.

Cash flow

Working capital from operations amounted to ISK 5.4 billion in 2009, as compared to ISK 5.8 billion in 2008. Net cash provided by operating activities was ISK 8.8 billion, as compared to ISK 4.5 billion in 2008. Cash at the end of the period amounted to ISK 1.9 billion, as compared to ISK 4.1 billion at the same time last year





Risk Management

Risk Management

Icelandair Group's operations, by their nature, are affected by various financial and enterprise-related risks. The Board of Directors is responsible for defining treasury strategy measures to reduce the Group's exposure to financial risk. The approved treasury policy outlines the parameters and framework to which the Group is subject when dealing with financial risk arising from price volatility, liquidity fluctuations, asset management and corporate financing. An internal Risk Management Team, chaired by the CEO, endeavours to reduce the risk exposure within the Board's policy limits to the extent feasible. The main policy objectives outline the methods to be used to reduce costs and minimise disadvantages arising from price volatility and uncertainty. To that end, the financial budget is used as a benchmark when evaluating market conditions and hedging strategies.

Foreign Currency Risk

The Group seeks to reduce its foreign exchange exposure arising from transactions in diverse currencies through a policy of matching, to the extent possible, receipts and payments in each individual currency. Any mismatch is addressed through currency trades within the Group before turning to outside parties. The biggest currency mismatch is found in Icelandair, where US dollar cash inflow falls short of dollar outflow by roughly USD 100 million due to fuel costs, lease payments and capital-related payments, which are to a large extent denominated in US dollars. This shortage is financed by a surplus of European currencies, most importantly the euro and Scandinavian currencies. The Group follows a policy of hedging 40-80% of a rolling 12-month currency exposure and uses a portfolio of instruments, mainly risk reversals and forwards. Market failures as well as added opportunity costs have jeopardised FX hedging activities, and by the end of the year no FX hedge contracts were in place.

Fuel Price Risk

The Group follows a strategy of hedging 40-80% of its fuel price exposure, 12 months forward. Of all the subsidiaries within Icelandair Group, Icelandair has by far the biggest risk exposure, as the other companies are in a better position to price in the risk or transfer it to counterparties. Icelandair has historically maintained the ratio level between 50-60%. This year has been an exception, however, due to more stable market conditions and the opportunity costs of hedging, which includes collateral requirements and added stress on liquidity. At the year's end there were no hedges in place.

Interest Rate Risk

The largest share of the Group's outstanding loans is directly related to aircraft financing and denominated in US dollars. The Group follows a strategy of hedging 40-80% of interest rate exposure of long term financing, with up to a 5-year horizon. Currently, foreign loans are hedged against interest rate fluctuations by means of swap contracts, where the floating rate is exchanged for fixed interest rates. End-of-year open contracts amount to USD 65 million and were quite favourable until 2009, when interest rates worldwide fell to a historical low, including 6 month USD at under 1%, as compared to the average contract rate of 4,65%. All of the swap contracts will expire in 2010 apart from one 10 million dollar contract, which will expire in 2011.

Price of EUR in terms of USD 2002-2009

Liquidity Risk

The Group's strategy as regards liquidity risk extends to three asset classes determined by duration. These classes are matched against the Group's liquidity preferences laid out by the management on an annual basis. Classes one and two include the estimated minimum of accessible funds for immediate and intermediate operational liquidity. Class three includes assets of longer duration for strategic liquidity, such as medium-term investments. The amounts in each class of assets are targeted once a year with reference to a number of economic indicators, most importantly the annual level of fixed costs, and turnover.

Credit Risk

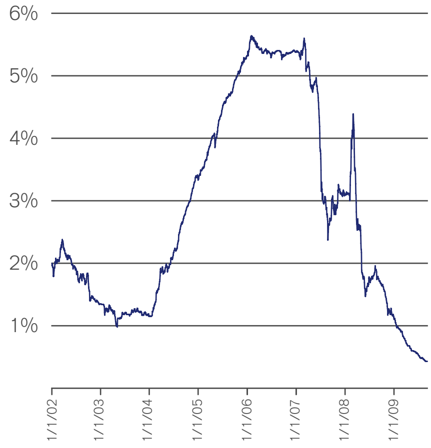
Credit risk is linked to the amount of outstanding trade receivables, allocation of liquid funds and financial assets and agreements with financial institutions relating to the Group's financial operations, e.g. credit support annexes concerning hedging. The relative spread of trade receivables across counterparties is also crucial for credit risk exposure. The risk involved is directly related to the fulfillment of outstanding obligations of the Group's counterparties. The Group is aware of potential losses related to credit risk exposure and chooses its counterparties based on business experience and satisfactory credit ratings.

Enterprise Risk

Risk management operations include attention to all enterprise-related risk in addition to the financial issues mentioned above. These items cover operational, strategic and hazard risk and require monitoring and plans for responsive measures. The Risk Management Team has placed increased weight on enterprise risk management analysis in collaboration with Internal Audit and has focused attention on aligning risk registration across all subsidiaries for consistency in compliance.

Price of Jet fuel 2002-2009
Price in USD pr. Tonne

6 month USD Libor 2002-2009



Corporate Governance

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

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

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

Shareholders' Meetings

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

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

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

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

Rights, Preferences and Restrictions on Shares

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

Actions Necessary to Change Shareholders' rights.

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

The annual general meeting shall be held before the end of May each year.

Board Practices

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

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

The Board of Directors and CEO are responsible for the management of the Company.

The Company's Board of Directors must at all times ensure that there is adequate supervision of the Company's accounts and the disposal of its assets and shall adopt working procedures in compliance with the Companies Act. Only the Board of Directors may assign powers of procuration on behalf of the Company. The signatures of the majority of the members of the Board are required to bind the Company. The CEO has charge of the day-to-day operation of the Company and is required in his work to observe the policy and instructions set out by the Company's Board of Directors. Day-to-day operation does not include measures which are unusual or extraordinary. Such measures can only be taken by the CEO with the specific 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 CEO is required to consult with the Chairman of the Board, if possible, after which the Board of Directors must immediately be notified of the measures. The CEO shall ensure that the accounts and finances of the Company conform to the law and accepted practices and that all assets belonging to the Company are securely safeguarded. The CEO is required to provide the members of the Board of Directors and Company auditors with any information pertaining to the operation of the Company which they may request, as required by law.

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

The Board of Directors elects a Chairman and Vice-chairman from among its members, and otherwise allocates its obligations among its members as needed. The Chairman calls Board meetings. A meeting must also be held if requested by a member of the Board of Directors or the CEO. Meetings of the Board are valid if attended by a majority of its members. However, important decisions shall not be taken unless all members of the Board have had an opportunity to discuss the matter, if possible. The outcome of issues is decided by force of vote, and in the event of an equality of votes, the issue is regarded as rejected. The CEO attends meetings of the Board of Directors, even if he or she is not a member of the Board, and has the right to participate in 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 CEO.

Auditing and Accounts

An auditing firm is elected at the annual general meeting each year. The auditor examines the Company's annual accounts, in accordance with generally accepted accounting standards, and has access to all the books and documents needed for this work. The accounting firm working for Icelandair Group is KPMG hf, and acting on their behalf are Jón S. Helgason, and Gudný H. Gudmundsdóttir.

Insider Information

The Board of Directors appoints a Compliance Officer and a Deputy Compliance Officer. The Compliance Officer's responsibilities are to ensure that all rules set by the Company regarding insider trading and insider information are observed at all times.

Audit Committee

The main tasks of the Audit Committee include coordinating all auditing work within the Group in co-operation with the Company's internal auditors, and acting in an advisory capacity to the Board of Directors with respect to financial reporting. The Audit Committee is appointed by the Company's Board of Directors and is composed of four members: Tómas Kristjánsson, chairman, Jón Ármann Gudjónsson, Magnús Magnússon and Kristín Einarsdóttir.

Wage Terms Committee

The purpose of appointing a Wage Terms Committee was to avoid placing the Company's managers in control of their own remuneration and, furthermore, to ensure that the management's remuneration is structured so as to serve the long-term interests of shareholders. The main tasks of the Wage Terms Committee are policy making with respect to the management's performance-related bonuses, including stock options. The Committee conducts evaluations of management remuneration and monitors the management's acquisition of stock in the Company. The members of the committee are: Sigurdur Helgason, chairman and Finnur Reyr Stefánsson

Members of the Board of Directors of Icelandair Group elected at the Annual General Meeting on 2 March 2009:

Board Members:
Gunnlaugur M. Sigmundsson, Chairman
Einar Sveinsson, Vice-chairman
Ásgeir Baldurs
Finnur Reyr Stefánsson
Martha Eiríksdóttir

Alternate Board Members:
Jón Benediktsson
Ómar Benediktsson
Sigurdur Atli Jónsson,

On 6 August 2009 an extraordinary shareholders meeting was held where the following members were elected to the Board of Directors:

Board Members:
Sigurður Helgason, Chaiman
Finnur Reyr Stefánsson, Vice-chairman
Jón Ármann Gudjónsson
Katrín Olga Jóhannesdóttir
Pétur J Eiríksson

Alternate board members:
Kristín Einarsdóttir
Magnús Magnússon
Tómas Kristjánsson

20 Largest Shareholders as of 31 December 2009

Shareholder	*Holdings*	*Shares in %*
Íslandsbanki hf	469,772,387	46.98%
Landsbanki Íslands hf	238,348,350	23.83%
Sparisjóðabanki Íslands hf	93,572,562	9.36%
Alnus ehf	32,992,831	3.30%
Icelandair Group hf	25,460,000	2.55%
Glitnir banki hf	20,925,000	2.09%
Sigla ehf	20,000,000	2.00%
Arkur ehf	17,500,000	1.75%
Saga Capital Fjárfestingarb hf	16,000,000	1.60%
N1 hf	12,844,611	1.28%
Stafir lífeyrissjóður	8,656,512	0.87%
Almenni lífeyrissjóðurinn	6,571,047	0.66%
Kaupfélag Suðurnesja	3,375,000	0.34%
Landsbanki Luxembourg S.A.	2,870,961	0.29%
Lífeyrissjóður Vestmannaeyja	2,000,000	0.20%
DnB NOR Bank ASA	2,000,000	0.20%
Landssjóður hf	1,924,512	0.19%
Jafet Ólafsson	1,843,300	0.18%
Festa - lífeyrissjóður	1,795,000	0.18%
Lífeyrissjóður Vestfirðinga	1,561,736	0.16%

Endorsement and Statement by the Board of Directors and the CEO

Operations in the year 2009

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

For the past year the Company has been working with its commercial bank, Islandsbanki hf., on improving its debt maturity profile and equity ratio. In March 2010 the Company entered into an agreement with its major stakeholders which sets forth the basic terms and conditions and the intensions of the Parties regarding the financial restructuring plan. The contents of the agreement is described in more details in note 53.

