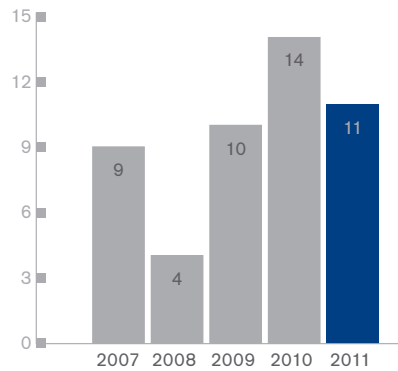
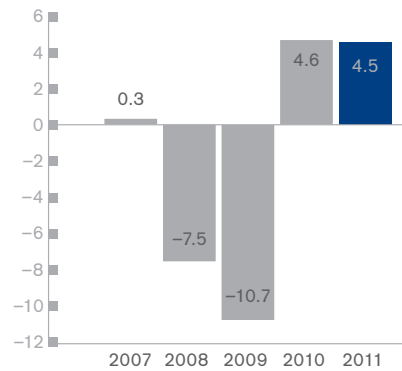
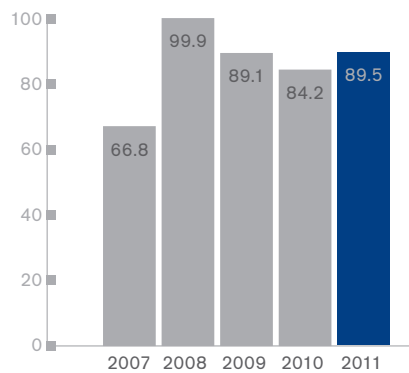
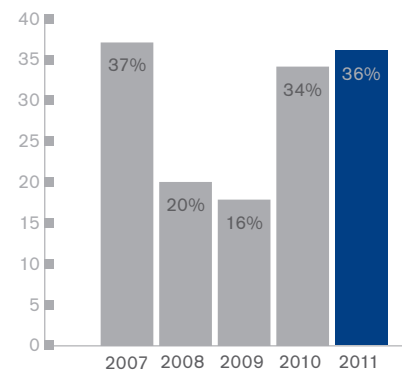
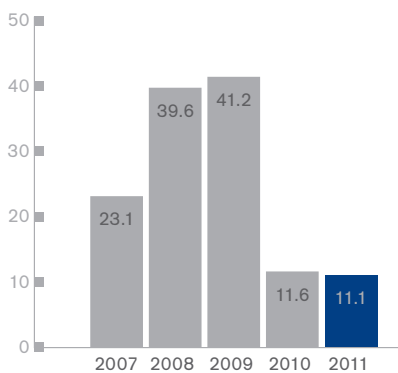
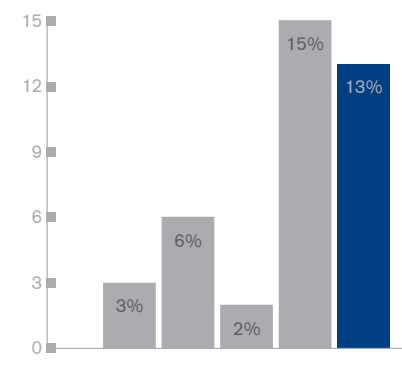


75 | YEARS OF AVIATION



## Key Figures

	2007	2008	2009	2010	2011
<b>OPERATING RESULTS</b>					
Total income	63,477	72,199	80,321	88,015	96,934
EBITDAR	11,056	8,821	17,435	21,254	17,751
EBITDA	5,477	3,053	8,135	12,578	10,413
EBIT	2,337	-7,351	1,483	6,254	4,735
EBT continuing operations	129	-8,985	-4,469	6,576	3,500
Profit / loss for the year	257	-7,468	-10,665	4,556	4,452
<b>BALANCE SHEET</b>					
Total assets	66,760	99,947	89,104	84,239	89,466
Total equity	25,033	20,080	14,605	28,403	32,291
Interest bearing debt	25,098	43,635	43,136	24,604	24,136
Net interest bearing debt	23,092	39,570	41,227	11,610	11,056
<b>CASH FLOW</b>					
Net cash from operating activities	3,889	4,531	8,781	15,673	14,386
Net cash used in investing activities	-5,461	-7,452	-7,799	-5,515	-13,017
Net cash from/used in financing activities	853	3,171	-3,283	-49	-3,384
Cash and cash equivalents and marketable securities end of year	2,006	4,065	1,909	12,994	13,080
<b>KEY RATIOS</b>					
Earnings per share ISK	0.25	-7.64	-10.94	3.07	0.89
Equity per share ISK	25.26	20.53	14.98	5.71	6.49
Equity ratio	37%	20%	16%	34%	36%
Current ratio	0.46	0.43	0.58	1.16	0.91
Debt/Equity	1.00	2.17	2.95	0.87	0.75
Net tangible worth ISK million	-1,813	-9,241	-8,993	7,191	10,632
CAPEX ISK million	9,217	7,908	5,922	5,015	15,326
Transport revenue as % of total revenues	57%	58%	59%	61%	64%
EBITDA ratio	9%	4%	10%	14%	11%
EBITDAR ratio	17%	12%	22%	24%	18%

**EBITDA % | 2007–2011****Net profit / loss ISK billion | 2007–2011****Total assets ISK billion | 2007–2011****Equity ratio | 2007–2011****Net interest bearing debt ISK billion | 2007–2011****Cash and cash equivalents and marketable securities as % of income | 2007–2011**

## Table of Contents

01	Chairman's Address	6
	President and CEO's Address	8
<hr/>		
02	Icelandair Group – The Company	12
<hr/>		
03	The 75th Anniversary	17
<hr/>		
04	Quarterly Overview	30
<hr/>		
05	Performance in 2011	36
	Financial Position	40
	Outlook	43
	Risk Management	44
<hr/>		
06	Subsidiaries	50
<hr/>		
07	Corporate Governance	60
	Shareholder Information	64
<hr/>		
08	Icelandair Group and the Community	68
	Environment	70
<hr/>		
09	Employees	74
	Executive Committee	77
	Subsidiaries Management	78
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### About the Annual Report

Icelandair Group's annual report for 2011 is inspired by the Icelandic winter and our 75th anniversary. The photographs in the report were taken around Iceland this winter and depict the unique landscape and atmosphere that Iceland has to offer. In our anniversary year we offer our readers a glimpse into our 75-year history, of which we are extremely proud. ■

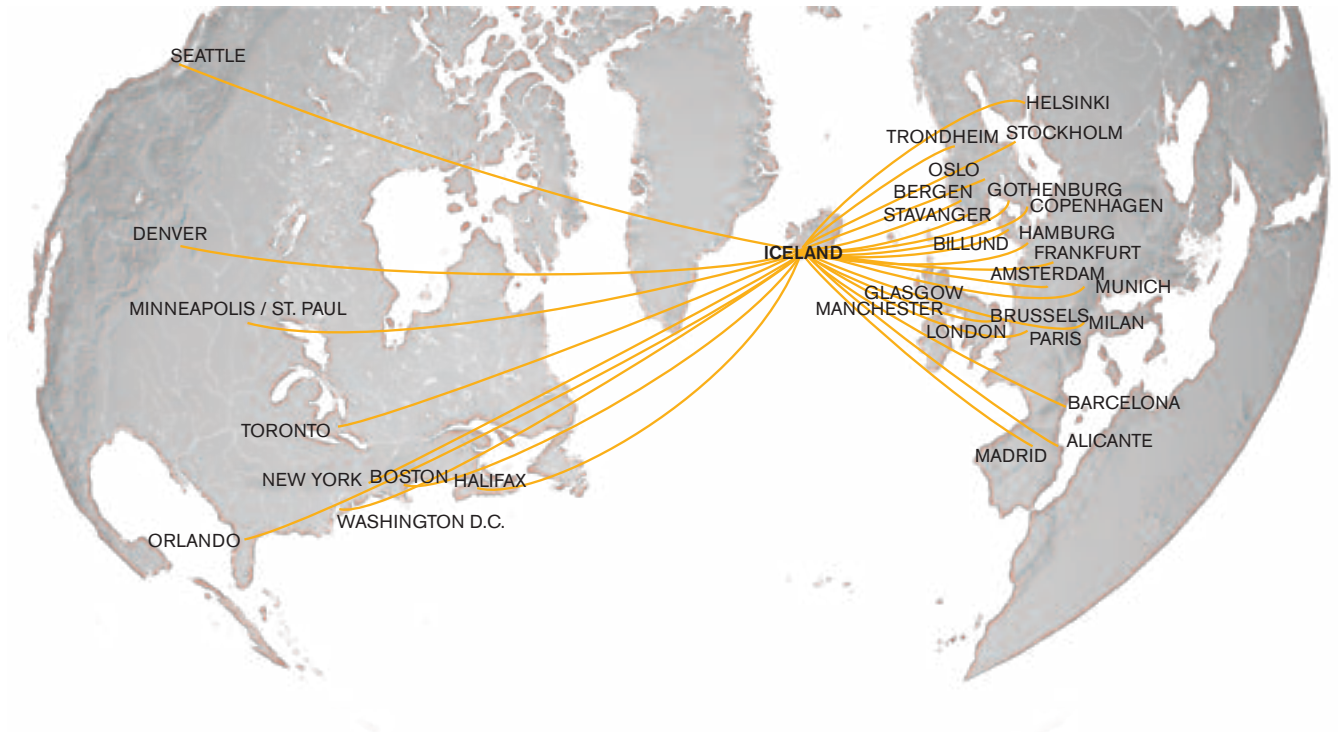
Design: Íslenska  
Photos by AriMagg  
Printing: Oddi ehf.



**DID YOU KNOW ...** that Reykjavík, the capital of Iceland,  
has more average daylight  
– 14.9 hours – than Miami, Florida



## Our Route Network



Iceland's uniquely central location between Europe and North America is the key to our hub-and-spoke network.

In 2012, the year of the Company's 75th anniversary our route network will connect 22 European cities with 9 North American cities through the Company's hub. The network is based on a 24-hour rotation, with morning and afternoon connections in Iceland.

## OUR VALUES

The Group aspires to have a brand synonymous with efficient and reliable operations, sound and trustworthy management, and dependable and flexible services for the benefit of its stakeholders.

- **WE CARE** for our customers, employees, environment and shareholders.
- **WE THINK CLIENTS** through consistency, reliability, clear product alternatives and friendly service.
- **WE DRIVE RESULTS** via teamwork, shared information and values, accountability and profitability.

## OUR MISSION

- To operate an integrated network of companies in air travel and related services, providing quality services built on the 75 years' experience and knowledge of its subsidiaries.
- To create value for customers and other stakeholders by focusing on efficiency and flexibility, as well as synergies between our companies.

## Letter to our Shareholders



**SIGURÐUR HELGASON,**  
CHAIRMAN OF THE BOARD  
OF DIRECTORS OF  
ICELANDAIR GROUP HF.

Fellow shareholders,

The year 2011 was an eventful one for Icelandair Group. After setting the tone for the restructured Group with good operating results in 2010, the Company continued to perform strongly in 2011. We delivered internal growth in both of our business segments and continued to strengthen our balance sheet and expand our service offering.

Since the economic turmoil in 2008, the Company has increased its capacity and marketing efforts, paving the way for the good result in 2011. Specific steps have been taken by the Company to identify areas of sustainable growth in our route network and affiliated businesses. Although we pride ourselves on our past performance, we remain cautiously optimistic about developments going forward. We have shown internal growth, with Icelandair expanding the scope of its route network with new destinations in the US in 2009, 2011 and 2012 and consistently increasing the frequency of flights on our routes to Europe.

In 2011 Icelandair Group's EBITDA amounted to ISK 10.4 billion and net profit amounted to ISK 4.5 billion. The financial strength of the Group remains significant, with a 36% equity ratio and cash and marketable securities at year-end of ISK 13.1 billion. In the course of the year the Company's stock market valuation rose by 60%, reflecting the Company's solid balance sheet and clear strategy. In 2011 the market capitalization of the Company increased by ISK 9.4 billion and the Board of Directors proposes that the Annual General Meeting should approve an ISK 0.8 billion dividend payment to our shareholders. We remain grateful to our shareholders for their ongoing support and we value their commitment to the Company in the turbulent times we have experienced over the last few years.

### THE INTERNATIONAL AVIATION MARKET

The aviation industry has been volatile, and recent forecasts from IATA suggest that leaner times may lie ahead. Demand is expected to remain subdued, and continued economic uncertainty around the world will continue to push unit costs near their historical highs. The backdrop to these changes is continued unrest in the Arab world, which has had adverse effects on trends in the price of oil, which increased by over 40% in the year 2011. Sustained increases in oil prices will continue to put pressure on the profitability of airlines going forward. With new EU legislation on emission quotas (ETS), the fuel bill and environmental issues will create new challenges that Icelandair Group will have to meet in an innovative manner to maintain its international competitive advantage.

The single-fleet concept has been the cornerstone of our business strategy for over 15 years. Taking on a single-type fleet of all three variants of the Boeing 757 drastically reduced ownership, maintenance and training costs, and this has been one of the sources of the Company's ongoing competitive advantages. In 1990 Icelandair was the first airline to offer scheduled flights across the North-Atlantic on a Boeing 757, and the experience that the Company has gained remains an invaluable resource going forward.

We are systematically weighing our options in relation to the future fleet of the Company. With continued improvements in our fleet, through the introduction of winglets to increase fuel efficiency and range and improved entertainment systems, the current fleet can serve the Company well for the next decade under the current circumstances. In fact, two 757 aircraft will be added to Icelandair's fleet in the first half of 2012, in further proof of our commitment to our current fleet of 757's.

The competitive landscape has been changing rapidly for Icelandair Group. We welcome competition and we believe that increased competition will further increase the size of the tourist market to Iceland. The growing number of competitors has made us redouble our efforts to offer a clear value proposition to our clients with the reliability and consistency of our service at the forefront. We believe that clients value our service level and commitment to excellence. Although about 15 airlines will operate flights to and from Iceland next summer, our broad service offering will continue to differentiate Icelandair Group from the competition.

#### CONTINUED ORGANIC GROWTH AND REDUCED SEASONALITY

Icelandair Group is an operating company engaging in diverse flight and tourist services. In 2011 the Company continued to fortify its position as one of the leading operators in the North Atlantic with Iceland as a hub between the US and Europe. Our commitment to creating sustainable shareholder value has been at the forefront of our organic expansion strategy. Our core values, with the focus on offering our clients reliable service, in harmony with our continuing effort to expand our service offering, are the hallmarks of our Company.

Icelandair Group prides itself on its role as the leading force in Icelandic travel services. Through its subsidiaries, the Company holds an enviable position in international aviation and leasing, in domestic air travel, the hotel market and other areas of tourist services. Our interests are intertwined with the Icelandic tourist industry as a whole in maintaining the flow of tourists to Iceland and in the promotion of Iceland as a tourist destination.

The Company has actively been addressing the inherent seasonality of its business model. We believe that the combination of new full-year destinations

and increased frequency in the route network, supported by continued infrastructure investments in our local businesses, will help us to dampen these fluctuations. Reducing seasonality remains both the largest challenge and the largest opportunity for Icelandic tourism, and thereby Icelandair Group as well. The Company has vast interests in building up Iceland as a preferred year-round tourist destination and our commitment to that goal has never wavered. We have been at the forefront of Icelandic companies in supporting successful marketing initiatives, and it remains a clear focus of the Group going forward to reduce these seasonal fluctuations.

■ *In our anniversary year I remain optimistic about the future prospects of Icelandair Group. The Company has learnt from its past mistakes and continued to build on its many successes. The value proposition of Iceland as a tourist destination translates into significantly favourable prospects, and I believe Icelandair Group is well positioned to benefit from the continued growth trends in Icelandic tourism.*

#### 75 YEARS OF INNOVATION AT ICELANDAIR GROUP

This year marks the 75th anniversary of Icelandair Group and its predecessors. Since its incorporation in 1937 the Company has been the driving force of Icelandic tourism and has led the way as the country's largest airline. The geographical location of Iceland has played a pivotal role in Icelandair's business model and we have continued to develop the TO-FROM-VIA concept, with Iceland as a

cornerstone in our business strategy. This role is one that we take pride in and we will continue to do so going forward.

Our history shows that the Company is well positioned to adjust to changes in the market landscape. In 2012 Icelandair will operate the most extensive flight schedule in its history, with 31 destinations, and the number of passengers over the year is projected at two million.

In our anniversary year I remain optimistic about the future prospects of Icelandair Group. The Company has learnt from its past mistakes and continued to build on its many successes. The value proposition of Iceland as a tourist destination translates into significantly favourable prospects, and I believe Icelandair Group is well positioned to benefit from the continued growth trends in Icelandic tourism.

On behalf of the Board of Directors, I would like to use this opportunity to thank our shareholders, employees and other stakeholders for their invaluable contribution to the Company's success in 2011. ■



## Letter from the President and CEO



**BJÖRGÓLFUR JÓHANSSON**  
PRESIDENT AND CEO  
OF ICELANDAIR GROUP HF.

Fellow shareholders,

Icelandair Group is reporting a net profit of ISK 4.5 billion and an EBITDA of ISK 10.4 billion despite high oil prices in 2011. This result is in line with management's expectations and it contributes to the strong financial standing of the Company. For the last two years we have delivered strong results in a challenging operating environment. Our financial result is welcomed by 1,300 shareholders and indirectly benefits the majority of Icelanders, as Icelandic pension funds are among our largest investors. We are proud of our Company's success and we will strive to do even better next year to the benefit of all of our stakeholders.

Icelandair Group is an operating company comprising subsidiaries operating an international route network and tourist services. This focus is clearly reflected in our new organizational structure, which facilitates Group synergies, accountability and results. Since 2009 the focus has been on increasing our operating efficiency, primarily through lean management and cost-saving initiatives.

We have been actively expanding our profitable operations. In that time we have increased the number of our international passengers by 18%, expanded our workforce by more than 430 full time equivalents since 2009, reduced our carbon footprint through the implementation of winglets and more efficient fuel management and significantly increased our market capitalization to the benefit of our shareholders. We regard all Icelanders as our stakeholders. We take pride in offering consistent and reliable service in a friendly manner.

### STRONG FINANCIAL RESULT

Airlines have been adversely affected by rising fuel prices, which largely account for the decline in performance between years at Icelandair Group. As regards the year as a whole we are satisfied with the result of ISK 4.5 billion in net profit, particularly in the light of the negative impact of increased fuel prices, a volcanic eruption in Grímsvötn and work stoppages.

Our profit and loss account shows a 10% growth in revenues from 2010, with total revenues amounting to ISK 96.9 billion in 2011. Our EBITDA ratio was 11% in 2011, as compared to 14% in the record year of 2010. Our net profit in 2011 amounted to ISK 4.5 billion, which is comparable to the net profit reported in 2010.

The Group's balance sheet has gone from strength to strength, with total equity increasing by 14% from 2010 and amounting to ISK 32.3 billion at year-end 2011. Our debt maturity profile is well balanced and our long-term funding is sound. With our equity ratio of 36% and cash and marketable securities amounting to ISK 13.1 billion at year-end, we are well positioned to meet growing competition and sustained external fluctuations.

■ *The pioneering spirit of Icelandair Group remains the hallmark of our operations. We expect continued organic growth in 2012, the year of the Company's 75th anniversary. Throughout this annual report we highlight the history of Icelandair Group and of our predecessors in evidence of our gratitude to those who have built up the Company over the last 75 years.*

### EXPANDING OUR PROFIT BASE

The year 2011 was characterised by significant organic growth. We anticipate still further expansion of our operations in 2012. Icelandair will have the most extensive flight schedule in its history in place in 2012. Two new aircraft will be added to Icelandair's fleet in the first half of this year. Icelandair Hotels will open a new hotel by Reykjavik Harbour in the spring, and Air Iceland will continue to increase capacity on its flights to Greenland. We will continue our marketing effort in the cargo and leasing business, and our tour operators are constantly expanding their product range.

Our performance has not gone unnoticed, and we are well prepared for increasing competition going forward. We are committed to our business model, and our unique product offering gives us a strong footing in the competitive landscape.

### GROUP SYNERGIES FACILITATE PROFITABILITY

We believe that our individual subsidiaries gain in strength from operating as a part of Icelandair Group. Following the financial restructuring of Icelandair Group, we shifted the centre of our attention from investment activities to operations. Over the course of the last three years we have diligently worked on increasing Group synergies to facilitate our growth. In terms of revenue, we have focused on offering a diverse product mix comprising offerings from our subsidiaries with substantial revenue synergies.

As an operating company we have focused on realising cost synergies across the Group. The aim is to provide the same or better service at a lower cost than before to the benefit of our shareholders and customers.

We are always re-evaluating the way we do business and it is vital for us to stay focused, even when things are going well. We strive to set new targets for the Group and we continuously work on updating our procedures and the way we make our business stronger and more sustainable.

### TOWARDS THE FUTURE

In my address to shareholders last year, I discussed the importance of Icelandair Group and other Icelandic companies in rebuilding the trust that was lost in the economic collapse in 2008. We have taken specific steps to rebuild that trust by consistently delivering on our promises to shareholders and by increasing the flow of information to the market. We take pride in maintaining a constructive dialogue with all market participants through a regular and consistent flow of information.

In 2009 we decided to expand the operations of Icelandair, and in 2010 and 2011, respectively, we delivered an internal growth of 15% and 18% in the route network. In 2010 we reported that we were committed to continuing to build up the infrastructure of Icelandic tourism and we opened a new hotel in Akureyri in 2011 and refurbished the old Hotel Loftleidir under a new brand name as well as expanding our fleet with two Boeing 757 aircraft. Finally, in 2011, the Company decided on a dividend policy and in 2012 the Board of Directors is proposing a payment of ISK 800 million in dividends. Our vision is clear and we have consistently delivered on the promises made to our 1,300 shareholders.

### 75 YEARS OF OPERATIONS

The pioneering spirit of Icelandair Group remains the hallmark of our operations. We expect continued organic growth in 2012, the year of the Company's 75th anniversary. Throughout this annual report we highlight the history of Icelandair Group and of our predecessors in evidence of our gratitude to those who have built up the Company over the last 75 years. We remain committed to adhering to our founding principles and we will continue to innovate and put our customers first.

We are a company built on the knowledge and experience of our employees. We value our staff members, and our employees are determined to do better every year. It is a privilege to lead a group of 2,350 professionals with an average career of 12 years. This experience is reflected in everything we do, and experience has been passed down from one generation to the next. This heritage is a feature that cannot be copied and will continue to set Icelandair Group apart from the competition for the next 75 years. ■





**DID YOU KNOW ...** that on every winter morning, even in a snow storm, thousands of Icelanders make it a rule to go to the next outdoor swimming pool



## Icelandair Group – The Company

Icelandair Group focuses on the international airline and tourism sectors, with Iceland as the cornerstone of an international route network.

The business concept of the Group is built on Icelandair’s route network and on marketing Iceland as a year-round destination. During 2011 the Group employed an average of 2,350 full time employees, and the Group generated total revenues of ISK 96.9 billion, carrying 1.75 million passengers on its routes.

Icelandair Group is the parent company of nine subsidiaries that form the two business segments of Route Network and Tourism Services.

The main focus of the Route Network is to operate flights based on the Hub and Spoke concept between Europe and across the Atlantic to North America via Iceland. The focus of the Tourism Services business segment is on catering to the growing demand for universal services for tourists in Iceland and on offering a wide variety of support services relating to airline operations.

The international airline Icelandair is the largest subsidiary of the Group, and even though its market share in the North Atlantic market is less than 1% the company is a key element in the Group’s

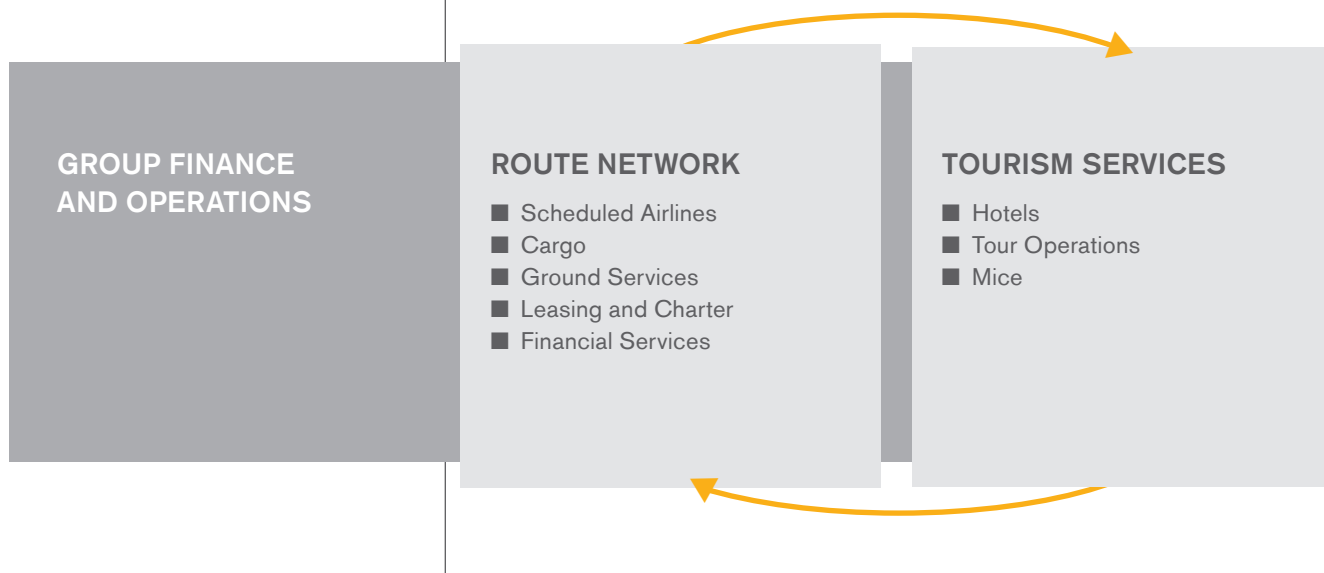
operation and its operating results are the largest determinant factor of the Group’s results. Due to the immense size of this market and the nominal market share held by Icelandair, the market in effect serves as a large reservoir of passengers.

In addition to passenger flights operated by the airline, the Group has vast interests in most aspects of Icelandic tourism and aviation, including hotel chains, travel agencies, domestic airlines and cargo, support services, ground handling and technical services, as well as fledgling ACMI and lease operations.

### OUR ORGANISATION

The Group’s management emphasises the importance of collaboration among its subsidiaries as highlighted in the segmentation of the Group into the Route Network and Tourist Services. The business segmentation stresses the importance for subsidiaries to focus on a Group-wide approach in their daily operations.

### ICELANDAIR GROUP HAS TWO BUSINESS SEGMENTS



## ICELANDAIR ROUTE NETWORK IS THE MAIN DRIVE IN ALL OF OUR OPERATIONS



The Company is convinced that one of its principal strengths lies in its employees. Its operations require a wide range of knowledge and specialised personnel within aviation technology, international marketing, finance and management. The average full-time position equivalents in 2011 were 2,350, and on average our employees have been with the Company for over 12 years.

### THE ROUTE NETWORK IS OUR CORNERSTONE

We fly to 31 destinations in our international route network, 9 destinations in the USA and Canada and 22 destinations in Europe. Our route network is built on a 24-hour rotation, with morning and afternoon connections through our hub in Iceland.

In our international network we operate a single-type fleet of Boeing 757 aircraft, which fits extremely well with Icelandair's route network and creates significant cost efficiency. At year end 2011 the fleet consisted of 35 aircraft with 20 aircraft owned by the Group and 15 aircraft under lease.