At the end of second quarter the share capital in the subsidiary Travel Service was increased and the non-controlling shareholders in the company subscribed for the increase. Following the share capital increase, Icelandair Group's share in the company decreased from 66.0% to 50.1%. As stated in note 49, Icelandair Group sold 20% of its shares in Travel Service on 25 November 2009 so the Company is not be part of the consolidated financial statements as of that date.

According to the consolidated statement of comprehensive income, net loss for the year 2009 amounted to ISK 10,665 million. Total comprehensive loss for the year amounted to ISK 4,374 million. According to the consolidated statement of financial postition, equity at the end of the year amounted to ISK 14,605 million, including share capital in the amount of ISK 975 million. Reference is made to the notes to the consolidated financial statements regarding information on changes in equity.

Dividend is not allowed to be paid to shareholders in the year 2010 due to accumulated deficit at year end 2009.

Share capital and Articles of Association

The share capital amounted to ISK 1,000 million at the end of the year, from which the Company held own shares in the amount of ISK 25 million. The share capital is divided into shares of ISK 1, each with equal rights within a single class of shares listed on the Icelandic Stock Exchange (OMX Iceland). The Board of Directors has the right to increase the share capital until 7 September 2014 up by ISK 60 million in the purpose to satisfy share option agreements. The Company issued 5 year convertible notes in October 2006. The nominal amount, ISK 2,000 million, will be paid in a single amount in 2011. The notes are convertible at the option of the holder into ordinary shares over the 5 year period at the price ISK 29.7 per share, 20% each year. The Board of Directors has the right to issue new shares in relation to the convertible notes. The Company has the right to purchase up to 10% of the nominal value of the shares of the Company according to the Company's Act.

On 6 August 2009 the Company's shareholders meeting authorized the Board of Directors to increase the shareholders capital by 4,000 million shares. The subscription rate can be decided by means of invitation to tender for new shares. Shareholders may pay, partially or in full, for the shares by means of set-off of indebtness, as may be further decided by the Board of Directors. This authorized share capital increase is part of the Company's plan, in cooperation with its largest shareholder and creditor, to improve the Company's debt maturity profile and equity ratio. This authorization is valid until 1 July 2010.

Share option agreements have been made with employees of the Group, which enables them to purchase shares in the Company at the exercise price of ISK 27.5 per share after a vesting period of 12 to 36 months. Further information on the share option agreements is disclosed in note 39.

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

Shareholders at the end of the year 2009 were 833 but were 850 at the beginning of the year, a decrease of 17 during the year. Two shareholders held more than 10% of outstanding shares each at year end 2009. They are Íslandsbanki hf. with 47.0% share and Landsbanki Íslands hf. with 23.8% share.

Information on matters related to share capital is disclosed in note 30

Statement by the Board of Directors and the CEO

The annual consolidated financial statements for the year ended 31 December 2009 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional Icelandic disclosure requirements for consolidated financial statements of listed companies.

According to our best knowledge it is our opinion that the annual consolidated financial statements give a true and fair view of the consolidated financial performance of the Company for the financial year 2009, its assets, liabilities and consolidated financial position as at 31 December 2009 and its consolidated cash flows for the financial year 2009.

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

The Board of Directors and the CEO have today discussed the annual consolidated financial statements of Icelandair Group hf. for the year 2009 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, 30 April 2010

Board of Directors:
Sigurður Helgason, chairman of the board
Finnur Reyr Stefánsson
Jón Ármann Guðjónsson
Katrín Olga Jóhannesdóttir
Pétur J. Eiríksson
Kristín Einarsdóttir
Tómas Kristjánsson

CEO
Björgólfur Jóhannsson

Independent Auditors' Report

To the Board of Directors and Shareholders of Icelandair Group hf.

Report on the Consolidated Financial Statements
We have audited the accompanying consolidated financial statements of Icelandair Group hf. and its subsidiaries (the "Group"), which comprise the report by the Board of Directors, the balance sheet as at December 31, 2009, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of Icelandair Group as at December 31, 2009, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Emphasis of matter
Without qualifying our opinion, we draw attention to note 53 to the consolidated financial statements, which states that the Company has entered into framework agreement with main creditors regarding the financial restructuring plan. If the restructuring, accourding to the agreement, will not be completed and the debt maturity profile and financial position of the Company will not be improved in other way it may cast doubt about the Company´s ability to continue as a going concern.

Reykjavík,
30 April 2010

KPMG hf.
Jón S. Helgason
Guðný H. Guðmundsdóttir

Consolidated Statement of Comprehensive Income

for the year 2009

	Notes	2009	2008
Continuing operation			Re-presented *
Operating income:			
Transport revenue	8	47,139	41,885
Aircraft and aircrew lease		19,425	16,951
Other operating revenue		13,757	13,363
		80,321	72,199
Operating expenses:			
Salaries and other personnel expenses	9	18,652	20,275
Aircraft fuel		13,250	15,703
Aircraft and aircrew lease		12,797	8,921
Aircraft handling, landing and communication		5,881	5,060
Aircraft maintenance expenses		6,825	5,499
Other operating expenses		14,781	13,688
		72,186	69,146
Operating profit before depreciation and amortisation (EBITDA		8,135	3,053
Depreciation and amortisation	11	(6,652)	(10,404)
Operating profit (loss) before net finance expense (EBIT)		1,483	(7,351)
Finance income		163	1,712
Finance costs		(6,163)	(3,658)
Net finance costs	12	(6,000)	(1,946)
Share of profit of associates, net of income tax	22	48	312
Loss before income tax		(4,469)	(8,985)
Income tax	13,14	485	80
Loss from continuing operations		(3,984)	(8,905)
Discontinued operation			
(Loss) profit from discontinued operation (net of income tax)	6,7	(6,681)	1,437
Loss for the year		(10,665)	(7,468)
Other comprehensive income			
Foreign currency translation differences for foreign operations		477	8,244
Net loss on hedge of net investment in foreign operation		(16)	(941)
Net investment hedge transferred to profit or loss		825	0
Effective portion of changes in fair value of cash flow hedge		5,005	(4,699)
Other comprehensive income for the year		6,291	2,604
Total comprehensive loss for the year		(4,374)	(4,864)
Loss attributable to			
Owners of the Company		(10,319)	(7,998)
Non-controlling interest		(346)	530
Loss for the year		(10,665)	(7,468)
Total Comprehensive income attributable to			
Owners of the Company		(4,919)	(4,837)
Non-controlling interest		545	(27)
Total comprehensive loss for the year		(4,374)	(4,864)
Loss per share:			
Basic loss per share (ISK)	31	(10,94)	(7,64)
Diluted loss per share (ISK)	31	(10,94)	(7,64)
Continuing operations			
Basic loss per share (ISK)	31	(4,09)	(9,11)
Diluted loss per share (ISK)	31	(4,09)	(9,11)

* See discontinued operation - note 6

The notes on pages 31 to 71 are an integral part of these consolidated financial statements.

Amounts are in ISK million

Consolidated Statement of Financial Position

as at 31 December 2009

	Notes	2009	2008
Assets:			
Operating assets	16-19	27,014	36,798
Intangible assets	20-21	23,598	29,306
Investments in associates	22	545	1,008
Prepaid aircraft acquisitions	23	1,134	4,226
Long-term cost	24	1,347	2,029
Long-term receivables and deposits	25	3,449	3,834
Deferred tax asset	38	140	0
Total non-current assets		57,227	77,201
Inventories	26	1,393	2,309
Trade and other receivables	27	9,725	13,836
Assets classified as held for sale	7	17,500	0
Prepayments	28	1,350	2,536
Cash and cash equivalents	29	1,909	4,065
Total current assets		31,877	22,746
Total assets		89,104	99,947
Equity:			
Share capital		975	975
Share premium		25,450	25,450
Reserves		6,899	1,856
Accumulated deficit		(18,755)	(8,216)
Total equity attributable to equity holders of the Company	30	14,569	20,065
Non-controlling interest		36	15
Total equity		14,605	20,080
Liabilities:			
Loans and borrowings	32-35	13,676	22,900
Prepayments	36	2,254	2,189
Long-term payables	37	3,688	2,026
Deferred income tax liability	38	0	23
Total non-current liabilities		19,618	27,138
Loans and borrowings	32	22,714	20,735
Trade and other payables	40	14,392	24,119
Liabilities classified as held for sale	7	10,597	0
Deferred income	41	7,178	7,875
Total current liabilities		54,881	52,729
Total liabilities		74,499	79,867
Total equity and liabilities		89,104	99,947

The notes on pages 31 to 71 are an integral part of these consolidated financial statements.