### THE GROUP APPROACH

Icelandair Group strives to sharpen its focus on its core operations and actively facilitates cross-selling between its two business segments. This includes utilising unused belly space in scheduled flights for cargo transportation and short-term and long-term leasing of aircraft in low seasons, to name only two of the contributing factors encompassed by the Group's wide approach.

An important factor of Icelandair Group's business model is the ability to readily adjust capacity to ever-changing demand patterns. This is achieved by increasing or decreasing the number of available seat kilometres at any given time by transferring aircraft from the route network to leasing operations at short notice.

We strive to reduce fluctuations in the Group's revenue streams by expanding the high-season into the shoulder seasons, and to meet lower demand over the winter by leasing excess capacity to gain short-term cost coverage. ■

■ *The main focus of the Route Network is to operate flights based on the Hub and Spoke concept between Europe and across the Atlantic to North America via Iceland. The focus of the Tourism Services business segment is on catering to the growing demand for universal services for tourists in Iceland and on offering a wide variety of support services relating to airline operations.*





**DID YOU KNOW ...** that Icelandair is one of the oldest airlines serving the geologically youngest country on Earth





## The 75th Anniversary

Icelandair Group and its predecessors will celebrate its 75th anniversary in 2012 with various activities commemorating its proud heritage. The Company has offered its customers outstanding service throughout a remarkable period in Iceland's history, which has seen the country transformed from a remote island nation in the North Atlantic into an attractive, accessible tourist destination and a busy hub for international air transport.

Icelandair Group has played a key role in transforming its home country from an isolated outpost without any air services into a thriving modern nation enjoying the highest level of air connectivity in the world.

Icelandair Group will be celebrating the anniversary year with a series of campaigns, events, publications and various other activities designed to showcase a company that, after three quarters of a century, still retains the vibrant pioneering aviation spirit of its founders.

True to its tradition, the Company will also celebrate this anniversary year by offering the most extensive and ambitious flight schedule and aviation service of its 75 year history.



## 75 Years of Aviation



### 1937 GIANT STEP

After a number of attempts to establish commercial flights had come to nothing, Icelanders took a bold step on 3 June 1937 and set up a public company called Flugfélag Akureyrar. The man behind this initiative was Agnar Kofoed-Hansen, later Director-General of Civil Aviation.

### 1940 MOVING SOUTH

In March 1940, the company moved to Reykjavík and changed its name to Flugfélag Íslands. Two earlier companies had operated with this name for short periods in 1919–20 and 1928–31. The Chairman of the new company was Bergur G. Gíslason, and a newly qualified pilot, Örn Ó. Johnson, was appointed Managing Director. The latter was destined to control Icelandic air transport for many years.

### 1942 SCHEDULED FLIGHTS BEGIN

In spring 1942, Icelanders were delighted to acquire their first twin-engine aircraft. It was a conventional 8-seat Beechcraft D-18, and its arrival heralded the start of regular scheduled flights. It flew from Reykjavík to Akureyri, Egilsstaðir and Hornafjörður.

### 1944 COMPETITION

As the Second World War drew to a close, the number of Icelandic pilots grew rapidly. Konrád Jóhannsson, Manitoba (or West Iceland), ran a flying school in Canada, and young men with dreams of flying flocked to his academy. Three of these pilots set up a new aircraft company, Loftleidir. It was established on 10 March 1944 and started passenger services to Ísafjörður. Competition on the domestic market had begun.

### 1944 THE FLEET EXPANDS

The two airlines, Flugfélag Íslands and Loftleidir, continued to add to their fleets in the following years. In the summer of 1944, Flugfélag Íslands operated two brand new De Havilland Rapide land-based planes in addition to the Beechcraft. And Loftleidir equipped itself with a new Stinson and a Grumman Goose flying boat. The two companies were flying high, and they carried passengers and freight to many destinations all around the country.

### 1944 FLYING ACROSS THE OCEAN

A milestone in the history of Icelandic aviation was passed in autumn 1944 when an Icelandic crew flew across the Atlantic for the first time. The two aircraft operators competed hard to be the first to complete the crossing. The leaders of the two teams were Örn Ó. Johnson and Sigurdur Ólafsson

Sigurdur set off from New York less than two weeks before Örn. He flew a Grumman flying boat, the first time a plane of this type had crossed the Atlantic. Örn landed in Reykjavík three days before Sigurdur, on 13 October 1944.

A year later, Flugfélag Íslands was allowed to make trial flights to Britain, and the first plane took off on 11 July 1945. It flew into Largs Bay in Scotland with four passengers. International flights from Iceland had become a reality.

## 1946 REAL AIRPORTS

Conventional aeroplanes gradually replaced the flying boats in the late 1940s, increasing the need for public airports. Up until this time the planes had landed in fields or on simple gravel airstrips. Reykjavík was the only place with a real airport. A British military unit had built it during World War II, and at the end of hostilities they presented the airport to the people of Iceland in a ceremony on 6 July 1946.

## 1947 FLYING DANCE HALL

"It looked like a large dance hall," said Alfred Elíasson, after his first view of a Douglas DC4 Skymaster, the plane that Loftleidir bought in 1947. This type of aircraft was often called "The Four" (Fjarkinn) in Iceland, and it was regularly used on international routes for the next decade. The first Skymaster was named Hekla. Loftleidir, now known abroad as Loftleidir Icelandic, bought a second aircraft in 1948 and called it Geysir. In the same year, Flugfélag Íslands, or Icelandair, bought the first in its "Gullfaxi" series, also a Skymaster. These highly respected aircraft carried 46 passengers. They were Iceland's first serious long-haul aircraft.

## 1947 IN-FLIGHT SERVICES

As passenger numbers increased, their needs had to be tended to during the journey. Flight times were long, even on domestic routes, and basic rations were not good enough for people who had chosen a luxury mode of travel. Women now had a role to play in the aviation world. Sigríður Gunnlaugsdóttir was the first air hostess appointed by Icelandair in 1946, creating great interest. When the next vacancy was advertised, six months later, 50 women applied.

## 1948 FLYING TO AMERICA

In 1948, Loftleidir Icelandic received a permit to start schedule flights between Iceland and the USA. The first flight left on 25 August that year, with much interest on both sides of the Atlantic. The flight permit was issued in accordance with an agreement made between the two countries in 1945. There was no provision in the contract regarding fares, which became an important factor for Loftleidir Icelandic a few years later. Representatives from the Mayor of New York's office welcomed Geysir's crew and the Loftleidir Icelandic directors when the company's first flight arrived in America.

## 1950 GEYSIR CRASHES

Loftleidir suffered a massive loss in autumn 1950 when its Skymaster aircraft Geysir crashed on a cargo flight between Luxembourg and the USA. The plane was due to make a refuelling stop in Reykjavík on 14 September, but an hour before its expected landing time, all contact with the plane was lost. An extensive search was carried out over the next few days, but the view was that the plane had crashed into the sea and there was little chance that the crew had survived. On 18 September, the coastguard ship Ægir received a feint radio signal, which led to the discovery of the aircraft where it had crash-landed on Bárðarbunga, high on Vatnajökull Glacier. All of the crew had survived.



## 75 years of aviation, continued:



### 1952 THE LOFTLEIDIR ICELANDIC ADVENTURE

1952 was an eventful year in the story of Loftleidir Icelandic. Fierce competition between the Icelandic airline companies led to the government deciding to divide domestic flights between them in 1952. The Loftleidir board was not satisfied with this and withdrew all domestic services. At the same time, one of the company's Skymaster aircraft was badly damaged when it went off the runway in Italy, and the board decided to end flying operations and switch to ships.

Disagreement about the issue led to upheaval at a board meeting on 15 October 1953. A new board was appointed that subsequently guided the company into a very fruitful period, especially after the formation of a partnership with the Norwegian airline Braathen's SAFE. Loftleidir Icelandic applied itself to the North Atlantic routes and low fares, and just a few years later the company was a major force in passenger transport between Europe and America.

### 1955 ACTIVITY ON THE DOMESTIC SCENE

Flugfélag Íslands increased its domestic coverage when it became the only operator in the market. Scheduled flights were resumed to most of Loftleidir Icelandic's former destinations, and passenger numbers rose. Icelanders were quick to realise the value of this mode of travel instead of driving along narrow, bumpy gravel roads. But domestic operations remained something of a financial burden for the company, which relied on its international routes to keep the books balanced. Stockholm was added to the list of international destinations in 1955. Regular flights also took off for Copenhagen, London and Oslo.

### 1955 PRICE WAR

As Loftleidir Icelandic's operations began to bear fruit, the company decided not to join the International Air Transport Association, IATA. This was a significant step, as the association helped airlines economise in some areas, but also decided fares on many routes. The principality of Luxembourg was not bound by IATA decisions, which was very convenient for Loftleidir. No airlines flew scheduled flights to Luxembourg and the government there was very interested in a joint venture. The result was the introduction of passenger flights in 1955. Loftleidir Icelandic could offer low prices between Europe and America, and ticket sales increased rapidly.

### 1957 INCREASED COMFORT

Up until this time, airline passengers had to put up with a great deal of discomfort. Aeroplanes took a long time to get from one country to the next for two reasons. They flew much slower than modern planes, and much lower, because of pressure differences. Travel was sometimes physically difficult, even painful. It was almost impossible to fly above weather or winds. But all this changed when Flugfélag Íslands bought two Vickers Viscount 759 turboprop airliners. This purchase generated a lot of interest; it was a big step for the Icelandic aviation industry. They were the first Icelandic aircraft to be powered by turbines, and they had pressurised passenger space. This allowed them to fly at heights of up to 25,000 feet; the old Skymaster was restricted to 10,000 feet unless those on board used oxygen masks. The Viscounts also flew considerably faster than the Skymasters. Their arrival made it possible to fly to Europe and back in one day. The flying time to Copenhagen was cut by two hours, to four and a half hours. It was understandable that Icelanders celebrated acquiring these splendid aircraft.

## 1964 LOFTLEIDIR ICELANDIC FLYING HIGH

Two years after Flugfélag Íslands acquired its turboprop planes, Loftleidir Icelandic took a similar step when it updated its fleet and bought the first of five Cloudmaster DC-6B aircraft. In 1964, the company also bought two Canadair CL-44s that were named “Rolls Royce 400” after their engines. This was an interesting move – the planes were manufactured as cargo carriers. They were “monsters”, much larger than any other aircraft used by Icelanders to date. Loftleidir Icelandic purchased four of these planes and they were enormously successful for the company. They flew countless journeys until 1971.



## 1965 THE FIRST FOKKER

“Blikfaxi” was the name given to the first aircraft specially designed for use in Iceland. It was a Fokker Friendship, and it arrived on 14 May 1965. Aircraft of this type served the Icelandic public for many years on domestic routes.



## 1967 THE FIRST JET

Flugfélag Íslands were next to move forward, buying Iceland’s first jet. It was a Boeing 727-100C, and it arrived in 1967. The jet was specially fitted for the airline, and the passenger cabin was decorated with typical Icelandic scenes. It was named “Gullfaxi”, just like the company’s previous flagships. The plane was a technological masterpiece; its passenger compartment could be made larger or smaller depending on how much freight had to be carried, making it an ideal choice for the company. However, the jet was not allowed to land at Reykjavík Airport, and Icelandair’s international flights were moved to Keflavík.



## 1969 CHARITY FLIGHTS

Icelandic aircraft were put to good use when war broke out in Biafra in the years 1967–70. The war caused devastating human suffering, and Nordic Christian charities tried to help starving people by sending food. Two of Loftleidir Icelandic’s DC-6B aircraft were used. In 1969, a special company, “Flughjálpi” or “Aid by Air”, was established to take over this work. Loftleidir Icelandic owned a 20% share of this company. Many Icelandic pilots took part in Biafra flights, including Thorsteinn E. Jónsson, who controlled flights for the last 16 months of the war.



## 1969 THE BAHAMAS BRANCH

Loftleidir Icelandic began its jet flights in an unusual manner in early 1969. Their low-fare permit from the US Government was tied to slow-flying aircraft, and this prevented a switch to faster jet planes. They advertised their service with the slogan “We are slower but we are lower,” until they found a solution to their quandary in the Bahamas. A small airline, Air Bahama, flew from the islands to Luxembourg and offered low fares – and used jets. Loftleidir Icelandic took over the company’s operation on 5 March 1969. A day later, Loftleidir Icelandic’s first jet flight left the Bahamas for Luxembourg.



## 75 years of aviation, continued:



### 1970 CARGOLUX ESTABLISHED

A year after Loftleidir Icelandic acquired Air Bahama, it was able to extend its use of jets to all its original scheduled routes. A new contract with the USA allowed it to keep its low-fare structure while using the faster planes. The company took three DC-8-63s on a lease-purchase plan in 1971, and then used jets on all its scheduled routes. The redundant Canadair “monsters” were put up for sale. No buyer emerged, and they were restored to operate in their original role as cargo carriers.

This idea led to the establishment of the Cargolux freight company, in partnership with the Swedish shipping company Salenia and Luxair. This enterprise quickly gained a strong foothold in the market, and became one of the largest cargo carriers in the world, providing jobs for many Icelanders over the years.

### 1970 DIFFICULT TIMES

Operations were becoming difficult for the Icelandic airlines. Competition was intense, especially in the Nordic countries, and in 1970 it became clear that some sort of government assistance was necessary to keep the industry afloat. Various partnership and merger proposals were put forward, but getting the two airlines to meet proved difficult. They finally agreed to formal talks late in 1971. The discussions dragged on into the summer of the following year and came to nothing. The matter now passed into the hands of the government.

### 1973 MERGER

Late in 1972, the government decided to enforce the merger of Loftleidir Icelandic and Flugfélag Íslands. A committee was appointed to oversee unification discussions. Although there was disagreement about some aspects of the merger, the companies' operations were now so perilous that most people admitted the economic sense of the amalgamation. The two airlines reached agreement on 11 April 1973, and Flugleidir, using the international brand name Icelandair, was established on 20 July of the same year. Örn Ó. Johnson and Alfred Elíasson were appointed to manage the new company, and Sigurdur Helgason joined them a year later. Sigurdur had been Managing Director of Loftleidir Icelandic in the USA.

### 1974 FIGHTS FOR PILGRIMS

Even after the merger of the two airlines, Flugleidir, the new company, remained in financial difficulties for some years. A reduction in international passengers did not help matters. Charter flights helped keep the company in business. A growing number of Icelandic and foreign passengers wanted to fly to destinations not served by scheduled flights, especially groups of pilgrims. The timing of the Islamic pilgrimage to Mecca was particularly convenient for Flugleidir; it took place in wintertime, when planes and crews were unused.

### 1978 ACCIDENT

In the middle of November 1978, a Flugleidir DC-8 jet crash-landed a short distance from the end of the runway in Colombo, Sri Lanka. It was a horrifying accident. One hundred and eighty Indonesians lost their lives along with eight Icelanders. Five Icelanders and 66 pilgrims survived.

It was the worst air traffic accident in Icelandic aviation history.

## 1979 THE TEN

Iceland's first wide-bodied jet, a DC-10 30, landed at Keflavík Airport on 5 January 1979. Icelandair negotiated a very favourable lease-purchase plan to acquire this 380-seat plane. But it turned out to be something of a nightmare transaction. The pilots' continuing dispute about new contract terms was at its height, and no agreement was reached about who would fly the new jet. American pilots were initially employed to fly it.

But matters took a turn for the worse when a jet of this type crashed on takeoff from O'Hare Airport, Chicago, in June 1979. The engine had broken loose, and all DC-10 aircraft were grounded until investigations were completed. The grounding was for a longer period in the USA, where Icelandair's plane was registered. This placed a heavy financial burden on the company. Icelandair sold this wide-bodied jet in 1980, and Icelanders had to wait for several years before they acquired their next plane of a comparable size.

## 1980 AIRLINE BOUGHT AND SOLD

Icelandair acquired a majority holding in Eagle Air in 1978. This company had been established two years earlier, mainly chartering small planes to visiting tourists. After several setbacks it was in a precarious position, and Icelandair bought all the available shares, which gave them a 57.5% holding. The two companies worked well together. However, one of the conditions of the government assistance package in 1980 was that Icelandair allowed Eagle Air staff to buy back the shares, and the staff association acquired a third of Icelandair's share, meaning that the parent company now owned 40%. A number of routes were also transferred to Eagle Air. This led to a political struggle in the Icelandic air traffic world.

## 1983 AEROPLANES GET NAMES AGAIN

In 1983, Icelandair, the merged company, celebrated its tenth anniversary in style at Reykjavík Airport. The airline announced its decision to resume naming its aircraft. Its Boeing 727-200 TF-FLI became known by the name Frónfari, and the Fokker F27 TF-FLR was named Vorfari.

## 1983 AIRPORT TERMINAL NEEDED

The old airport buildings at Keflavík Airport were temporary structures, built in the middle of the military base in 1949. Their expected lifetime was a maximum of 20 years. However, they remained in service for much longer. The first steps towards separating military and civil flights were taken in 1970, but work on a new terminal didn't start until 7 October 1983. The design of the new buildings then took a long time, and disputes about its size and the participation of the Americans further lengthened the process.



## 75 years of aviation, continued:



### 1984 SAGA CLASS

At this time, Icelandair was in no financial position to renew its fleet, and most of its purchases were made at cut-price sales. The airline bought three DC-8-63 jets on good terms, and sold them four years later for twice the price they paid. But new aircraft were not on the shopping list, even though some of the airline's planes were 20 years old.

The carrier needed to find new ways to satisfy passengers' differing spending power and their demands for comfort. They decided to divide the cabin space, and offer more comfortable facilities and more service for a higher ticket price. This innovation, introduced on 1 April 1984, was named Saga Class.



### 1987 RESTRUCTURING

On 3 June 1987, Icelanders celebrated 50 years of commercial flights; half a century had passed since Flugfélag Akureyrar, one of the predecessors of the current company, came into being. The first step in the renewal of the fleet was announced. At the anniversary board meeting, the Icelandair Managing Director signed an agreement with Boeing for the purchase of two 737-400 jets and options on two others.

This was the start of the recreation of the airline.



### 1987 LEIFUR "THE LUCKY" EIRÍKSSON

We now reach the point where the new air terminal finally opens. It was a splendid structure covering 14,000 sq.m. The opening celebration took place on 15 April 1987, when the building was named the Leifur Eiríksson Air Terminal. Three thousand people attended the opening amid great pomp and ceremony. The original plan was for a larger building, but this was thought to be unnecessary. No one expected the number of passengers passing through the terminal to rise as much as it did, and within a few years the terminal was struggling to cope with the throng. When the first spade was sunk into the site of the foundations, 460,000 passengers arrived or departed from Keflavík Airport annually. That figure has now risen to 2 million.

The building has been extended twice, and in 2007, Leifur Eiríksson Air Terminal covered 56,000 sq.m.



### 1987 NEW ROUTES AND NETWORK

The new terminal brought new possibilities. One of them allowed for changes to Icelandair's flight network. The company had operated two systems built on the old routes: to Europe, and between Luxembourg and the USA. A new system was introduced in 1987 that made Keflavík the hub of a network with many routes heading east and west. The number of flights increased, and schedules were coordinated so that passengers arriving from the USA early in the morning could continue on to European destinations a short while later. European flights arrived in the afternoon, and continued on to America later. This system proved successful and it is still used today.

## 1990 BIGGER JETS

The first Boeing 757-200 landed in Iceland in 1990, and was named Hafdís. There was seating for 189, with 22 spacious seats in Saga Class. A second aircraft of this type, Fanndís, arrived a month later. Svandís, the third in the series, was leased to Britannia Airlines, and did not enter service with Icelandair until 1993. The new fleet was especially economical. Fuel costs were now 30–40% lower. In addition, maintenance costs were much less and crews were smaller. All these factors contributed to the increased efficiency of the airline.

In 1995, a decision was taken to use only one type of aircraft on international routes, and contracts were signed with Boeing for the purchase of six of their 757 airliners, the largest single purchase in Icelandic aviation history.

## 1992 NEW FOKKERS

The domestic fleet was also updated. Four new Fokker 50 aircraft arrived on a lease-purchase deal. They replaced the older Fokkers, which were sold at a good price. The new planes arrived in 1992. They landed at the main internal airports, the first at Akureyri. The next plane landed at Egilsstaðir, then Ísafjörður, and finally in the Westman Islands. When the last plane arrived, the whole group set off for Reykjavík, arriving together in formation.

With the new Fokkers and three Boeing 757-200 aircraft, Icelandair now had eleven new aeroplanes. The whole fleet had been renewed in three years and it had become one of the youngest in the world.

## 1996 A NEW DOMESTIC AIRLINE

Substantial changes were made to domestic flights in the mid 1990s. The market was opened in 1997. Up until then the government applied a system of special licences to control internal commercial flights. Icelandair prepared for the changes by creating a new company especially for domestic routes. Flugfélag Nordurlands and Icelandair's domestic carrier merged to form an independent Icelandair subsidiary. Flugfélag Íslands, the fourth company with that name, entered the market.

A price war on the most popular routes broke out after the market was opened, and prices dropped by up to 40% while passenger numbers increased by only 20%. Having to run at a loss like this put some airlines out of business. Flugfélag Íslands did all it could to improve efficiency. The workforce was reduced and tickets were no longer issued. Passengers gradually began booking their seats on the Internet. These measures seem to have been effective, because in 2002, the domestic carrier recorded a profit of ISK 200m.



## 75 years of aviation, continued:



### 1996 COME TO ICELAND

Icelandair acquired one of Iceland's largest travel agencies in 1996 as part of its new strategy to develop its tourist services. Introductions to Iceland had been an important part of the company's operations since Loftleidir started offering stopover packages to transatlantic passengers. This marketing sector was gaining increasing importance. Massive sums were injected into advertising. The network was expanded to draw passengers onto routes that passed through Iceland. New destinations in North America were added, and the tourist season was greatly extended. Icelandair paid particular attention to increasing its presence on the western side of the Atlantic, and began flying to Boston, Halifax and Minneapolis. These new markets brought hundreds of thousands of new customers, and increased tourist interest in Iceland markedly. In 1994, 180,000 tourists visited Iceland for long or short stays. Six years later, that figure had risen to 303,000.

### 1999 WOMEN'S FLIGHTS

On Women's Rights Day, 19 June 1999, an Icelandic airliner was flown by a female crew for the first time. The captain was Geirthrúður Alfreðsdóttir, assisted by Linda Gunnarsdóttir. The flight attendants were led by the captain's sister Katrín Alfreðsdóttir, both daughters of the founder of Loftleidir, Alfred Elíasson.

Two years later, another notable flight took off with female pilots and male flight attendants. An interesting reversal of the traditional roles of airline crews. At that time, Icelandair employed 240 captains and pilots of whom only eight were women.

### 2000 REORGANISATION OF FREIGHT SERVICES

Cargo flights have always played an important role in Icelandair operations. When the company was established in 1973, a special cargo division was created that has since grown year by year. Freight is carried in special cargo aircraft as well as in the holds of passenger aircraft.

At the beginning of the new millennium, the cargo division formed a new subsidiary to attend to the construction of a freight handling centre at Keflavík, which opened in 2001. The new company was named Icelandair Cargo.

### 2002 LOFTLEIDIR FLIES AGAIN

When Icelandair transferred its charter operation to a special subsidiary in 2002, it decided to name the new company after its predecessor and call it Loftleidir Icelandic. The new subsidiary has developed rapidly since its formation, and now offers a wide range of solutions for other carriers and tour companies. Loftleidir Icelandic charters its planes with or without crews or maintenance, for a range of uses, including round the world flights, when groups of people fly from city to city all around the globe in aeroplanes specially equipped for passenger comfort.

### 2003 FLIGHTS FOR CHILDREN

In celebration of its 30th anniversary, Icelandair set up a fund to give children with long-term illnesses or those living in special circumstances the chance to travel. The idea came from Peggy Helgason, wife of Board Chairman and former CEO Sigurður Helgason, who has worked for many years as a volunteer in the children's hospital in Reykjavík. Every year, the fund allows at least 20 children and their families to take a dream trip. It is financed by Icelandair and the airline's passengers, who donate frequent flier points or foreign coins to the cause. The fund has surpassed all expectations.

**2003 ICELANDAIR BECOMES AN INVESTMENT COMPANY**  
 In 2003, Icelandair was converted into an investment company, with the purpose of boosting the return on the share capital in its own operations and those of its subsidiaries, especially those in the airline, tourist and transport sectors. Two years later, the company's name was changed to FL-Group, and its investment strategy led to the acquisition of Bluebird and Sterling.

**2005 ICELANDAIR GROUP ESTABLISHED**  
 Icelandair Group was established in October 2005 as a holding company with ten subsidiaries operating air and tourist services. The largest of the Group's operations is the international carrier Icelandair. Other companies were Loftleidir Icelandic, Bluebird Cargo, Icelandair Cargo, Icelandair Ground Services, Icelease, Flugfélag Íslands, Icelandair Hotels, Íslandsferdir and Fjárvakur.

In December 2006, Icelandair Group (ICEAIR) was registered as a public company on the Icelandic stock exchange.

**2007 SEVENTY YEARS ON ...**  
 Icelandair Group, a descendant of Flugfélag Akureyrar, celebrated 70 years of flying in the company's hanger at Akureyri Airport on 3 June, and to mark the occasion, the company presented the Aircraft Museum with a Stinson Reliant aeroplane, exactly like the aircraft that arrived in Iceland in 1944.

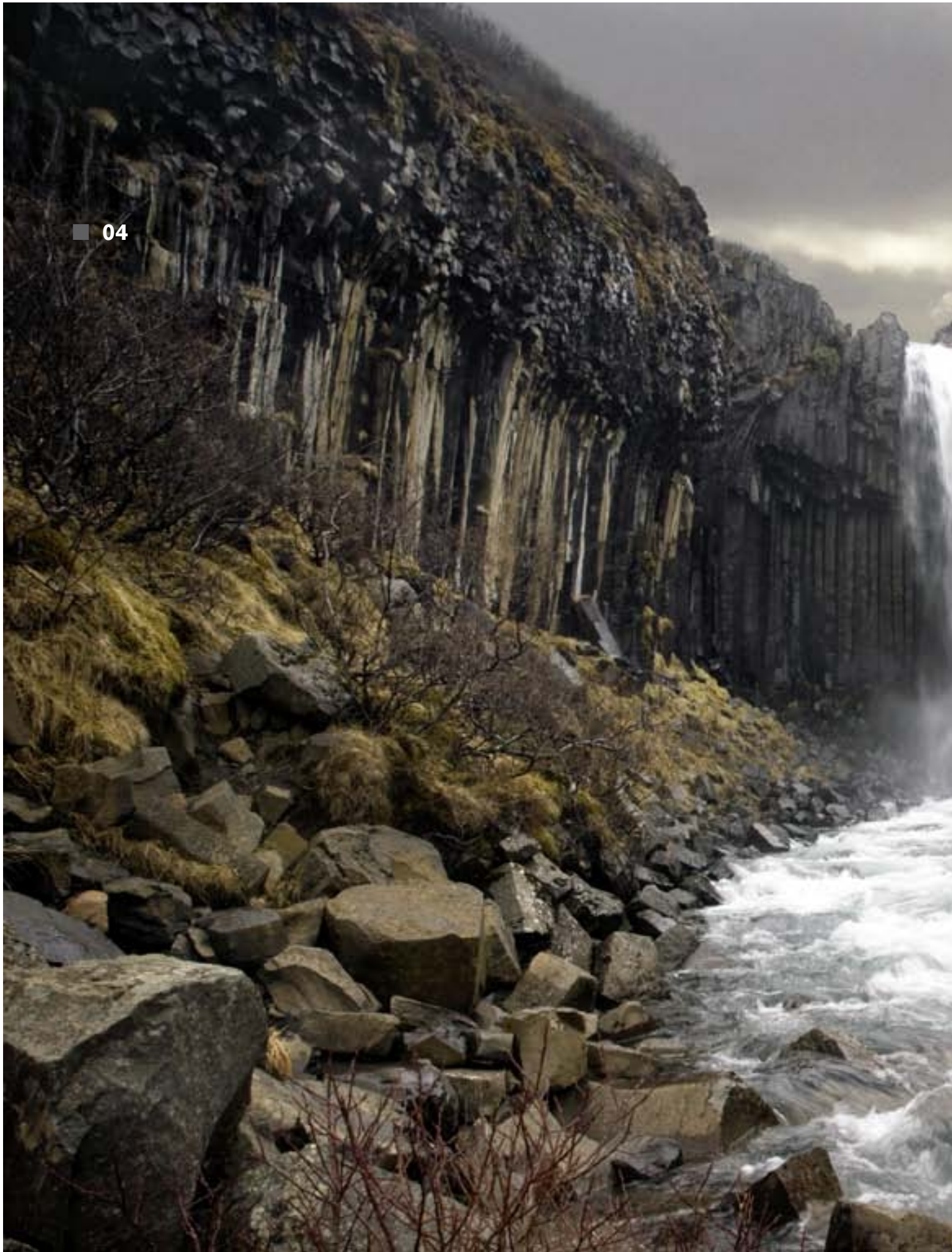
**2008 FOCUS ON OPERATIONS**  
 In 2008 a new management team took over and Icelandair Group's business model was subsequently simplified, with the emphasis centred on operations instead of investment activities. The Group's focus was set on the operation of an international route network with Iceland as a hub and on services to travellers.