Amounts are in ISK million

Consolidated Statement of Changes in Shareholders' Equity

for the period from 1 January to 31 December 2009

	Attributable to equity holders of the Company								
			Reserves						
	Share capital	Share premium	Share option reserve	Hedging reserve	Translation reserve	Accumulated deficit	Total	Non-controlling Interest	Total equity
1 January to 31 December 2008									
Equity 1.1.2008	981	25,593	168	(24)	(1,440)	(293)	24,985	48	25,033
Total comprehensive income for the year									
Profit or loss						(7,998)	(7,998)	530	(7,468)
Other comprehensive income									
Foreign currency translation differences					8,285		8,285	(41)	8,244
Net loss on hedge of net investment in foreign operation					(941)		(941)		(941)
Effective portion of changes in fair value of cash flow hedges, net of tax				(4,183)			(4,183)	(516)	(4,699)
Total other comprehensive income	0	0	0	(4,183)	7,344	0	3,161	(557)	2,604
Total comprehensive income for the year	0	0	0	(4,183)	7,344	(7,998)	(4,837)	(27)	(4,864)
Transactions with owners, recorded directly in equity									
Contributions by and distributions to owners									
Own shares, change	(6)	(143)					(149)		(149)
Share based payments			(15)			75	60		60
Total contributions by and distributions to owners	(6)	(143)	(15)	0	0	75	(89)	0	(89)
Changes in ownership interests in subsidiaries that do not result in a loss of control									
Total changes in ownership interests in subsidiaries					6		6	(6)	0
Total transactions with owners	0	0	0	0	6	0	6	(6)	0
Balance at 31 December 2008	975	25,450	153	(4,207)	5,910	(8,216)	20,065	15	20,080
1 January to 31 December 2009									
Equity 1.1.2009	975	25,450	153	(4,207)	5,910	(8,216)	20,065	15	20,080
Total comprehensive income for the year									
Profit or loss						(10,319)	(10,319)	(346)	(10,665)
Other comprehensive income									
Foreign currency translation differences					686		686	(209)	477
Net loss on hedge of net investment in foreign operation					(16)		(16)		(16)
Net investment hedge transferred to profit or loss					825		825		825
Effective portion of changes in fair value of cash flow hedges, net of tax				3,905			3,905	1,100	5,005
Total other comprehensive income	0	0	0	3,905	1,495	0	5,400	891	6,291
Total comprehensive income for the year	0	0	0	3,905	1,495	(10,319)	(4,919)	545	(4,374)
Transactions with owners, recorded directly in equity									
Contributions by and distributions to owners									
Share based payments			(53)			86	33		33
Total contributions by and distributions to owners	0	0	(53)	0	0	86	33	0	33
Changes in ownership interests in subsidiaries that do not result in a loss of control									
Sale of non-controlling interest					(304)	(306)	(610)	(524)	(1,134)
Total changes in ownership interests in subsidiaries					(304)	(306)	(610)	(524)	(1,134)
Total transactions with owners	0	0	(53)	0	(304)	(220)	(577)	(524)	(1,101)
Balance at 31 December 2009	975	25,450	100	(302)	7,101	(18,755)	14,569	36	14,605

The notes on pages 31 to 71 are an integral part of these consolidated financial statements.

Amounts are in ISK million

Consolidated Statement of Cash Flows

for the year 2009

	Notes	2009	2008
Cash flows from operating activities:			
Loss for the year		(10,665)	(7,469)
Adjustments for:			
Depreciation and amortisation	11	6,652	10,404
Depreciation and amortisation of discontinued operations		265	133
Other operating items	50	9,121	2,727
Working capital from operations		5,373	5,795
Net change in operating assets and liabilities	51	3,408	(1,264)
Net cash from operating activities		8,781	4,531
Cash flows from investing activities:			
Acquisition of operating assets	16	(2,226)	(3,820)
Proceeds from the sale of operating assets		942	447
Acquisition of intangible assets	20	(92)	(165)
Prepaid aircraft acquisitions, increase		(61)	(2,215
Cash of disposed subsidiaries	6	(1,413)	0
Cash of subsidiaries held for sale	7	(221)	0
Acquisition of subsidiaries, net of cash acquired		0	(750)
Acquisition of long-term cost		(3,543)	(1,710)
Long-term receivables, (increase) decrease		(1,185)	761
Net cash used in investing activities		(7,799)	(7,452)
Cash flows from financing activities:			
Repurchase of own shares		0	(149)
Proceeds from non-controlling interest		262	0
Proceeds from long term borrowings		4,211	6,499
Repayment of long term borrowings		(3,355)	(9,381)
Proceeds from long term payables		248	279
Proceeds from short term borrowings		(4,649)	5,923
Net cash (used in) from financing activities		(3,283)	3,171
(Decrease) increase in cash and cash equivalents		(2,301)	250
Effect of exchange rate fluctuations on cash held		145	1,809
Cash and cash equivalents at beginning of the year		4,065	2,006
Cash and cash equivalents at 31 December 2009	29	1,909	4,065

The notes on pages 31 to 71 are an integral part of these consolidated financial statements.

Amounts are in ISK million

Notes

1. Reporting entity

Icelandair Group hf. (the “Company”) is a limited liability company incorporated and domiciled in Iceland. The address of the Company´s registered office is at Reykjavíkurflugvöllur in Reykjavík, Iceland. The consolidated financial statements of the Company as at and for the year ended 31 December 2009 comprise the Company and its subsidiaries (together referred to as the “Group” and individually as “Group entities”) and the Group´s interests in associates. The Group´s operations are in the airline transportation and tourism industry. The Company is listed on the Iceland Stock Exchange.

2. Basis of preparation

a. *Statement of compliance*

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

The financial statements were approved and authorised for issue by the Board of Directors on 30 April 2010.

b. *Basis of measurement*

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

c. *Functional and presentation currency*

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

d. *Use of estimates and judgements*

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

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

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

e. *Changes in accounting policies*

The consolidated financial statements are prepared using the same accounting policies as the previous year. The presentation of the financial statements has been changed in accordance with new rules concerning presentation of financial statements.

The Group applies revised IAS 1 Presentation of Financial Statements (2007), which became effective as of 1 January 2009. As a result, the Group presents in the consolidated statement of changes in equity all owner changes in equity, whereas all non-owner changes in equity are presented in the consolidated statement of comprehensive income. Comparative information has been re-presented so that it also is in conformity with the revised standard. Since the change in accounting policy only impacts presentation aspects, there is no impact on earnings per share.

The Group applies IFRS 8, Operating Segments, which became effective as of 1 January 2009. The Group presents a statement of segment based on internal reporting to managing director. Implementation of the standard does not change the presentation of business segments.

Notes, contd.:

3. Significant accounting principles

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

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

a. Basis of consolidation

(i) Subsidiaries

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

(ii) Investments in associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity. Associates are accounted for using the equity method and are initially recognised at cost. The Group´s investment includes goodwill identified on acquisition, net of any accumulated impairment losses. The consolidated financial statements include the Group's share of the total recognised gains and losses and equity movements of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount including any long-term investments is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has an obligations or made payments on behalf of the investee.

(iii) Transactions eliminated on consolidation

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

b. Foreign currency

(i) Foreign currency transactions

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

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

The assets and liabilities of foreign operations and Icelandic subsidiaries with functional currency other than Icelandic krona, including goodwill and fair value adjustments arising on acquisitions, are translated to Icelandic kronas at exchange rates at the reporting date. The income and expenses of foreign operations are translated to Icelandic kronas at exchange rates at the dates of the transactions. Foreign currency differences arising on retranslation are recognised in other comprehensive income. When a foreign operationis disposed of, in part or in full, the relevant amount in the foreign curreny translation reserve (FCTR) within equity is transferred to profit or loss as part of the profit or loss on disposal.

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

Notes, contd.:

3b. contd.:

(iii) Hedge of net investment in foreign operations

Foreign currency differences arising on the retranslation of a financial liability designated as a hedge of a net investment in foreign operations are recognised in other comprehensive income, to the extent that the hedge is effective, and are presented within equtiy in the FCTR. To the extent that the hedge is ineffective, such differences are recognised in profit or loss. When the hedged net investment is disposed of, the relevant amount in the FCTR is transferred to profit or loss as part of the profit or loss on disposal.

c. Financial instruments

(i) Non-derivative financial instruments

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

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

Cash and cash equivalents comprise cash balances and call deposits.

Accounting for finance income and finance costs is discussed in note 3(p).

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

(ii) Derivative financial instruments, including hedge accounting

The Group generally holds derivative financial instruments to hedge its foreign currency, fuel price and interest rate risk exposures (see note 42). 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 hedge, the Company formally documents the relationship between the hedging instrument(s) and hedged item(s), including the risk management objectives and strategy in undertaking the hedge transaction, together with the methods that will be used to assess the effectiveness of the hedging relationship. The Company 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 could ultimately affect reported net income.

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. The amount recognised in other comprehensive income is removed and included in profit or loss in the same period as the hedged cash flows affect profit or loss under the same line item in the statement of comprehensive income as the hedged item. Any ineffective portion of changes in the fair value of the derivative is recognised immediately in profit or loss.

Notes, contd.:

3c. *(ii)* contd.:

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

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

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

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

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

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

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

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

d. Operating assets

(i) Recognition and measurement
Items of operating assets are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Cost also may include transfers from other comprehensive income of any gain or loss on qualifying cash flow hedges of foreign currency purchases of operating assets. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

Notes, contd.:

3d. *(i)* contd.:

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

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

(ii) Aircrafts and flight equipment

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

(iii) Subsequent costs

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

(iv) Depreciation

Depreciation is calculated over the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each item of operating assets since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. The estimated useful lives for the current and comparative periods are as follows:

	Useful life
Aircrafts and flight equipment	4-20 years
Engines	Cycles.
Buildings	17-50 years
Other property and equipment	3-8 years

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

e. Intangible assets

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

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

Goodwill is stated at cost less any 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 slots with indefinite useful lives are stated at cost less accumulated impairment losses.

(ii) Other intangible assets

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

Notes, contd.:

3e. *(ii)* contd. :

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

Amortisation methods, useful lives and residual values are reviewed at each financial year-end 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 is expensed as incurred.

f. Prepaid aircraft acquisitions

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

g. Leased assets

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

h. Inventories

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

i. Impairment

(i) 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 objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

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

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognised in profit or loss, then the impairment loss is reversed, with the amount of the reversal recognised in profit or loss.

(ii) Non-financial assets

The carrying amounts of the Group's non-financial assets other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, recoverable amount is estimated at each reporting date.

Notes, contd.:

3i. *(ii)* contd.:

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a post-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

j. Non-current assets held for sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets, or components of a disposal group, are remeasured in accordance with the Group's accounting policies. Thereafter generally the assets, or disposal group, are measured at the lower of their carrying amount and fair value less cost to sell. Any impairment loss on a disposal group first is allocated to goodwill, and then to remaining assets and liabilities on pro rata basis, except that no loss is allocated to inventories, financial assets and deferred tax assets, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

k. Employee benefits

(i) Defined contribution plans

Obligations for contributions to pension plans are recognised as an expense in the statement of comprehensive income when they are due.

(ii) Share-based payment transactions

The grant date fair value of share-based payment awards to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the awards. The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are met.