**2010 FINANCIAL RESTRUCTURING COMPLETED**  
 Following the economic turmoil in 2008 the Company entered into a financial restructuring partnership with its creditors in order to secure the foundation of the Company's future operations. The financial restructuring was completed when new shareholders participated in a share capital increase at year-end 2010.

**2011 THE LARGEST SCHEDULE IN OUR HISTORY**  
 In 2011 Icelandair announced a route schedule for 2012 which is the largest in the company's history and 13% more extensive than the 2011 schedule. A new year-round destination, Denver, Colorado, has been added, and the frequency of flights to various cities in the United States and Europe has been increased. Icelandair's network in 2012 is the biggest ever.

**2012 75 YEARS OF AVIATION**  
 This year the number of Icelandair passengers is projected at 2 million, as compared to around 1.7 million in 2011. A total of 16 Boeing 757 aircraft are used to serve our route network, two more than in 2011. This summer Icelandair's aircraft will take off up to 400 times each week, and passengers will number about 10,000 per day at peak periods. ■





**DID YOU KNOW ...** that mountain avens  
is Iceland's national flower



## Quarterly Overview

# Q1

### IMPROVED RESULTS BETWEEN YEARS IN SPITE OF HIGH FUEL PRICES

Icelandair Group returned a net loss of ISK 1.1 billion in Q1 2011, as compared to a net loss of ISK 1.9 billion in Q1 2010. Fuel prices were on average 42% higher than in Q1 2010, resulting in higher fuel expenses of ISK 0.8 billion. In light of this the Company was satisfied with the outcome of the quarter. The capacity in the Company's international route network was increased by 12% between years, and the number of passengers increased by 13%. Icelandair's load factor was the highest ever recorded for this quarter, at 71.1%.

### FINANCIAL RESTRUCTURING FORMALLY COMPLETED

Formal closing of the financial restructuring took place on 10 February 2011. However, as the documentation was fully executed in 2010 the restructuring was fully accounted for in the Group's balance sheet at the end of 2010.

### AIR ICELAND INCIDENT IN GREENLAND

An Air Iceland flight from Reykjavik Nuuk Greenland experienced a hard landing due to severe wind conditions. 34 passengers and 2 pilots on board were able to walk away unharmed, but the Dash 8-100 was damaged. The airline was fully insured for the loss and the incident did not have a significant impact on the Icelandair Group results.

### TWO BOEING 757 200 AIRCRAFT PURCHASED

In March and April Icelandair Group purchased two Boeing 757 200 aircraft. The purchase price was paid out of the Group's own funds. One of the aircraft had been on long-term lease and was used in Icelandair's route network.

	Measurement	Company	Q1 2011	Chg. from Q1 LY
Total Income	billion ISK	Icelandair Group	16.0	-2%
EBITDA	billion ISK	Icelandair Group	-0.2	-0.4
Net loss	billion ISK	Icelandair Group	-1.1	0.8
Fuel price	USD	Icelandair Group	972	42%
Assets	billion ISK	Icelandair Group	91.4	-2.2
Equity ratio	%	Icelandair Group	30	16 ppt
Net interest bearing debt	billion ISK	Icelandair Group	5.7	-36.9
Passengers	thousand	Icelandair	258	13%
Load factor	%	Icelandair	71.1	2.9 ppt
Passengers Air Iceland	thousand	Air Iceland	77	-4%
Load factor	%	Air Iceland	68.6	-0.8 ppt
Freight ton kilometres	thousand	Icelandair Cargo	18.6	-8%
Room utilization	%	Icelandair Hotels	52.5	-5.2 ppt

## Q2 CHARACTERISED BY STRONG ORGANIC GROWTH

The second quarter was characterised by strong organic growth, with capacity on international flights increasing by 25% between years. At the same time the number of passengers increased by 27%. Loftleidir saw a 28% increase in turnover, and Air Iceland added more flights to Greenland, with the number of passengers increasing by 5% over the period. Net profit in the quarter was ISK 0.4 billion, as compared to a loss of ISK 0.2 billion in Q2 2010. Fuel price levels, which were well above those recorded at the same time in 2010, were the main reason for the decline in results between years.

## ICELANDAIR AND JET BLUE LAUNCHED AN INTERLINE PARTNERSHIP

In early May, Icelandair and JetBlue Airways announced the launch of a new interline partnership. Through the partnership, customers are able to book a single combined ticket for JetBlue and Icelandair operated flights.

## VOLCANIC ERUPTION IN GRÍMSVÖTN

In late May a volcanic eruption began in Grímsvötn in the Vatnajökull glacier. A number of flights had to be cancelled, but fortunately the eruption paused after only five days and the disruptions it caused were small in comparison to the events of 2010. The total effect both on revenues and cost was estimated to be around ISK 0.3 billion.

## NEW HOTEL OPENINGS

In June Icelandair Hotels opened a new hotel in Akureyri, in the north of Iceland. The hotel is a perfect base for exploration of the many attractions of the north. Icelandair Hotels also celebrated the completion of a total refurbishment of the historic Hotel Loftleidir under a new name: Icelandair Hotel Reykjavik Natura. Both of these hotels will contribute to the continued marketing effort supporting winter tourism in Iceland.

# Q2

	Measurement	Company	Q2 2011	Chg. from Q2 LY
Total Income	billion ISK	Icelandair Group	25.0	14%
EBITDA	billion ISK	Icelandair Group	2.1	-0.1
Net profit	billion ISK	Icelandair Group	0.4	0.6
Fuel price	USD	Icelandair Group	1,057	47%
Assets	billion ISK	Icelandair Group	94.6	-3.2
Equity ratio	%	Icelandair Group	29	16 ppt
Net interest bearing debt	billion ISK	Icelandair Group	3.4	-30.7
Passengers	thousand	Icelandair	464	27%
Load factor	%	Icelandair	79.3	3.0 ppt
Passengers	thousand	Air Iceland	89	14%
Load factor	%	Air Iceland	67.7	1.6 ppt
Freight ton kilometres	thousand	Icelandair Cargo	18.1	12%
Room utilization	%	Icelandair Hotels	70.1	4.4 ppt

## Quarterly Overview, continued:

# Q3

### STRONG ORGANIC GROWTH CONTINUED IN Q3

The capacity of the Company's international route network was increased by 20%, and the number of passengers increased by 17% in the third quarter, as compared to the third quarter in 2010. The Company's net profit in the quarter amounted to ISK 5.4 billion, increasing by ISK 0.2 billion, as compared to the third quarter last year. Fuel prices continued to be unfavourable and were 46% higher on average than in the corresponding period in 2010.

### THREE-YEAR CONTRACT WITH EMPLOYEES

In August the last batch of the open union contracts were concluded with a three-year agreement. This will give the Company scope for long-term strategic planning, which has been challenging in recent years due to short-term contracts.

### DIVIDEND POLICY

In September the Board of Directors of Icelandair Group approved a new dividend policy, stating the ambition of the Group to pay 20–40% of each year's

net profit as dividend. The final decision on annual dividend payments will be based on the financial position of the Company, operating capital requirements and overall market conditions.

### GROWTH PLANS FOR 2012 ANNOUNCED

In September Icelandair announced its flight schedule for 2012, which will be the largest schedule in the company's history, with capacity increasing by 14% from 2011. Two Boeing 757 aircraft will be added to the fleet. A new year-round destination, Denver, Colorado, will be added to the route network, and the frequency of flights to various cities in the United States and Europe will be increased. The number of the company's passengers in 2012 is projected at 2 million in 2012, as compared to 1.75 million in 2011. The growth in 2012 will be proportionally greater over the winter months than in the summer. In fact, the company's winter schedule in 2012–2013 will be as extensive as Icelandair's summer schedule two years ago.

	Measurement	Company	Q3 2011	Chg. from Q3
LY Revenues	billion ISK	Icelandair Group	35.9	15%
EBITDA	billion ISK	Icelandair Group	8.7	–0.5
Net profit	billion ISK	Icelandair Group	5.4	0.2
Fuel price	USD	Icelandair Group	1,021	46%
Assets	billion ISK	Icelandair Group	91.4	0.2
Equity ratio	%	Icelandair Group	36	18 ppt
Net interest bearing debt	billion ISK	Icelandair Group	6.3	24.7
Passengers	thousand	Icelandair	671	17%
Load factor	%	Icelandair	83.4	–1.7 ppt
Passengers	thousand	Air Iceland	106	2%
Load factor	%	Air Iceland	72.1	3.0 ppt
Freight ton kilometres	thousand	Icelandair Cargo	18.9	9%
Room utilization	%	Icelandair Hotels	83.2	2.7 ppt

#### Q4 RESULTS MATCH COMPANY'S EXPECTATIONS

Icelandair Group's net profit in the fourth quarter was negative by ISK 0.2 billion, as compared to a positive result of ISK 1.4 billion in the fourth quarter of 2010. High fuel prices led to significant increases in cost in the quarter, which accounts for the decline in performance between years.

#### ICELAND – ALL YEAR ROUND

In October a new market partnership was launched in the Icelandic tourist sector with the objective of increasing winter tourism and levelling out the seasonal fluctuations in the Icelandic tourist industry. The initiative was launched under the title "Iceland – all year round" under the leadership of the Ministry of Industry and key enterprises in the field in Iceland. The campaign is scheduled to extend over the next three years.

#### DEBT FINANCING WITH DEUTSCHE BANK COMPLETED

Icelandair Group negotiated a new loan facility with Deutsche Bank in October in the amount of USD 18 million.

#### ICELANDAIR'S NEW FRONTIER

In December Icelandair and Frontier Airlines announced a new interline partnership, expanding the travel options from Denver International Airport.

#### TWO BOEING 757 200 AIRCRAFT PURCHASED

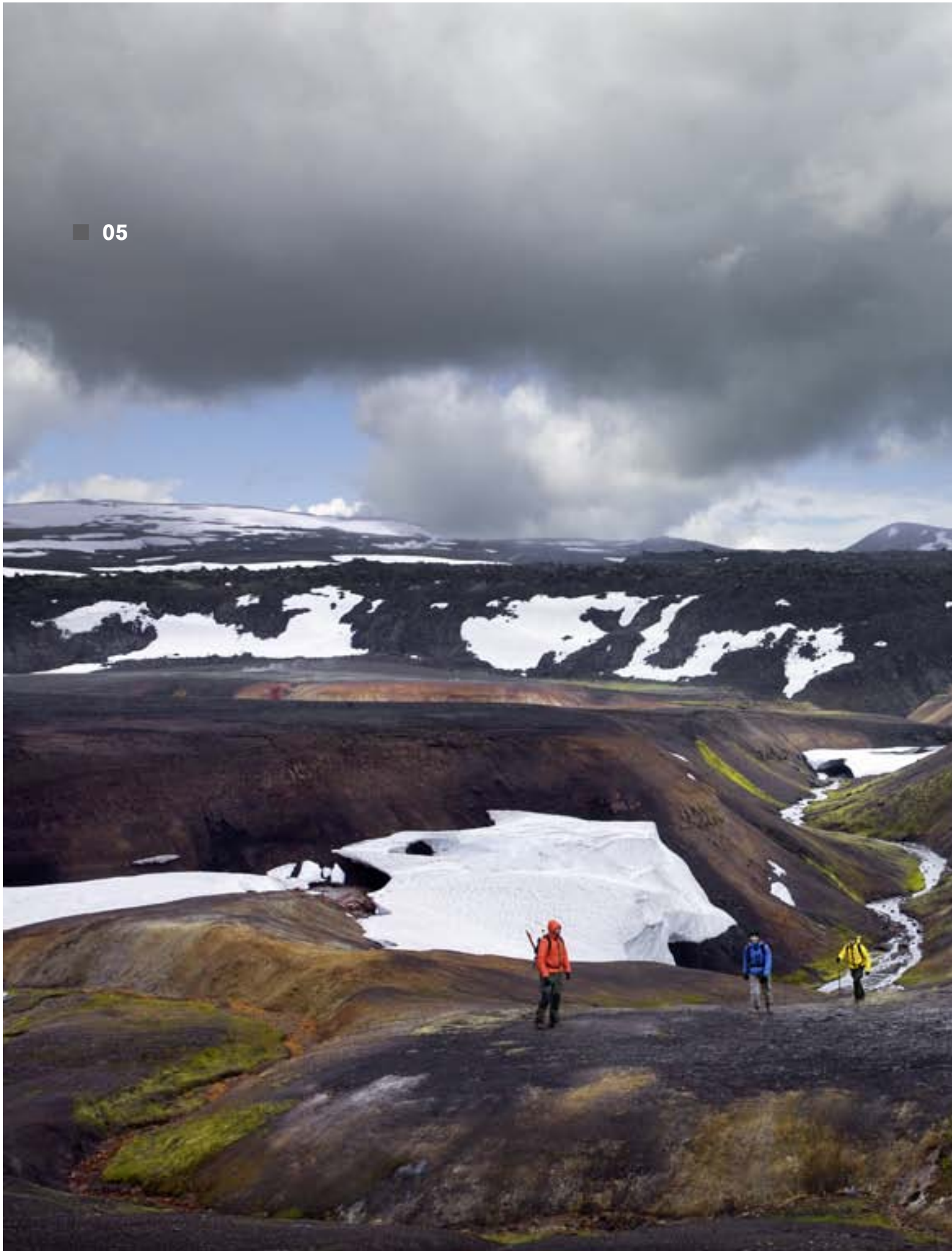
In December Icelandair Group purchased two Boeing 757 200 aircraft, which the Group previously had on a long-term lease. The majority of the purchase price was financed with a loan of approximately 24 million USD with a maturity of 6 years. The two aircraft have been used in Icelandair's route network and will continue to operate within that network.