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

Share-based payment arrangements in which the Group receives services as consideration for its own equity instruments are accounted for as equity-settled share-based payment transactions, regardless of how the equity instruments are obtained by the Group.

Notes, contd.:

3 contd.:

l. Provisions

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

(i) Onerous contracts

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

(ii) Overhaul commitments relating to aircrafts under operating lease

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

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

m. 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.

(i) Frequent flyer program

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

n. 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. Sold not used, non-refundable documents are recognized as revenue two months after expected transport. Revenue from mail and cargo transportation is recognised after transportation has been provided

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

(ii) Aircraft and aircrew lease

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

(iii) Other operating revenue

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

Notes, contd.:

3n. *(ii)* contd.:

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

o. Lease payments

(i) 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. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

p. Finance income and finance costs

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

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

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

q. Income tax

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

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

A deferred tax asset is recognised 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 utilised. 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 realised.

r. Discontinued operations

A discontinued operation is a component of the Group's business that represents a separate major line of business or geographical area of operations that has been disposed of or is held for sale, or is a subsidiary acquired exclusively with a view to resale. Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale, if earlier. When an operation is classified as a discontinued operation, the comparative statement of comprehensive income is re-presented as if the operation had been discontinued from the start of the comparative period.

s. Earnings per share

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

Notes, contd.:

3 contd.:

t. Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues 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 are the aircraft fleet, the majority of which are registered in Iceland. Since the Group's aircraft fleet is employed flexibly across its route network, there is no suitable basis of allocating such assets and related liabilities to geographical segments.

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

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

Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment, and intangible assets other than goodwill.

u. New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2009, and have not been applied in preparing these consolidated financial statements. None of these will have material effect on the consolidated financial statements of the Group.

4. Determination of fair values

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

(i) Operating assets

The fair value of operating assets recognised as a result of a business combination is based on market values. The market value of aircrafts and properties is the estimated amount for which they could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably and willingly. The fair value of items of equipment, fixtures and fittings is based on the market approach and cost approaches using quoted market prices for similar items when available and replacement cost when appropriate.

(ii) Intangible assets

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

(iii) Inventories

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

(iv) Receivables

The fair value of receivables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. The fair value is determined for disclosure purposes.

Notes, contd.:

4 contd.:

(v) Derivatives

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

The fair value of interest rate swaps is based on broker quotes. Those quotes are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

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

(vi) Non-derivative financial liabilities

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

(vii) Deferred income

The amount allocated to the frequent flyers points is estimated by reference to the fair value of the discounted services for which they could be redeemed, since the fair value of the points themselves is not directly observable. The fair value of the discounted servicess 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. Such amount is recognised as deferred income.

5. Segment reporting

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 three segments, scheduled airline and tourism operations, global capacity and aircraft trading and shared 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.

Scheduled airline and tourism operations

Six companies are categorised as being part of the Scheduled Airline and Tourism Operation focus of the Group: Icelandair, the international full-service airline with a hub in Iceland; Icelandair Cargo, a full-service air-freight company and Icelandair Ground Services, which handles airlines and passenger services at Keflavik Airport. These companies work closely together and have long historical ties. Three companies; Iceland Travel, a tour operator and travel agency in in-coming tourism, Icelandair Hotels, which markets and operates two hotel chains, Icelandair Hotels and Edda Hotels, and Air Iceland a scheduled domestic carrier which also offers regular flights to Greenland and the Faeroe Islands form the travel and tourism part of the Group. These companies all provide strategic support to the international scheduled operations, their main focus is on profitable operations.

Global capacity solutions and aircraft trading

The six companies forming this part of Icelandair Group hf. are Loftleiðir-Icelandic and Smartlynx (previously LatCharter), a capacity providers for the international airline and tour operator industry, Bluebird Cargo, a transportation service provider, Icelease, which handles the buying, selling and leasing of aircrafts using IG Invest as its holding company, and Travel Services which is consolidated as of 1 April 2008. These six companies are grouped together to emphasise Icelandair Group's increased focus on international expansion in this field. Their role is to capitalise on internal know-how by offering aircraft operation services to third parties and taking advantage of trading opportunities in a fast-growing world market, as well as looking for opportunities for mergers and acquisitions.

Notes, contd.:

5. contd.:

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

Business segments

2009	**Scheduled airline and tourism operations**	**Global capacity and aircraft trading**	**Shared services**	**Elimina-tions**	**Consoli-dated**
External revenue	62,915	17,216	190		80,321
Inter-segment revenue	16,731	265	646	(17,642)	
Total segment revenue	79,646	17,481	836	(17,642)	80,321
Segment EBITDAR	14,542	2,375	(585)		16,332
Segment EBITDA	7,391	1,341	(597)		8,135
Segment results	3,138	(1,028)	(627)		1,483
Net finance expense	(868)	(153)	(4,979)		(6,000)
Share of profit of associates	1	47	0		48
Income tax	(655)	100	1,040		485
Discontinued operations	0	(6,681)	0		(6,681)
Profit (loss) for the year	1,616	(7,715)	(4,566)		(10,665)
Segment assets	55,109	21,840	57,003	(45,393)	88,559
Investments in associates	99	417	29		545
Total assets	55,208	22,257	57,032	(45,211)	89,104
Segment liabilities	49,774	19,316	40,936	(35,527)	74,499
Total liabilities	49,774	19,316	40,936	(35,527)	74,499
Capital expenditure	4,435	1,412	14		5,861
Depreciation	4,006	588	17		4,611
Amortisation of intangible assets	248	235	11		494
Impairment loss		1,019			1,019
Impairment on assets held for sale		528			528

Amounts are in ISK million

Notes, contd.:

5. contd.:

Business segments

2008	Scheduled airline and tourism operations	Global capacity and aircraft trading	Shared services	Elimina-tions	Consoli-dated
External revenue	57,453	14,507	239		72,199
Inter-segment revenue	16,139	121	620	(16,880)	
Total segment revenue	73,592	14,628	859	(16,880)	72,199
Segment EBITDAR	7,193	2,631	(1,003)		8,821
Segment EBITDA	1,936	2,120	(1,003)		3,053
Segment results	(5,197)	(516)	(1,638)		(7,351)
Net finance expense	(751)	223	(1,418)		(1,946
Share of profit of associates	1	311	0		312
Income tax	318	(429)	191		80
Discontinued operations	0	1,437	0		1,437
(Loss) profit for the year	(5,629)	1,026	(2,865)		(7,468)
Segment assets	53,200	32,549	56,178	(42,988)	98,939
Investments in associates	116	835	57		1,008
Total assets	53,315	33,384	56,235	(42,988)	99,947
Segment liabilities	51,859	28,301	35,100	(35,393)	79,867
Total liabilities	51,859	28,301	35,100	(35,393)	79,867
Capital expenditure	5,268	405	22		5,695
Depreciation	2,832	481	14		3,327
Amortisation of intangible assets	204	443	15		662
Impairment loss	4,097	1,712	606		6,415

6. Discontinued operation

For the past year the Company has been working with its commercial bank, Islandsbanki hf., on improving its debt maturity profile and equity ratio. As a part of the restructuring plan the Board of Directors has in addition with the dilution of Travel Service (note 49), proposed redefinition of the business model of the company, leading to subsidiaries being split between core and non-core. Accordingly the main focus of the Group will be on scheduled airline operations and tourism evolving around Iceland, and related services. Smartlynx Latvia, and the remaining shares in Travel Service are defined as non-core, leading to reclassification on these companies financial results for the year 2009 as discontinued operations. Amounts for the year 2008 have been re-presented in the profit and loss statement for comparative reasons.

Amounts are in ISK million

Notes, contd.:

6. contd.:

On 1 July 2009 the Group acquired 51% ownership in three companies; Siglo FIU, Siglo FIR and Siglo FIJ. Previously the Group owned 49% of the shares and accounted for them as shares in associates. Since the acquisition, the companies are a part of the consolidation but as the ownership is considered as temporary and process of disposal has commenced, total assets and liabilities are classified as discontinued.

The results of the discontinued operation are specfied as follows:

Results of discontinued operation	**2009**	**2008**
Revenue	56,192	41,176
Expenses	(59,325)	(39,515)
Results from operating activities	(3,133)	1,661
Financial (expenses) income	(536)	498
Income tax	229	(722)
Results from operating activities, net of income tax	(3,440)	1,437
Loss on sale of discontinued operation	(687)	0
Expensed loans and guarantees of discontinued operation	(1,806)	0
Impairment on shares	(748)	0
(Loss) profit for the year	(6,681)	1,437
Basic (loss) profit per share	(6,86)	1,47
Diluted (loss) profit per share	(6,86)	1,47
Cash flows used in discontinued operation		
Net cash (used in) from operating activities	(31)	2,454
Net cash used in investing activities	(2,510)	(2,332)
Net cash from financing activities	673	867
Net cash (used in) from discontinued operation	(1,868)	989

Effects of disposal of Travel Service on the financial position of the Group	**2009**
Operating assets	583
Intangible assets	156
Prepaid aircraft acquisitions	3,277
Long-term receivables and deposits	1,038
Trade and other receivables	4,181
Cash and cash equivalents	1,413
Deferred tax liabilities	(192)
Loans and borrowings	(4,689)
Trade and other payables	(3,298)
Deferred income	(620)
Net assets and liabilities	1,849
Consideration received, receivable at year-end	277
Cash and cash equivalents disposed of	(1,413)

Amounts are in ISK million

Notes, contd.:

7. Assets and liabilities classified as held for sale

The Company's Board of Directors decided in December as a part of it's financial restruction plan, to consider two of it's subsidiaries, Bluebird Cargo and Smartlynx as assets held for sale. Also included is the 30% remaining share in Travel Service. Total assets and liabilities of these companies are classified as held for sale in the financial position.

According to IFRS 5, when classified as held for sale, assets and liabilities are measured at the lower of carrying value and fair value less cost to sell. As a result, loss amounting to ISK 528 million is recognised as impairment on assets held for sale. Total loss recognized on discontinued operation (see note 6) and assets and liabilities classified as held for sale is therefore ISK 7,209 million.

Assets and liabilities classified as held for sale are specfied as follows:

	2009
Assets classified as held for sale	
Operating assets	11,080
Intangible assets	2,793
Other non-current assets	2,258
Inventories	106
Trade and other receivables	1,042
Cash and cash equivalents	221
	17,500
Liabilities classified as held for sale	
Non-current loans and borrowings	4,025
Deferred income tax liability	298
Current loans and borrowings	2,722
Trade and other payables	3,184
Deferred income	368
	10,597

8. Operating income

	2008	2009
Transport revenue is specified as follows:		
Passengers	41,581	36,140
Cargo and mail	5,558	5,745
Total transport revenue	47,139	41,885

Amounts are in ISK million

Notes, contd.:

9. Operating expenses

	2009	2008
Salaries and other personnel expenses are specified as follows:		
Salaries	12,286	13,756
Equity-settled share based payment transactions	33	60
Contribution to pension funds	1,656	1,858
Other salary-related expenses	1,114	1,069
Other personnel expenses	3,563	3,532
Total salaries and other personnel expenses	18,652	20,275
Average number of full year equivalents	2,182	2,437

10. Auditors' fees

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

Audit of financial statements	35	33
Review of interim accounts	25	19
Other services	15	18
Total auditors' fees	75	70

The abovementioned figures include fees to the auditors of all companies within the Group. Fees to auditors, other than the auditors of the Parent Company amounted to ISK 25 million during the year 2009 (2008: ISK 17 million).

11. Depreciation and amortisation

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

Depreciation of operating assets, see note 16	4,611	3,327
Amortisation of intangible assets, see note 20	494	662
Impairment, see note 20	1,019	6,415
Impairment on assets held for sale, see note 7	528	0
Depreciation and amortisation recognised in profit or loss	6,652	10,404

Amounts are in ISK million

Notes, contd.:

12. Finance income and finance costs

	2009	2008
Finance income and finance costs are specified as follows:		
Interest income on bank deposits	52	121
Other interest income	111	41
Net foreign exchange gain	0	1,420
Trading derivatives	0	130
Finance income total	163	1,712
Interest expense on loans and borrowings	3,669	3,469
Other interest expenses	484	189
Net foreign exchange loss	1,984	0
Loss from sale of derivatives	26	0
Finance costs total	6,163	3,658
Net finance costs	(6,000)	(1,946)

13. Income tax

Income tax recognised in profit or loss is specified as follows:

Deferred tax expense		
Origination and reversal of temporary differences	(547)	(102)
Change in tax rate from 15% to 18% / 18% to 15%	62	22
Total income tax in profit or loss	(485)	(80)

In December 2009, the Icelandic Parliament approved to increase the income tax ratio from 15% to 18% as of 1 January 2010 and the change comes into effect for the tax assessment in the year 2011. The effect thereof has been recognised in the financial statements for the year 2009 and the increase in deferred income tax asset amounts to ISK 62 million.

14. Reconciliation of effective tax rate:

Reconciliation of effective tax rate:

		2009		2008
Loss before tax and discontinued operation		(4,804)		(8,985)
Income tax according to current tax rate	15,0%	(721)	15,0%	(1,348)
Change in tax rate from 15% to 18% / 18% to 15%	(1,3%)	62	(0,2%)	22
Tax exempt revenues	0,2%	(10)	0,5%	(42)
Non-deductible expenses	(14,5%)	697	(16,4%)	1,477
Foreign currency subsidiaries	0,0%	0	(2,3%)	207
Discontinued operations	9,1%	(435)	8,0%	(723)
Other items	1,6%	(78)	(3,6%)	327
Effective tax rate	10,1%	(485)	0,9%	(80)

Amounts are in ISK million

Notes, contd.:

15. Income tax recognised directly in equity:

	2009	2008
Derivatives	332	1,065
Total income tax recognised directly in equity	332	1,065

16. Operating assets

Operating assets are specified as follows:

Gross carrying amounts	Aircrafts and flight equipment	Buildings	Other property and equipment	Total
Balance at 1 January 2008	20,357	3,008	2,307	25,672
Additions through business combinations	381	5	49	435
Additions during the year	3,344	86	390	3,820
Sales and disposals during the year	(692)	(29)	(33)	(754)
Exchange rate difference	15,440	373	85	15,898
Balance at 31 December 2008	38,830	3,443	2,798	45,071
Additions during the year	1,941	47	238	2,226
Sales and disposals during the year	(1,555)	0	(58)	(1,613)
Exchange rate difference	1,162	74	18	1,254
Assets classified as held for sale	(8,835)	(897)	(294)	(10,026)
Balance at 31 December 2009	31,543	2,667	2,702	36,912
Depreciation and impairment losses				
Balance at 1 January 2008	2,295	145	400	2,840
Depreciation for the year	2,787	134	406	3,327
Depreciation for the year of discontinued operations	63	19	36	118
Sales and disposals during the year	(388)	(4)	(25)	(417)
Exchange rate difference	2,286	62	57	2,405
Balance at 31 December 2008	7,043	356	874	8,273
Depreciation for the year	4,055	141	415	4,611
Depreciation for the year of discontinued operations	150	35	43	228
Sales and disposals during the year	(1,085)	0	(49)	(1,134)
Exchange rate difference	371	4	9	384
Assets classified as held for sale	(2,228)	(74)	(162)	(2,464)
Balance at 31 December 2009	8,306	462	1,130	9,898
Carrying amounts				
At 1 January 2008	18,062	2,863	1,907	22,832
At 31 December 2008	31,787	3,087	1,924	36,798
At 31 December 2009	23,237	2,205	1,572	27,014
Depreciation ratios	5-25%	2-6%	13-33%	

Amounts are in ISK million

Notes, contd.:

17. Mortgages and commitments

The Group's operating assets are mortgaged to secure debt. The remaining balance of the debt amounted to ISK 28,379 million at the end of the year 2009 (2008: ISK 34,186 million).

18. Insurance value of aircrafts and flight equipment

The insurance value and book value of aircrafts and related equipment of the Company at year-end 2009 are specified as follows:

	Insurance value	Carrying amount
Boeing - 5 aircrafts	29,675	18,218
Other aircrafts	7,387	1,570
Flight equipment	2,792	3,449
Total aircrafts and flight equipment	39,854	23,237

19. Insurance value of buildings and other operating assets

The principal buildings owned by the Group at 31 December 2009 are the following:

	Official assessment value	Insurance value	Carrying amount
Maintenance hangar, Keflavík Airport	1,490	2,858	657
Freight building, Keflavík Airport	399	756	347
Office building, Reykjavík Airport	797	1,191	277
Service building, Keflavík Airport	413	774	221
Hangar 4 and other buildings, Reykjavík Airport	603	1,027	276
Other buildings	395	1,010	427
Buildings total	4,097	7,616	2,205

Official valuation of the Group's leased land for buildings at 31 December 2009 amounted to ISK 637 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 4,129 million at the end of the year 2009. The carrying amount at the same time was ISK 1,572 million.

Amounts are in ISK million

Notes, contd.:

20. Intangible assets

Intangible assets are specified as follows:

Gross carrying amounts	Goodwill	Trademarks and slots	Customer relations	Other intangibles	Total
Balance at 1 January 2008	20,143	4,920	1,083	1,412	27,558
Additions through business combinations	1,257	833	263	442	2,795
Additions during the year	0	0	0	165	165
Sales and disposals during the year	(580)	0	0	(18)	(598)
Exchange rate difference	5,181	1,295	486	277	7,239
Balance at 31 December 2008	26,001	7,048	1,832	2,278	37,159
Additions during the year	0	0	0	92	92
Sales and disposals during the year	(1,468)	(564)	(212)	(542)	(2,786)
Discontinued operation	(1,818)	(1,784)	(1,014)	(725)	(5,341)
Exchange rate difference	323	105	33	35	496
Balance at 31 December 2009	23,038	4,805	639	1,138	29,620
Amortisation and impairment losses					
Balance at 1 January 2008	0	0	153	559	712
Amortisation for the year	0	0	204	458	662
Amortisation for the year of discontinued operation	0	0	0	15	15
Impairment loss	5,182	884	340	9	6,415
Sales and disposals during the year	0	0	0	(16)	(16)
Exchange rate difference	0	0	24	41	65
Balance at 31 December 2008	5,182	884	721	1,066	7,853
Amortisation for the year	4	0	158	332	494
Amortisation for the year of discontinued operation	0	0	0	37	37
Impairment loss	1,019	0	0	0	1,019
Sales and disposals during the year	(1,468)	(564)	(212)	(542)	(2,786)
Discontinued operation	(12)	0	(287)	(303)	(602)
Exchange rate difference	1	(1)	0	7	7
Balance at 31 December 2009	4,726	319	380	597	6,022
Carrying amounts					
At 1 January 2008	20,143	4,920	930	853	26,846
At 31 December 2008	20,819	6,164	1,111	1,212	29,306
At 31 December 2009	18,312	4,486	259	541	23,598

Amounts are in ISK million

Notes, contd.:

21. Impairment test

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

	2009	2008
Goodwill	18,312	20,819
Trademarks and slots	4,486	6,164
Total	22,798	26,983

For the purpose of impairment testing on goodwill, goodwill is allocated to the subsidiaries which represent the lowest level within the Group at which the goodwill is monitored for internal management purposes. The aggregate carrying amount of goodwill allocated to each segment (group of units) are as follows:

	2009	2008	2009	2008
	Goodwill		Trademarks and slots	
Scheduled airline and tourism operations	9,822	9,826	3,294	3,294
Global capacity and aircraft trading	7,851	10,352	1,192	2,870
Shared services	639	641	0	0
Total goodwill	8,312	20,819	4,486	6,164

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

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

	Scheduled airline and tourism operations	Global capacity and aircraft trading	Shared services
Long term growth rate	4,0%	3,9%	4,0%
Revenue growth:			
Weighted average 2009	9,6%	5,7%	14,0%
2010 - 2013	3,5%	2,7%	6,8%
WACC	9.3 - 12.6%	8.9 - 10.5%	11.5%
Debt leverage	51.7%	53.2%	74.5%
Interest rate	4.5 - 7.2%	3.7 - 4.4%	7.1%
Changes in key assumptions would have the following impact on the carrying amount of goodwill:			
WACC +1%	(672)	(1,033)	0
EBITDA - 5%	(431)	(447)	0

Amounts are in ISK million

Notes, contd.:

22. Investments in associates

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

	Ownership 2009	Ownership 2008
Barkham Associates SA	49%	49%
China Ice No 1 ehf. - bought 100% from Jan 2009	100%	40%
China Ice No 2 ehf. - bought 100% from Jan 2009	100%	40%
China Ice No 3 ehf. - bought 100% from Jan 2009	100%	40%
China Ice No 4 ehf. - bought 100% from Jan 2009	100%	40%
China Ice No 5 ehf. - bought 100% from Jan 2009	100%	40%
China Ice No 6 ehf. - bought 100% from Jan 2009	100%	40%
EBK ehf.	25%	25%
Icesing ehf.	49%	49%
Siglo FIJ Ltd. - bought 100% from July 2009	100%	49%
Siglo FIR Ltd. - bought 100% from July 2009	100%	49%
Siglo FIU Ltd. - bought 100% from July 2009	100%	49%
Tjarnir ehf.	22%	22%
Assets	3,006	7,373
Liabilities	2,306	6,356
Revenues	473	1,763
Expenses	359	1,034
Net profit	114	729
Share of profit of associates	48	312

23. Prepaid aircraft acquisitions

Prepaid aircraft acquisitions in the statement of financial position is for the purchase of four Boeing 787 Dreamliner aircrafts to be delivered in the year 2012, 2013 and 2014. The Company has capitalised borrowing cost amounting to ISK 173 million related to these prepayments based on the average USD interest rate which was 6.3% at year-end. The Company also has an option to purchase three additional 787 Dreamliner aircrafts.