#### THE SUBSIDIARY SMARTLYNX SOLD

Icelandair Group sold late in December its Latvian subsidiary SmartLynx. The sale is accounted for in the annual accounts for 2011. ■

# Q4

	Measurement	Company	Q4 2011	Chg. from Q4 LY
Revenues	billion ISK	Icelandair Group	20.0	7%
EBITDA	billion ISK	Icelandair Group	-0.1	1.2
Net loss	billion ISK	Icelandair Group	-0.2	-1.6
Fuel price	USD	Icelandair Group	1,011	28%
Assets	billion ISK	Icelandair Group	89.5	5.2
Equity ratio	%	Icelandair Group	36	2 ppt
Net interest bearing debt	billion ISK	Icelandair Group	11.1	-1.1
Passengers	thousand	Icelandair	351	11%
Load factor	%	Icelandair	77.9	0.5 ppt
Passengers	thousand	Air Iceland	81	-1%
Load factor	%	Air Iceland	66.5	-1.7 ppt
Freight tonn kilometres	thousand	Icelandair Cargo	22	17%
Room utilization	%	Icelandair Hotels	54.4	3.5 ppt



**DID YOU KNOW ...** that Icelanders are listed in the telephone directory alphabetically by first name



## Performance in 2011

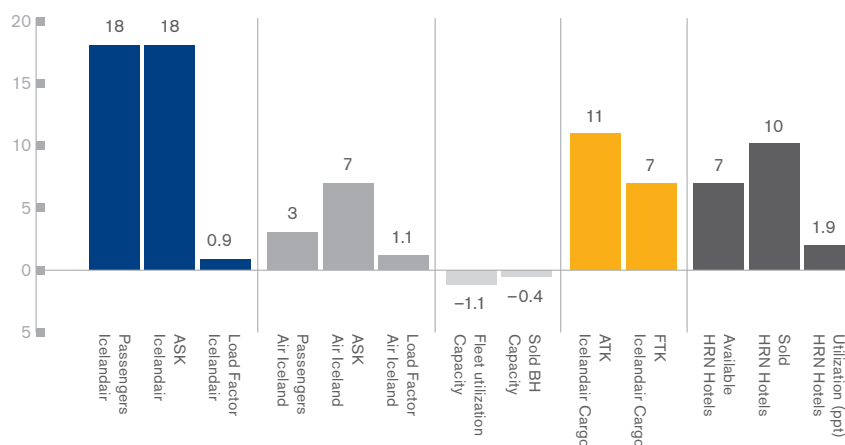
The year 2011 was characterised by strong organic growth. High fuel prices weighed on the result for Icelandair Group and accounted for the decline in performance between years. Total income increased by 10%. EBITDA was ISK 10.4 billion and the EBITDA ratio was 11%. The Company reported a net profit of ISK 4.5 billion.

### TRANSPORT FIGURES

Icelandair Group's volume of business increased substantially in 2011. Icelandair increased its capacity by 18% from the preceding year. Passengers were 1.75 million, up by 260 thousand, or 18%. The passenger load factor was the best in the company's history, at 79.3%, up by 0.9 percentage points. Passengers on Air Iceland flights were 353 thousand, increasing in number by 3% between years. The company successfully focused on expanding its flights to Greenland, and in addition the number of passengers on domestic flights also increased between years. The number of sold hours in the Company's capacity sector was almost the same in 2011 as in 2010. Air freight on scheduled flights increased by 7%. Available hotel room nights in Icelandair hotels were 253 thousand in all, up by 7% between years. The utilization of hotel rooms was 67.9%.

		2011	2010	% Chg.
<b>ICELANDAIR</b>				
Number of Passengers . . . . .	thousand	1,744	1,483	18%
Load Factor . . . . .	%	79.3	78.4	0.9 ppt
Available Seat KM (ASK) . . . . .	thousand	6,169,070	5,220,066	18%
<b>AIR ICELAND</b>				
Number of Passengers . . . . .	thousand	353	343	3%
Load Factor . . . . .	%	69.3	68.2	1.1 ppt
Available Seat KM (ASK) . . . . .	thousand	179,740	167,318	7%
<b>CAPACITY</b>				
Fleet Utilization . . . . .	%	93.5	94.6	-1.1 ppt
Sold Block Hours . . . . .	number	34,524	34,664	0%
<b>ICELANDAIR CARGO</b>				
Available Tonne KM (ATK) . . . . .	thousand	168,759	151,894	11%
Freight Tonne KM (FTK) . . . . .	thousand	77,991	72,888	7%
<b>ICELANDAIR HOTELS</b>				
Available Hotel Room Nights . . . . .	number	253,052	237,018	7%
Sold Hotel Room Nights . . . . .	number	171,924	156,569	10%
Utilization of Hotel Rooms . . . . .	%	67.9	66.1	1.9 ppt

Traffic figures | YOY change in %



## EARNINGS DEVELOPMENT

### Strong operating result in 2011

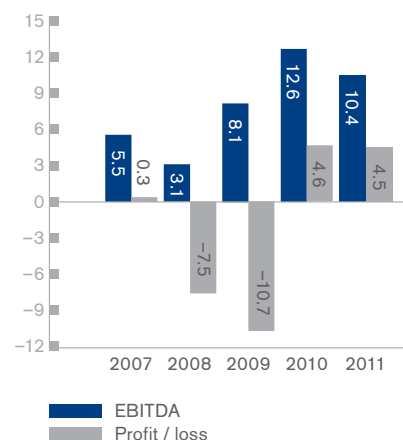
The Company showed a strong operating result in 2011. Organic growth was delivered in both of our business segments and the service offering was expanded. The net profit in 2011 was ISK 4.5 billion, as compared to a profit of ISK 4.6 billion in 2010. EBITDA in 2011 amounted to ISK 10.4 billion, as compared to ISK 12.6 billion in 2010. High fuel prices led to significant increases in cost in 2011, which accounts for the decline in performance between years.

### Latvian subsidiary SmartLynx sold at the end of 2011

In 2011 Icelandair Group sold its Latvian subsidiary SmartLynx. The sale is accounted for in the annual accounts for 2011. The impact of the sale on Icelandair Group's bottom line is ISK 1.1 billion, of which 0.7 billion is due to income tax and ISK 0.4 billion to profit from discontinued operations.

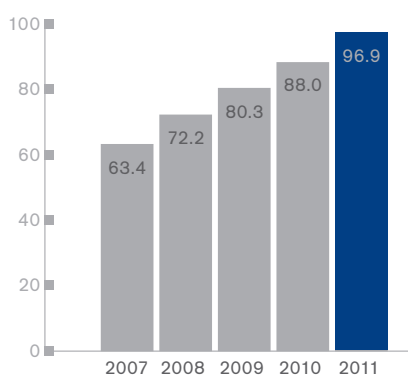
ISK million	2011	2010	Chg.
EBITDAR .....	17,751	21,254	-3,503
EBITDA .....	10,413	12,578	-2,165
EBIT .....	4,735	6,254	-1,519
EBT continuing operations .....	3,500	6,576	-3,076
Profit / loss .....	4,452	4,556	-104
EBITDAR % .....	18%	24%	-6 ppt
EBITDA % .....	11%	14%	-4 ppt

EBITDA and Profit / loss | ISK billion



## Performance in 2011, continued:

Total income | ISK billion



### INCOME

Operating income amounted to ISK 96.9 billion in 2011, as compared to ISK 88.0 billion in 2010, which represents an increase by 10% between years. Operating income is divided into three main categories as shown in the table below:

ISK million	2011	2010	% Chg.
Transport revenue .....	62,215	53,944	15%
Aircraft and aircrew lease .....	16,749	19,972	-16%
Other operating revenue .....	17,970	14,099	27%
<b>Total .....</b>	<b>96,934</b>	<b>88,015</b>	<b>10%</b>

### Organic growth as planned

Transport revenue totalled ISK 62.2 billion, increasing by 15% from 2010. Thereof, passenger revenues amounted to ISK 57.7 billion, increasing by 19%. The capacity increase in our route network in 2011 was 18%, placing the load factor at 79.3%, or 0.9 percentage points above the 78.4% load factor in 2010. Passenger revenues increased on all of our three markets, on the home market from Iceland, the tourist market to Iceland and the market between Europe and North-America.

### Other revenues up by 2%

Aircraft and aircrew lease revenue amounted to ISK 16.7 billion in 2011, as compared to ISK 20.0 billion in 2010, which represents a decrease of 16%. Revenue from operations that exited the Group late in 2010 as part of the financial restructuring of the Company was included in the 2010 figures. Other revenue increased by 28% and totalled ISK 18.0 billion. The increase is a result of growing income from Icelandair Hotels and Iceland Travel, whose revenues fell in 2010 due to the volcanic eruption in Eyjafjallajökull.

### EXPENSES

ISK million	2011	2010	% Chg.
Salaries and related expenses .....	22,809	20,415	12%
Aircraft fuel .....	22,014	14,927	48%
Aircraft and aircrew lease .....	10,290	11,866	-13%
Aircraft handling, landing and communication ...	7,121	6,103	17%
Aircraft maintenance expenses .....	7,174	6,475	11%
Other operating expenses .....	17,113	15,651	9%
<b>Total .....</b>	<b>86,521</b>	<b>75,437</b>	<b>15%</b>

Operating expenses amounted to ISK 86.5 billion in 2011, as compared to ISK 75.4 billion in 2010, an increase of 15% between years.

#### Employee cost increased by 12%

Salaries and other personnel expenses amounted to ISK 22.8 billion, increasing by 12% in comparison with 2010. The reason is primarily the increased capacity on the Company's international flights and contractual salary increases between years. In August 2011 the last batch of the open union contracts were concluded with a three-year agreement. The average number of full year employees was 2,350 in 2011, as compared to 2,197 in 2010.

#### Significant increase in fuel price reason for decline in results

Fuel cost totalled ISK 22.0 billion, rising by ISK 7.1 billion, which represents a 48% year-on-year increase. Fuel cost was 25% of total expenses in 2011, as compared to 20% of total expenses in 2010. The direct increase in expenses resulting from the price hikes over the year 2011 was ISK 5.8 billion. The increase in fuel costs resulting from increased capacity was ISK 2.7 billion. Other items, such as hedging and favourable currency effects, decreased fuel cost between years by ISK 1.4 billion.

#### Other expenses increased by 4%

Aircraft and aircrew lease decreased by ISK 1.6 billion between years, or 13%, due to operations such as Bluebird, which no longer forms a part of the Group and due to the purchase of one Boeing 757-200 in the first quarter, which the Company previously had on lease. Aircraft servicing, handling and navigation expenses amounted to ISK 7.1, increasing by 17% between years as a result of the increase in capacity and considerable price hikes. Maintenance expenses amounted to a total of ISK 7.2 billion, increasing by 11%. Other expenses amounted to ISK 17.1 billion, up by ISK 1.5 billion, or 9%, between years.

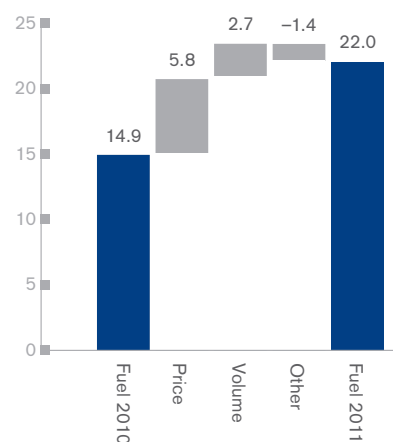
#### Depreciation and amortisation amounted to ISK 5.7 billion

Total depreciation of operating assets amounted to ISK 5.5 billion in 2011, as compared to ISK 5.2 billion in 2010. Amortisation of intangible assets totalled ISK 0.2 billion, decreasing by ISK 0.2 billion from 2010. No impairments were made in 2011 compared to ISK 0.7 billion in 2010.

#### Net finance cost decreased significantly from 2010

Net finance cost totalled ISK 1.2 billion in 2011, as compared to ISK 3.5 billion in 2010. The biggest contributing factor was the decrease in interest expense on loans and borrowings from 3.2 billion in 2010 to 1.4 billion in 2011. This is a result of the successful financial restructuring of Icelandair Group that was completed early in 2011. Interest income increased from ISK 0.3 billion in 2010 to ISK 0.9 billion in 2011. ■

**Aircraft fuel – main deviations between 2010 and 2011** | ISK billions



## Financial Position

Icelandair Group's financial position is strong. Assets amounted at year-end to ISK 89.5 billion, increasing by 6% from the beginning of the year. The equity ratio was 36%, increasing by 2 percentage points from the beginning of the year. Cash and cash equivalents and marketable securities totalled ISK 13.1 billion and total capital expenditures during in 2011 amounted to ISK 15.3 billion.