24. Long-term cost

Long-term cost corresponds to amounts paid for heavy maintenance of leased aircraft and is expensed over the life of the lease of the aircraft. Long-term cost will be expensed as follows:

Long-term cost	2,208	3,338
Expensed in 2010 / 2009	(861)	(1,309)
Total long-term cost	1,347	2,029

Amounts are in ISK million

Notes, contd.:

24. contd.:

	2009	2008
Long-term cost will be expensed as follows:		
Expensed in 2009	-	1,309
Expensed in 2010	861	1,192
Expensed in 2011	608	598
Expensed in 2012	313	203
Expensed in 2013	160	4
Expensed in 2014	175	4
Subsequent	91	28
Total long-term cost, including current maturities	2,208	3,338

25. Long-term receivables and deposits

Long-term receivables consist of notes, deposits for aircraft and engine lease and various other travel related security fees.

Long-term receivables and deposits are specified as follows:		
Loans, effective interest rate 7.3% / 7.6%	476	611
Deposits	3,032	3,323
	3,508	3,934
Current maturities of long-term receivables	(59)	(100)
Long-term receivables and deposits total	3,449	3,834

Long-term receivables contractual repayments are specified as follows:		
Repayments in 2009	-	100
Repayments in 2010	59	44
Repayments in 2011	505	728
Repayments in 2012	291	420
Repayments in 2013	322	345
Repayments in 2014	2,091	1,920
Subsequent	240	377
Total loans, including current maturities	3,508	3,934

Long-term receivables and deposits denominated in currencies other than the functional currency comprise ISK 3,277 million (2008: ISK 5,841 million).

26. Inventories

Inventories are specified as follows:

Spare parts	957	1,879
Other inventories	436	430
Inventories total	1,393	2,309

Amounts are in ISK million

Notes, contd.:

26. contd.:

In 2009 the write-down of inventories to net realisable value amounted to ISK 518 million (2008: 46 million). The write-down is included in aircraft maintenance expenses and other operating expenses.

27. Trade and other receivables

	2009	2008
Trade and other receivables are specified as follows:		
Trade receivables	6,613	8,789
Current maturities of long term-receivables	59	100
Restricted cash	1,875	409
Other receivables	1,178	4,538
Trade and other receivables total	9,725	13,836

At 31 December 2009 trade receivables are shown net of an allowance for doubtful debts of ISK 448 million (2008: ISK 825 million).

Receivables denominated in currencies other than the functional currency comprise ISK 4,666 million (2008: ISK 4,780 million) of trade receivables.

The Group's exposure to credit and currency risks, and impairment losses related to trade and other receivables is disclosed in note 42.

28. Prepayments

Prepaid expenses which relates to subsequent periods amounted to ISK 1,350 million (2008: ISK 2,536 million) at year end. The prepayments consist mainly of insurance expenses and prepaid rental expenses.

29. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

Bank deposits	1,877	3,743
Marketable securities	0	90
Cash on hand	32	232
Cash and cash equivalents total	1,909	4,065

30. Equity

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

On 6 August 2009 the Company's shareholders meeting authorized the Board of Directors to increase the shareholders capital by 4,000 million shares. The subscription rate can be decided by means of invitation to tender for new shares. Shareholders may pay, partially or in full, for the shares by means of set-off of indebtness, as may be further decided by the Board of Directors. This authorized share capital increase is part of the Company's plan, in cooperation with its largest shareholder and creditor, to improve the Company's debt maturity profile and equity ratio. This authorization is valid until 1 July 2010.

Amounts are in ISK million

Notes, contd.:

30. contd.

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

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

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

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

31. 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 outstanding number of shares during the period and shows the earnings per each share. The calculation of diluted earnings per share takes into consideration the issued convertible notes when calculating the share capital.

Basic earnings per share:	**2009**	**2008**
Loss for the period attributable to equity holders of the Parent	(10,319)	(7,998)
Average share capital	975	978
Earnings per share of ISK 1	(10,58)	(8,18)

Diluted earnings per share is equal to earnings per share as the conversion of convertible notes is not dilutive.

Loss attributable to ordinary equity holders of the parent company:		
Loss for the year attributable to equity holders of the Parent	(10,319)	(7,998)
Discontinued operations	6,681	(1,437)
Total	(3,638)	(9,435)
Weighted average number of ordinary shares		
i*n million shares*		
Issued ordinary shares at beginning of year	975	981
Effect of bought own shares	0	(3)
Weighted average number of ordinary shares at 31 December	975	978
Loss per share:		
Loss per share (ISK)	(10,94)	(7,64)
Diluted loss per share (ISK)	(10,94)	(7,64)

Amounts are in ISK million

Notes, contd.:

31. contd.

	2009	2008
Loss per share from continuing operations:		
Basic loss per share (ISK)	(4.09)	(9.11)
Diluted loss per share (ISK)	(4.09)	(9.11)

32. Loans and borrowings

This note provides information about the contractual terms of the Group´s interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Group´s exposure to interest rate, foreign currency and liquidity risk, see note 42.

Non-current loans and borrowings are specified as follows:

Secured bank loans	11,211	23,963
Unsecured loans	2,727	1,579
Convertible notes	1,947	1,918
	15,885	27,460
Current maturities	(2,209)	(4,560)
Total non-current loans and borrowings	13,676	22,900

Current loans and borrowings are specified as follows:

Current maturities of non-current liabilities	2,209	4,560
Short-term notes	1,160	3,681
Short-term loans from credit institutions	19,345	12,494
Total current loans and borrowings	22,714	20,735
Total loans and borrowings	36,390	43,635

Due to breach of covenants at year end, loans amounting to ISK 8,338 million have been reclassified as short-term loans. As disclosed in note 53 the group is working on restructuring its financial positions in cooperation with its major creditors.

33. Secured bank loans are specified as follows:

	Average interest rates	Total remaining balance 2009	Average interest rates	Total remaining balance 2008
Debt in USD	5.1%	10,936	5.3%	20,776
Debt in EUR	0.0%	0	4.3%	1,995
		10,936		22,771
		22,771		13,894
Debt in ISK indexed	7.1%	275	6.7%	808
Debt in ISK not indexed	0.0%	0	18.0%	384
Total secured bank loans		11,211		23,963

Amounts are in ISK million

Notes, contd.:

34. Repayments of loans and borrowings are specified as follows:

	2009	2008
Repayments in 2009	-	20,735
Repayments in 2010	22,714	3,609
Repayments in 2011	6,310	8,308
Repayments in 2012	1,741	1,922
Repayments in 2013	1,886	2,642
Repayments in 2014	3,530	6,195
Subsequent repayments	209	224
Total loans and borrowings	36,390	43,635

35. Convertible notes

Convertible notes are specified as follows:

Proceeds from issue of convertible notes - nominal amount	2,000	2,000
Transaction cost	(39)	(39)
Net proceeds	1,961	1,961
Amount classified as equity	(110)	(110)
Expensed transaction cost	96	67
Carrying amount of liability	1,947	1,918

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

36. Prepayments

Prepayments at the end of the year consist of deposits from 3rd party in relation to future aircraft transactions.

37. Long-term payables

Long-term payables corresponds to estimated cost of overhauling engines of leased aircraft and security deposits from charter contracts. Long term obligation at year end 2009 amounts to ISK 3,688 million (2008: ISK 2,026 million) and short term obligation, which is included in other payables amounts to 1,589 million (2008: ISK 1,695 million).

38. Deferred income tax asset (liability)

The deferred income tax asset (liability) is specified as follows:

Deferred income tax liability 1.1.	(23)	(134)
Additions through business combination	0	218
Exchange rate difference	(143)	(529)
Income tax recognised in profit or loss	485	(643)
Income tax recognised in equity	(332)	1,065
Assets held for sale	153	0
Deferred income tax asset (liability) 31.12.	140	(23)

Amounts are in ISK million

Notes, contd.:

38. contd.

Deferred tax assets and liabilities is attributable to the following:

	Assets		Liabilities		Net	
	2009	2008	2009	2008	2009	2008
Operating assets	0	319	(1,801)	(2,107)	(1,801)	(1,788)
Intangible assets	0	24	(195)	(62)	(195)	(38)
Derivatives	67	420	0	0	67	420
Trade receivables	6	38	0	(21)	6	17
	73	801	(1,996)	(2,190)	(1,923)	(1,389)
Tax loss carry-forwards	2,096	1,200	0	0	2,096	1,200
Other items	0	193	(33)	(27)	(33)	166
Deferred income tax	2,169	2,194	(2,029)	(2,217)	140	(23)

	1 January 2009	Recognised in income statement	Exchange rate difference	Additions through business combination	Recognised in equity	31 December 2009
Operating assets	(1,788)	(365)	2	350	0	(1,801)
Intangible assets	(38)	(157)	0	0	0	(195)
Derivatives	420	(13)	(8)	0	(332)	67
Trade receivables	17	17	0	(28)	0	6
Tax loss carry-forwards	1,200	1,014	(106)	(12)	0	2,096
Other items	166	(11)	(31)	(157)	0	(33)
	(23)	485	(143)	153	(332)	140

	1 January 2008	Recognised in income statement	Exchange rate difference	Additions through business combination	Recognised in equity	31 December 2008
Operating assets	(1,453)	(489)	212	(58)	0	(1,788)
Intangible assets	(91)	(9)	19	43	0	(38)
Derivatives	5	(648)	(2)	0	1,065	420
Trade receivables	(34)	24	7	20	0	17
Tax loss carry-forwards	1,339	521	(835)	175	0	1,200
Other items	100	(42)	70	38	0	166
	(134)	(643)	(529)	218	1,065	(23)

Amounts are in ISK million

Notes, contd.:

39. Share-based payments

The terms and conditions of grants are as follows:

Grant date / employees entitled	Number of instruments in thousands	Vesting conditions	Contractual life of option
Options granted 2007	60,340	12/24/36 months service	3 year
Total	60,340		

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

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

	Weighted average exercise price 2009	Number of options 2009	Weighted average exercise price 2008	Number of options 2008
Outstanding at 1 January	27.5	28,253	27.5	51,270
Forfeited during the year	27.5	(14,127)	27.5	(23,017)
Outstanding at 31 December	27.5	14,126	27.5	28,253
Exercisable at 31 December		0		0

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

	Granted 2008
Fair value at grant date, average 12, 24, and 36 months options, average	5.85
Share price	27.5
Exercise price	27.5
Expected volatility (weighted average volatility)	29.0%
Option life (expected weighted average life)	2 years
Expected dividends per share	ISK 1
Risk-free interest rate (based on government bonds)	11.7%%

Total recognised expenses for the year arising from share-based payment transactions amounted to ISK 33 million (2008: ISK 60 million) including forfeited options during the year and accrued social security expenses related to share-based payments. All outstanded options at year end 2009 were forfeited in January 2010.

Notes, contd.:

40. Trade and other payables

Trade and other payables are specified as follows:

	2009	2008
Trade payables	3.464	7.898
Derivatives used for hedging	369	5.534
Other payables	10,559	10,687
Total trade and other payables	14,392	24,119

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 42.

41. 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.

42. Financial risk management

Overview

The Group has exposure to the following risks from its use of financial instruments:

– credit risk
– liquidity risk
– market risk

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

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board has established the Risk Management Commitee, which is responsible for developing and monitoring the Group's risk management policies. The committee reports regularly to the Board of Directors on its activities.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Group Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

Credit risk

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

Trade and other receivables

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

Amounts are in ISK million

Notes, contd.:

42. contd.:

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

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

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

Exposure to credit risk
The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	Notes	**2009**	**2008**
Long-term receivables and deposits		3,449	3,834
Trade and other receivables	25	9,725	13,836
Cash and cash equivalents	27	1,909	4,065
		15,083	21,735

Impairment losses
The aging of trade receivables at the reporting date was:

	Gross 2009	**Impairment 2009**	**Gross 2008**	**Impairment 2008**
Not past due	5,302	(27)	5,637	0
Past due 0-30 days	380	(9)	1,278	0
Past due 31-120 days	773	(71)	1,477	(160)
Past due 121-365 days	288	(162)	653	(266)
More than one year	318	(179)	569	(399)
	7,061	(448)	9,614	(825)

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

	2009	**2008**
Balance at January	825	241
Discontinued operations	(313)	0
Impairment loss (reversed) recognized	(64)	584
Balance at 31 December	448	825

Amounts are in ISK million

Notes, contd.:

42. contd.:

Based on historical default rates, the Group believes that no impairment allowance is necessary in respect of trade receivables not past due or past due by 30 days; a significant part of the balance relates to customers that have a good track record with the Group.

The allowance account in respect of trade receivables is used to record impairment losses unless the Group is satisfied that no recovery of the amount owing is possible; at that point the amount is considered irrecoverable and is written off against the financial asset directly.

Liquidity risk

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

The Group policy is to divide liquid assets into three classes depending on duration and match them against the Group's liquidity preferences laid out by the management on annual basis. Classes one and two include the estimated minimum of accessible funds for operational liquidity, but differ in terms of asset duration. Class three includes assets of longer duration for strategic liquidity, such as medium term investments. The amounts in each class of assets are targeted once a year with reference to a number of economic indicators, most importantly the annual level of fixed costs, and turnover.

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

2009	Carrying amount	Contractual cash flows	Within 12 months	1-2 years	2-5 years	After 5 years
Financial liabilities						
Unsecured bond issue	18,807	(18,807)	(18,807)	0	0	0
Secured bank loans	11,211	(13,266)	(2,884)	(2,161)	(8,004)	(217)
Convertible notes	1,947	(2,344)	(229)	(2,115)	0	0
Payables and prepayments	20,334	(20,334)	(14,392)	(2,252)	(3,690)	0
	52,299	(54,751)	(36,312)	(6,528)	(11,694)	(217)
Off balance sheet liabilities						
Operating lease payments	0	(38,137)	(12,502)	(10,939)	(13,489)	(1,207)
Pre delivery payments	0	(18,531)	(839)	(1,966)	(15,726)	0
	0	(56,668)	(13,341)	(12,905)	(29,215)	(1,207)
Exposure to liquidity risk	52,299	(111,419)	(49,653)	(19,433)	(40,909)	(1,424)
2008						
Financial liabilities						
Unsecured bond issue	16,175	(16,175)	(16,175)	0	0	0
Secured bank loans	25,542	(31,396)	(5,852)	(4,674)	(14,379)	(6,491)
Convertible notes	1,918	(2,189)	0	0	(2,189)	0
Payables and prepayments	28,334	(28,334)	(24,119)	(2,026)	(2,189)	0
	71,969	(78,094)	(46,146)	(6,700)	(18,757)	(6,491)

Amounts are in ISK million

Notes, contd.:

42. contd.

2008	Carrying amount	Contractual cash flows	Within 12 months	1-2 years	2-5 years	After 5 years
Off balance sheet liabilities						
Operating lease payments	0	(66,556)	(17,345)	(14,672)	(28,302)	(6,237)
Pre delivery payments	0	(23,287)	(876)	(815)	(14,907)	(6,689)
	0	(89,843)	(18,221)	(15,487)	(43,209)	(12,926)
Exposure to liquidity risk	71,969	(167,937)	(64,367)	(22,187)	(61,966)	(19,417)

Unused loan commitments at year end 2009 amounted to ISK 155 million.

Market risk

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

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

Currency risk

The Group is exposed to currency risk on sales, purchases and borrowings that are denominated in a currency other than the respective functional currencies of Group entities

The Group seeks to reduce its foreign exchange exposure arising from transactions in various currencies through a policy of matching, receipts and payments in each individual currency. Then internal trades across the range of subsidiaries are arranged by the Group as possible. Nevertheless, the USD cash inflow falls short of USD outflow due to fuel costs, lease and capital related payments which are to a large extent denominated in USD. This shortage is financed by a surplus of European currencies, most importantly EUR and Scandinavian currencies. The Group follows a hedging policy of 40-80% of net exposure with a 12 month horizon and uses a portfolio of instruments, mainly forwards and options. Market failures as well as added opportunity costs has jeppordized hedging activities and currently no FX hedge contracts are in place.

Exposure to currency risk

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

2009	USD	EUR	DKK	SEK	NOK	CZK
Net bal. sheet exposure	1,786	(2,199)	279	337	331	545
Estim. forecast revenue	27,302	15,356	3,618	3,220	2,985	0
Estim. forecast purchases	(40,850)	(5,675)	(1,644)	(340)	(455)	0
Net currency exposure	(11,762)	7,482	2,254	3,218	2,861	545

Amounts are in ISK million

Notes, contd.:

42. contd.:

2008	USD	EUR	DKK	SEK	NOK	CZK
Net bal. sheet exposure	5,563	(1,271)	132	120	53	(2,142)
Estim. forecast revenue	45,820	30,031	2,064	1,973	1,412	27,296
Estim. forecast purchases	(70,405)	(23,421)	(655)	(469)	(467)	(9,364)
Forward FX contracts	3,997	(3,997)	0	0	0	0
Net currency exposure	(15,025)	1,342	1,541	1,594	998	15,790

The following significant exchange rates applied during the year:

	Average rate		Reporting date spot rate	
	2009	2008	2009	2008
USD	123.93	88.16	125.21	121.61
EUR	172.99	127.69	180.41	170.09
DKK	23.26	17.15	24.25	22.84
SEK	16.35	13.23	17.63	15.64
NOK	19.86	15.46	21.77	17.42
CZK	6.54	5.48	6.69	6.38

Sensitivity analysis

A 10% strengthening of the ISK against the following currencies at 31 December would have increased (decreased) post-tax equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. This analysis is performed on the same basis for 2008.

2009	Equity	Profit or loss
USD	964	964
EUR	(614)	(614)
DKK	(185)	(185)
SEK	(263)	(263)
NOK	(235)	(235)
CZK	(45)	0
2008		
USD	1,277	1,517
EUR	(114)	45
DKK	(131)	(131)
SEK	(135)	(135)
NOK	(85)	(85)
CZK	(1,342)	0

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

Amounts are in ISK million

Notes, contd.:

42. contd.

Interest rate risk

The largest share of outstanding long term loans, carrying 3-6 months floating interest rates are directly related to aircraft financing and denominated in USD. That is a consequence of the fact that the most liquid market for commercial aircraft denominates prices in USD. The Group follows a policy of hedging 40-80% of interest rate exposure. Swap contracts are mainly used to exchange floating rates for fixed up to 5 years ahead, which currently amounts to USD 65 million and carry on average 4.65% interest rates. Due to exceptional financial market circumstances, extensions of current swap contracts have not been made available and they will expire in 2010 and 2011.

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

	Carrying amount	
	2009	2008
Fixed rate instruments		
Financial assets	3,449	3,834
Financial liabilities	(331)	(5,617)
	3,118	(1,783)
Variable rate instruments		
Financial liabilities	(36,059)	(38,018)

Fair value sensitivity analysis for fixed rate instruments

The Group does not account for any fixed rate financial assets and liabilities at fair value through profit or loss, and the Group does not designate derivatives (interest rate swaps) as hedging instruments under a fair value hedge accounting model. Therefore a change in interest rates at the reporting date would not affect profit or loss.