### ASSETS

#### Total assets amounted to ISK 89.5 billion

At the end of the financial year 2011 total assets amounted to ISK 89.5 billion, increasing by ISK 5.2 billion, or 6%, from the beginning of the year.

#### Operating assets up by 23%

Total non-current assets amounted to ISK 59.2 billion at year-end 2011, increasing by ISK 6.6 billion from the preceding year. Operating assets amounted thereof to ISK 33.9 billion, as compared to ISK 27.6 billion at the beginning of the year. The increase is largely a result of the acquisition of four Boeing 757 200 aircraft and one Airbus 320 in the course of the year. Three of the aircraft were previously under long-term lease. The acquisitions will have a positive effect on profit and cash flow going forward. Intangible assets and goodwill totalled ISK 21.7 billion, mainly comprising goodwill in amount of ISK 16.9 billion. Trademarks and airport slots amounted to ISK 4.1 billion. Other non-current assets amounted to ISK 3.7 billion at year-end, as compared to 3.9 billion at the end of 2010.

#### Assets held for sale down to ISK 0.8 billion

Current assets totalled ISK 30.2 billion at the end of 2011, ISK 1.3 billion lower than in the preceding year. Trade and other receivables were ISK 14.5 billion at year-end, up from ISK 14.2 billion from the end of 2010. Cash and marketable securities increased slightly, from ISK 13.0 billion at year-end 2010 to ISK 13.1 billion at the end of 2011. Assets held for sale decreased by ISK 2.0 billion in 2011 due to the sale of the subsidiary SmartLynx in December 2011 and amounted to ISK 0.8 billion at year end 2011.

### LIABILITIES

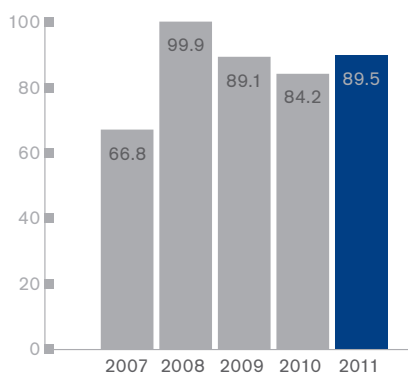
#### Total liabilities ISK 57.2 billion

Non-current liabilities amounted to ISK 24.1 billion at year-end 2011. Loans and borrowings amounted thereof to ISK 20.0 billion and other non-current liabilities to ISK 4.1 billion. Current liabilities were ISK 33.1 billion at year-end 2011. Thereof, loans and borrowings amounted to ISK 4.1 million, trade and other payables to ISK 16.6 billion and deferred income to ISK 12.4 billion.

#### Interest-bearing debt ISK 24.1 billion

Interest-bearing debt decreased by ISK 0.5 billion from the beginning of the year. Payments on long-term liabilities amounted to ISK 8.1 billion; of that figure ISK 4.1 billion had not reached maturity. In October the Company finalised a borrowing from Deutsche Bank in the amount of USD 18 million for a term of 7 years. In December the Company borrowed USD 24 million for a term of 6 years from Lloyds Bank in connection with the purchase of two Boeing 757-200 aircraft, which the Company previously had on a long-term lease. Net interest-bearing debt amounted to ISK 11.1 billion at year-end.

Total assets | ISK billion



Calculation of net interest-bearing debt:

ISK million	31.12.11	31.12.10	% Chg.
Loans and borrowings non-current .....	19,999	21,356	-6%
Loans and borrowings current .....	4,137	3,248	27%
Marketable securities .....	-3,345	-1,306	156%
Cash and cash equivalents .....	-9,735	-11,688	-17%
<b>Net interest bearing debt .....</b>	<b>11,056</b>	<b>11,610</b>	<b>-5%</b>

**EQUITY**

**Equity ratio up to 36%**

Icelandair Group's total equity amounted to ISK 32.3 billion at 31 December 2011, increasing by ISK 3.9 billion from the beginning of the year. This growth is principally due to the positive net profit of ISK 4.5 billion. The equity ratio rose as a result to 36% from 34% in 2010. The share capital at year-end amounted to ISK 5,000 million in nominal value. The Company held own shares in the amount of ISK 25 million at year-end 2011.

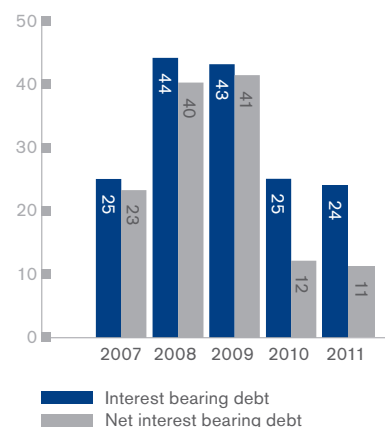
**CASH FLOW AND INVESTMENTS**

ISK million	2011	2010	Chg.
Working capital from operations .....	12,541	12,889	-348
Net cash from operating activities .....	14,386	15,673	-1,287
Net cash used in investing activities .....	-13,017	-5,512	-7,505
Net cash used in financing activities .....	-3,384	-49	-3,335
Decrease / increase in cash and cash equivalents .....	-2,015	10,112	-12,127
<b>Cash and cash equivalents at 31 December .....</b>	<b>9,735</b>	<b>11,688</b>	<b>-1,953</b>

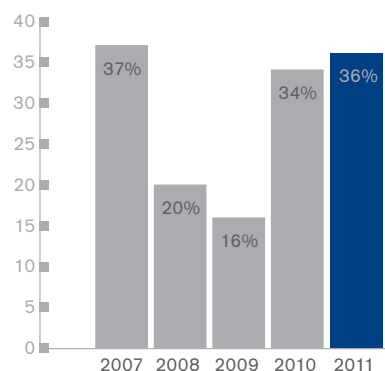
**ISK 14.4 billion generated from operating activities**

Working capital from operations amounted to ISK 12.5 billion in 2011, decreasing by 0.3 billion from 2010. Cash and cash equivalents in 2011 decreased by ISK 2.0 billion, mainly due to large investments during the year and repayment of long-term borrowings, thereof ISK 4.1 billion which were not due until 2013. Cash and cash equivalents at year-end amounted to ISK 9.7 billion, as compared to ISK 11.7 billion in 2010.

**Interest bearing and net interest bearing debt**  
ISK billions | 2007-2011

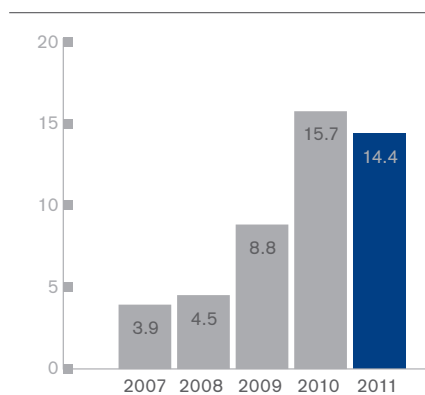


**Equity ratio | 2007-2011**

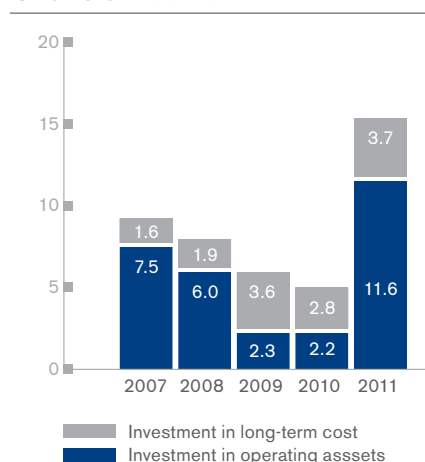


## Financial Position, continued:

**Cash flow from operating activities**  
ISK billion | 2007–2011



**Total investment**  
ISK billions | 2007–2011



### Investment totalled ISK 15.3 billion in 2011

Investments in operating assets amounted to ISK 11.6 billion. Icelandair invested in four B757-200 aircraft for ISK 5.5 billion, Air Iceland invested in two Dash 8-200 aircraft and spare parts for ISK 1.0 billion; the new aircraft will replace two earlier Dash 8-100 aircraft. Icelandair Group invested in one Airbus 320 aircraft for ISK 0.8 billion. Investments in engine overhauls amounted to ISK 2.0 billion over the period. Investments in long-term expenses amounted to ISK 3.7 billion, of which investments in overhauls of leased engines amounted to ISK 3.6 billion, and investments in intangible assets amounted to ISK 0.1 billion. Expensed long-term cost in the profit/loss statement amounted to ISK 3.9 billion in 2011.

### FLEET

The fleet is the Group's largest asset and a core operating resource. Icelandair operates a single-type fleet of Boeing 757 aircraft in its international network. The type fits extremely well with Icelandair's route network and a single-type fleet creates significant cost efficiency in terms of maintenance and training for crew and mechanics. This has been one of the sources of the Company's on-going competitive advantages.

Icelandair Group is systematically weighing its options in relation to the future fleet of the Company and expects the current fleet of 757's and 767's to serve the Company well into the year 2020. With continued improvements of the fleet, through the introduction of winglets and improved entertainment systems, the current fleet can serve the Company well for the next decade. In the first half of the year 2012, two 757 aircraft will be added to Icelandair's fleet, which demonstrates our commitment to our current fleet of 757's.

At year-end 2011 the Company's fleet comprised a total of 35 aircraft, of which 20 were owned and 15 leased. The table below shows the Company's fleet at year-end and changes over the year. ■

Aircraft type	Icelandair	Loft-Cargo	Loft-leidir	Air Iceland	Total fleet 31.12.11	Owned aircraft	Leased aircraft	Ch. from 31.12.10
B757 200 ....	12	5	4		21	11	10	1
B757 300 ....	1				1	1	0	0
B767 300 ....			5		5	0	5	0
Fokker F-50 ..				6	6	6	0	0
Dash 8-100 ..				1	1	1	0	-1
A-320 .....					1	1	0	1
<b>Total .....</b>	<b>13</b>	<b>5</b>	<b>9</b>	<b>7</b>	<b>35</b>	<b>20</b>	<b>15</b>	<b>1</b>

## Outlook

### CONTINUED ORGANIC GROWTH

Icelandair, the Group's largest subsidiary, will operate the most extensive flight schedule in its history in 2012. Bookings for the first months of the year have been strong and are off to a promising start. A new year-round destination, Denver, Colorado, will be added, and at the same time the frequency of flights to various cities in the United States and Europe will increase. Icelandair will have 31 destinations, and is expected to transport about 2 million passengers over the year, which represents a 15% increase over 2011. The unique TO-FROM-VIA business model based on the geographical location of Iceland offers a flexible route network and opportunities to increase the company's seat capacity. Two new aircraft will be added in the first half of 2012 and they will contribute in growing Icelandair's number of passengers above the average market growth going forward.

Further, Icelandair Hotels will open a new hotel with 111 rooms by the harbour of central Reykjavík; Air Iceland will increase its capacity to Greenland, where the company currently offers five destinations, of which three are year-round destinations; and VITA intends to increase its market share in the charter market from Iceland by the establishment of the Internet site Ferd.is, which will specialise in economy vacation flights and leisure tours.

### EBITDA FORECAST

#### AT ISK 11.0–12.0 BILLION IN 2012

Given the addition of new aircraft, high fuel prices and a less favourable EUR/USD exchange rate we assume a weaker profit for Q1 2012 than Q1 2011. However, assuming a EUR/USD exchange rate of 1.25 and fuel prices of 1,050 USD per ton (excluding hedging), the Company is expecting a full year 2012 EBITDA in the range of ISK 11.0–12.0 billion, an increase from 2011, when EBITDA was ISK 10.4 billion.

### CHALLENGING YEAR AHEAD FOR THE AVIATION INDUSTRY

According to the latest IATA report from January 2012, the year ahead for the global aviation industry could be challenging given higher fuel costs, downward pressure on average fares and a flat passenger market. The Board of Directors is nevertheless confident that the Company is well positioned to face these challenges, given its unique business model, strong balance sheet and ongoing growth initiatives. ■

Icelandair Group anticipates still further expansion of its operations in 2012. The Company is committed to its business model, and its unique product offering provides a strong competitive footing. Icelandair Group is expecting a full-year 2012 EBITDA in the range of ISK 11.0–12.0 billion, an increase from 2011, when EBITDA was ISK 10.4 billion.

## Risk Management

Icelandair Group's objective in its risk management is to manage and control risk exposures and keep them within acceptable parameters subject to optimised returns by using derivatives or other available means. All risk management is carried out within guidelines set by the Board of Directors.

Various sources of financial and enterprise-related risks affect the Group's operations. The Board of Directors is responsible for defining policy measures to reduce exposure to financial and enterprise risk. These measures outline the parameters and framework which need to be considered when managing risk, especially those arising from price volatility and liquidity fluctuations. An internal Risk Management Committee, chaired by the CEO, endeavours to reduce risk exposure to the maximum feasible extent within the Board's policy limits. The main policy objectives outline the methods to be used to reduce costs and disadvantages arising from the unstable environment and uncertainty. To that end, the financial budget is used as a benchmark when evaluating market conditions and hedging strategies. In 2010 the Board of Directors updated its Risk Management Policy by shortening the time horizon for exposure assessment from 12 to 9 months and by adding measures to reduce the risk of liquidity side effects caused by hedging. Although the policy revision is relatively minor it represents a recognition of the Company's improved enterprise flexibility in capacity and pricing techniques. These were put to the test in 2010 and 2011, when an ash cloud impeded European flights, and in 2008, when fuel prices reached historical heights and the bank crisis put liquidity under pressure.