A change of 100 basis points in interest rates would have increased or decreased equity by 50 million (2008: 247 million).

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 shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. The analysis is performed on the same basis for 2008

	Equity	
	100 bp increase	100 bp decrease
2009		
Variable rate instruments	49	(50)
Total	49	(50)
2008		
Variable rate instruments	122	(125)
Total	122	(125)

Amounts are in ISK million

Notes, contd.:

42. contd.

Other market risk

Fuel price risk

The Group maintains a policy of hedging fuel price exposure by a ratio of 40-80% by using swaps and options. Financial market conditions have been such that the Group has not been offered feasible hedge instruments in 2009 and has therefore remained fully exposed to fuel price volatility since November 2009. The oil market was fairly stable for the second half of the year compared to 2008 and therefore the Group was not burdened by the low hedge ratio.

Sensitivity analysis

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

	2009	2008	2009	2008
	Effect on equity		Effect on profit before tax	
Increase in fuel prices by 10 %	0	412	0	(60)
Decrease in fuel prices by 10 %	0	(414)	0	67

Capital management

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

The Board's target is that managers of the Group hold the Company's ordinary shares. The Board has entered into share option agreements with managers for that purpose. At year-end 2009 the managers of the Group hold ISK 0.5 million of the shares and have entered into share option agreements for ISK 14.1 million as disclosed in note 39.

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

43. Financial instruments and fair values

The fair values of financial assets and liabilities, together with the carrying amounts shown in the statement of financial position, are as follows:

	2009		2008	
	Carrying amount	Fair value	Carrying amount	Fair value
Loans and receivables	13,174	13,174	19,890	19,890
Cash and cash equivalents	1,909	1,909	4,065	4,065
Unsecured bond issue	(19,345)	(19,345)	(12,494)	(12,494)
Secured bond loans	(11,211)	(11,211)	(25,542)	(25,542)
Convertible notes	(1,947)	(1,947)	(1,918)	(1,918)
Payables and prepayments	(20,334)	(20,334)	(26,773)	(26,773)
Total	(37,754)	(37,754)	(42,772)	(42,772)

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

Amounts are in ISK million

44. Off-balance sheet items

As a lessee the Group has in place operating leases for 19 aircrafts at the end of December 2009. The leases are for fifteen Boeing 757 aircrafts and four Boeing 767 aircrafts. The Group also has in place operating leases for storage facilities, accommodations, equipment and fixtures for its operations, the longest until the year 2018. At the end of the year 2009 the leases are payable as follows:

	Real estate	Aircrafts	Other	Total 2009	Total 2008
In the year 2009	-	-	-	-	17,345
In the year 2010	1,202	10,882	418	12,502	14,672
In the year 2011	1,082	9,656	201	10,939	12,710
In the year 2012	998	7,848	121	8,967	9,870
In the year 2013	925	2,757	97	3,779	5,722
In the year 2014	403	248	90	741	4,404
Subsequent	1,119	0	90	1,209	1,833
Total	5,729	31,391	1,017	38,137	66,556

45. As a lessor the Company leases aircrafts on wet, dry and other various leases, both on short and long term leases. Lease income for the year 2009 amounted to ISK 19,425 million (2008; ISK 16,951 million).

46. Capital commitments

The Group has agreements with Boeing regarding the purchase of two Boeing 737-800 aircraft to be delivered in 2010 and five Boeing 787 Dreamliner aircrafts to be delivered in the year 2012 and in 2015. The Group also has an option to purchase three additional 787 Dreamliner aircrafts.

47. Litigations and claims

During the first half of 2007 the Competition Authorities fined the subsidiary, Icelandair ehf., due to an alleged breach of the competition law. The penalty amounts to ISK 130 million after it was lowered by 30% after the decision was appealed. Icelandair Group hf. took this case to court which ruled in Febuary 2010 to dismiss the penalty. The court ruling has not been appealed to Supreme court.

48.Related parties

Identity of related parties

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

Transaction with associates

During the year 2009 the Group purchased services from associates amounting to ISK 358 million (2008: ISK 516 million), but the Group did not sell them any services. The Group has not granted any loans to its associates. Transactions with associates are priced on an arm's length basis.

Transactions with management and key personnel

Salaries and benefits of management paid for their work for Group companies during the year 2009, share option agreements and shares in the Company are specified as follows:

Amounts are in ISK million

48. contd:

	Salaries and benefits	Share options	Shares held at year-end 2009	Share held by related parties
Board of Directors:				
Sigurður Helgason, chairman of the board	1.6 *			
Finnur Reyr Stefánsson	3.0			38.2
Jón Ármann Guðjónsson	0.8			
Katrín Olga Jóhannesdóttir	0.8			
Pétur J. Eiríksson. former MD of Icelandair Cargo ehf.	19.1			
Kristín Einarsdóttir, alternative board member	0.2			
Magnús Magnússon, alternative board member	0.1			
Tómas Kristjánsson, alternative board member	0.5			20.0
Gunnlaugur M. Sigmundsson, former chairman	4.9			
Ásgeir Baldurs, former board member	1.8			
Einar Sveinsson, former board member	2.3			12.8
Ómar Benediktsson, former board member	1.1			
Jón Benediktsson, former alt. board member	0.7		0.4	12.8
Martha Eiríksdóttir, former alt. board member	2.1		0.1	
Sigurður Atli Jónsson, fomer alt. board member	0.9			
CEO:				
Björgólfur Jóhannsson CEO of Icelandair Group hf.	38.7			
Sigþór Einarsson, Deputy CEO of Icelandair Group hf.	25.5	1.0	0.1	
Managing directors:				
Twelve MD of group companies	258.7	6.3		

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

*The chairman of the board has dismissed his right to salaries so instead the board agreed to pay the same amount to a charity fund - Special children travel fund.

Amounts are in ISK million

49. Group entities

The Company holds thirteen subsidiaries at year end 2009 which are all included in the consolidated financial statements. They are:

	Ownership interest 2009	2008
Scheduled airline & tourism operations:		
Air Iceland ehf.	100%	100%
Iceland Travel ehf.	100%	100%
Icelandair ehf.	100%	100%
Icelandair Cargo ehf.	100%	100%
Icelandair Ground Services ehf. (IGS)	100%	100%
Icelandair Hotels ehf.	100%	100%
Global capacity solutions and aircraft trading:		
Bluebird Cargo ehf.	100%	100%
IceLease ehf.	100%	100%
IG Invest ehf.	100%	100%
Loftleiðir - Icelandic ehf.	100%	100%
Smart Lynx, Latvia	100%	100%
Travel Service, Czech Republic	30%	66%
Shared services:		
IceCap Ltd., Guernsey	100%	100%
Icelandair Shared Services ehf.	100%	100%

The subsidiaries own 25 subsidiaries that are also included in the consolidated financial statements.

On 25 November 2009 Icelandair Group hf. sold 20% of its share in Travel Service. After the transaction the Group holds a 30% share in the Company and accordingly, control of Travel Services ceases by Icelandair Group hf. As a result, Travel Service is not part of the Consolidated Financial statements for 2009 and is presented under discontinued operations in the income statement.

50. Statement of cash flows

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

Gain on the sale of operating assets	(30)	(161)
Exchange rate difference and indexation of liabilities and assets	2,146	448
Expensed long term cost	3,972	3,016
Share of profit of associates	(48)	(178)
Income tax	163	(450)
Loss from assets held for sale	3,241	0
Other items	3	52
Total other operating items in the statement of cash flows	9,121	2,727

Amounts are in ISK million

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

	2009	2008
Inventories, decrease (increase)	385	(460)
Trade and other receivables, decrease	437	153
Trade and other payables, decrease	(61)	(974)
Prepaid income, increase	2,647	17
Net change in operating assets and liabilities in the statement of cash flows	3,408	(1,264)

52. Additional cash flow information:

Interests paid	3,083	3,186
Interests received	113	200

53. Restructuring

For the past year the Company has been working with its main creditors on improving its debt maturity profile and equity ratio. As a part of the restructuring plan the Board of Directors has in addition with the dilution of Travel Service (note 49), proposed redefinition of the business model of the company, leading to subsidiaries being split between core and non-core. Accordingly the main focus of the Group will be on scheduled airline operations and tourism evolving around Iceland, and related services. Smartlynx Latvia, and the remaining shares in Travel Service are defined as non-core, leading to reclassification on these companies financial results for the year 2009 as discontinued operations as disclosed in note 6.

In March 2010 Icelandair Group hf. and its largest creditors, Íslandsbanki and Glitnir Bank hf., entered into framework agreement which sets forth the basic terms and conditions and the intensions of the Parties regarding the financial restructuring plan. The objectives of the restructuring plan are as follows:

- Debts amounting to ISK 3.6 billion will be converted to equity.
- Assets valued at ISK 7.6 billion, shares in Travel Service, Bluebird and IG Invest will be used to lower debts amounting to the same amount.
- Loan agreements with Íslandsbanki and Glitnir will be restated in the way that suits the Company´s maturity and currency risk profile.
- The Company will raise new share capital in 2010 from new investors in open and closed offerings for a total amount in the range of ISK 8-10 billion.
- Holders of issued bonds amounting to ISK 1.7 billion are asked to convert the debt to equity or extend the maturity of debts.

The Company commits in the agreement to hold a shareholders' meeting to obtain approval for the share capital increase set forth in the agreement.

If the restructuring according to the agreement will not be completed and the debt maturity profile and financial position of the Company will not be improved in other way it may cast doubt about the Company's ability to continue as a going concern.

54. Other matters

During the first quarter of 2010 the Company reclassified its shares in Siglo FIU, Siglo FIR and Siglo FIJ as part of the continuing operations. As a result the assets, mainly aircrafts, and the liabilities will be part of the statement of financial position in the year 2010.

Amounts are in ISK million

55. Ratios

	2009	2008
The Group's primary ratios at year end are specified as follows:		
Working capital ratio	0.58	0.43
Equity ratio	0.16	0.20
Intrinsic value of share capital	14.98	20.59

Design & Art Direction: Islenska
Printing: Oddi

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