### FOREIGN CURRENCY RISK

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 to the extent possible. Any mismatch is dealt with using currency trades within the Group before turning to outside parties. The biggest currency mismatch is found in the USD, where the US dollar

cash inflow falls short of the dollar outflow by approximately 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 9-month currency exposure and uses a portfolio of instruments, mainly risk reversals and forwards.

### FUEL PRICE RISK

The Risk Management Committee followed a revised policy in 2011 where the Board of Directors had decided to shorten the rolling hedge period from 12 to 9 months and allowed temporary deviations from 40–60% hedge ratio limits down to certain lower limits confined to the forward ticket sales. The strategy entailed a mixture of swaps and options which were allocated in accordance with the stakes within the business cycle. The policy and hedge strategy take account of several factors apart from the pure volume-based exposure. The correlation between jet fuel and other influential components are identified, and the same goes for pricing, service supply control and contractual risk transfer where possible.

### INTEREST RATE RISK

A considerable share of the Group's outstanding loans is directly related to aircraft financing and denominated in US dollars. The Group follows a policy of hedging 40–80% of the interest rate exposure of long-term financing with up to a 5-year horizon. Currently, foreign loans are hedged against interest rate fluctuations with fixed-rate loan contracts or swap contracts, where the floating rate is exchanged for fixed interest rates. When evaluating the interest risk exposure, account is taken

Six Month USD Libor | 2007–2011



Jet Fuel Price per Tonne | 2007–2011



EUR/USD exchange rate | 2007–2011



## Risk Management, continued:

■ *In 2010 the Board of Directors updated its Risk Management Policy by shortening the time horizon for exposure assessment from 12 to 9 months and by adding measures to reduce the risk of liquidity side effects caused by hedging. Although the policy revision is relatively minor it represents a recognition of the Company's improved enterprise flexibility in service provision and pricing techniques.*

of the level of cash and marketable securities and various other offsetting economic factors.

### CARBON PRICE RISK

From the beginning of 2012 all airlines offering European destinations are obliged to comply with the EU Emissions Trading Scheme (ETS), which commits them to raise carbon permits in proportion to the emission of carbon. Icelandair Group is already hedged against 60% of its exposure through the EU allocations of emissions quotas. With respect to risk management, the Group's 2012 estimated carbon shortfall had not been hedged in 2011, but various arrangements were made to prepare for the forthcoming obligations regarding trading and procurement. As part of that preparation, a decision was made to follow a policy of compliance by trading in carbon permits in accordance with the fuel consumption and consequent carbon emissions on a rolling monthly basis.

### LIQUIDITY RISK

The Group's policy on liquidity risk extends to three asset classes determined by duration. Those classes are matched against the Group's liquidity preferences as laid down by the Board of Directors on an annual basis. Classes one and two include the estimated minimum of accessible funds for immediate operational liquidity and reserve purposes. 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 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 fulfilment of outstanding obligations by the Group's counterparties. The Group is aware of potential losses relating to credit risk exposure and chooses its counterparties based on business experience and satisfactory credit ratings.

### INDUSTRY-RELATED RISK FACTORS

At Group and subsidiary levels, management monitors and assesses the airline industry's risk exposure, which has historically posed uncertainty to normal operations. A part of the company culture stems from its long history, including a general recognition of the value of learning from past experience. Yet, in addition to the retrospective view, management focuses systematically on potential threats from a prospective viewpoint, as the environment is ever changing. The group operates and thrives on well established and defined markets. As such, they can be regarded as invaluable intangible assets which require attention. The credibility and reputation of Icelandair is crucial for its market status and growth. But the markets are also sensitive to external factors, such as the macroeconomic elements governing aggregate demand. An economic downturn usually reduces the general purchasing power of potential customers and the demand for air travel. Airlines are prone to even greater vulnerability when it comes to other types of shocks which are more sudden and forceful. The cold winters in Europe and volcanic eruptions over the

course of two years have caused costly and unanticipated disruptions of such nature. Terrorist incidents and pandemics are also examples of events which need to be considered at all times. Those factors that can be analyzed and monitored with respect to reasonable risk of occurrence and impact call for close monitoring and readily available contingency plans. The ash cloud experience put the risk management systems of Icelandair Group to the test and they proved successful. The company seems to owe its adaptive potential and flexibility of operations to its capable human resources, contingency policies and economies of scale. The quality of these responsive processes enable the company to cope with various other incidents and hostile industry factors, such as seasonality, competition, insurance and new taxes, e.g. carbon emission charges.

#### OPERATIONAL RISK.

The Group distinguishes between industry-related risks and those which expose the subsidiaries on an individual company level. Methods of coping with threats of disruptions and disturbances are more decentralized when it comes to operational hazards. Again, great value is found in the long and successful history of Icelandair Group and its companies, which serves as the foundation, as well as the benchmark, for many of the policies and contingency plans used across the Group. The Group's computer and communication systems are crucial for sales and market activities, but also for uninterrupted internal operations. Equipment maintenance is needed to guarantee airworthiness. Third-party services may become bottlenecks in the production chain, whether relating to catering, ground services or flight control. Human resources need to be managed, labour disputes resolved and strikes prevented. The Management constantly

evaluates the risks involved and the consequences of individual events. Scenario projections are charted and contemplated and action plans launched based on projected outcomes, where collaboration is maintained between the Group and individual companies.

#### ENTERPRISE RISK MANAGEMENT

Risk management has to secure a steady flow of information about all enterprise-related risks at the Group level and thus requires centralized mapping and registration of their inherent values and potential consequences. The Group's Risk Management Committee has placed increased emphasis on enterprise-related risk assessment in collaboration with Internal Audit and has focused attention on aligning risk registration across all subsidiaries for consistency and compliance. The key objective of Enterprise Risk Management is to enhance motivation in risk analysis and improve risk awareness, standardize risk assessment in the form of numerical values and establish the Company culture that is needed to promote everyday risk awareness and risk-reducing measures. ■

■ *The ash cloud experience put the risk management systems of Icelandair Group to the test and they proved successful. The company seems to owe its adaptive potential and flexibility of operations to its capable human resources, contingency policies and economies of scale.*

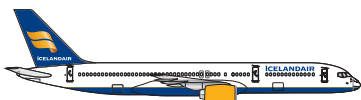




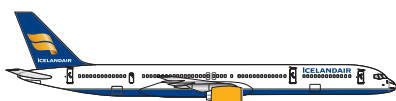
**DID YOU KNOW ...** that every year, ten Icelandic rock bands set out to conquer the world

## Icelandair

Number of aircraft by aircraft type  
Icelandair

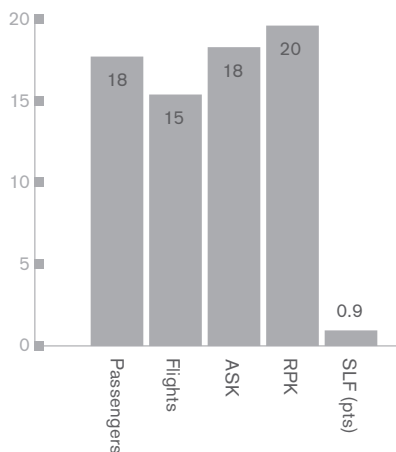


13 Boeing 757-200



1 Boeing 757-300

Traffic Data Icelandair | YOY change in %



Icelandair business strategy is based on the geographical position of Iceland on the flight route between northern Europe and North America. By combining in its aircraft passengers travelling to Iceland, passengers travelling abroad from Iceland and passengers travelling across the Atlantic via Iceland, Icelandair has managed to expand its Hub and Spoke network steadily.

Icelandair connects 22 European cities with 9 North American cities through the company's hub in Iceland in its summer schedule. The network is based on a 24-hour rotation, with morning and afternoon connections in Iceland.

Icelandair is a key component of Icelandair Group. It aims to be the airline of choice for travel to and from Iceland on the grounds of its efficiency and flexibility, and a unique and exciting alternative for air travel across the North Atlantic. Icelandair's mission is to operate a first-rate airline and maintain a reliable quality service through the experience and knowledge gained in 75 years of operations.

Icelandair operates under an Air Operators Certificate issued by the Icelandic Civil Aviation Authority and is, as such, considered European Aviation Safety Agency (EASA) compliant. Icelandair is an Icelandic carrier and has route rights in accordance with this status.

In addition to aircraft flown on its scheduled network, Icelandair operates aircraft on behalf of Loftleidir-Icelandic and Icelandair Cargo, thus securing economies of scale. The Group foresees the utilisation of the current aircraft type for the next decade.

Operating on three different and independent passenger markets (the North Atlantic market, From Iceland market and To Iceland market) gives the company a variety of options in network and revenue management. Apart from marketing and sales efforts, demand for

air travel mainly depends on the economy, exchange rates, destination popularity and the cost of flying. Operating in different markets makes the company less vulnerable to fluctuations in demand for any particular market segment. Continued emphasis is placed on a lean organisational structure, quick decision making and flexibility as the company works constantly on optimising the route network and looks at new markets.

The company's business activities have seen substantial growth since 2008, and the increase in scheduled flights between the years 2009 and 2012 is over 50%.

Icelandair Technical Services provides maintenance and technical services for the Icelandair fleet and is an integral part of Icelandair. Most of the work is performed at the Service Centre at Keflavik Airport, but maintenance is increasingly carried out abroad because of increased international flight operations.

### SOME HIGHLIGHTS OF ICELANDAIR'S OPERATIONS IN 2011

#### Route network expanded and strengthened

Icelandair started the year by announcing a projected 17% growth from the preceding year and passengers in excess of 1.7 million for 2011. Icelandair saw an opportunity in the market between Europe and North America, as demand was high and capacity proportionally less than before, both because aircraft manufacturers were having difficulties delivering new aircraft and because the growth in Asia was diverting aircraft from other markets. Icelandair decided to increase the number of aircraft in scheduled services from 12 to 14, and thus form the largest passenger fleet in the company's history.

### Fleet cockpit renovation

Early on in the year work began on renewing the cockpits of the Boeing 757 aircraft fleet, and the first aircraft to fly on a scheduled flight following the alterations took off in February. Icelandair was the first airline in Europe to undertake this alteration; the new equipment improves flight safety, reduces maintenance cost and is also lighter than the earlier type, which results in reduced fuel consumption. The Boeing 757 aircraft have served Icelandair extremely well and proven an excellent fit with the route network. Icelandair is at the forefront in developing this type of aircraft, by installing winglets on the aircraft several years ago to save fuel, renovating the fleet with new seats and entertainment systems for all passengers, and now developing the cockpits and improving working conditions for pilots. The alterations are done by Icelandair's Technical Services in the course of regular major maintenance inspections.

### Record number of passengers

Icelandair's volume of business increased substantially in 2011. Icelandair increased its capacity by 18% from the preceding year. Passengers were 1.75 million, up by 260 thousand, or 18%. This is the largest number of passengers in the company's history. The passenger load factor was also the best in the company's history, at 79.3%, up by 0.9 percentage points from the year before.

### Co-operation with JetBlue

Icelandair is constantly working on strengthening its international operating environment and market position, and one aspect of this work involves partnership agreements with other airlines. In April Icelandair signed an agreement with JetBlue Airways regarding sales and ticketing on the routes of both companies. JetBlue is a low-fare airline which has carved out a market position for

itself through exceptional and outstanding service; it is known in particular for its offer of live television broadcasts in its aircraft, leather seats and generous leg room. The company is extremely popular, and in a short period of time it has become the largest airline flying domestically in the United States out of Boston and New York. In a brief period of time Icelandair has concluded several important partnership agreements with airlines on both sides of the Atlantic, i.e. Finnair, SAS, Alaska Airlines, and now JetBlue and Frontier. These agreements are in line with Icelandair's strategy of preserving its independence and unique position in international air travel, while at the same time opening up lines of communication and co-operation with other airlines.

### Washington added to the route network

In May Icelandair launched scheduled flights to the U.S. capital, Washington. At the same time it was announced that owing to great demand the number of scheduled flights would be increased significantly, and in fact Washington immediately became a year-round destination. Icelandair is strengthening its services over the winter months and has significantly increased seating capacity outside peak periods, both to and from Europe and North America. In the summer of 2011 Icelandair flew 53 times each week to North America, far more frequently than any other airline in Scandinavia.

### Volcanic eruption in Grímsvötn

There was some alarm when news emerged that a volcanic eruption had started in Grímsvötn in Vatnajökull in late May, and that Keflavik Airport was about to close down owing to clouds of ash. Icelandair put in action the company's contingency plans, with most of the employees in fresh training as a result of

the eruption in Eyjafjallajökull the year before. A number of flights had to be cancelled, but it eventually became evident that the eruption and emission of ashes was trivial in comparison with the previous year's upheaval, and 24 hours later the company's normal schedule had more or less been resumed.

### Nine Scandinavian cities in the route network

Services to Billund and Gothenburg were introduced last summer, increasing the number of Scandinavian destinations from seven to nine. Icelandair flew to Oslo, Bergen, Stavanger and Trondheim in Norway, to Copenhagen and Billund in Denmark, to Stockholm and Gothenburg in Sweden and to Helsinki in Finland.

### Three-year contract with employees

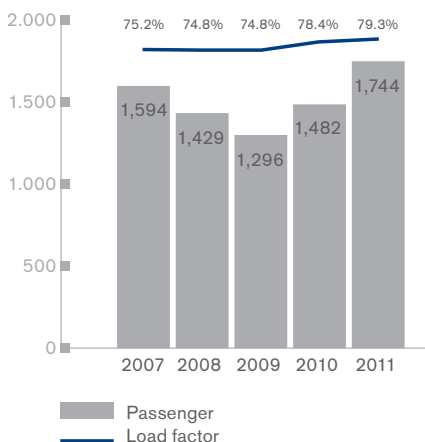
In the course of the year union contracts were concluded with Icelandair's employees and a three-year agreement was negotiated. This will give the company scope for long-term strategic planning, which was challenging in recent years due to short-term contracts. This round of negotiations was in many ways difficult, and there were some flight disruptions due to work stoppages.

### Sights set on growth in 2012

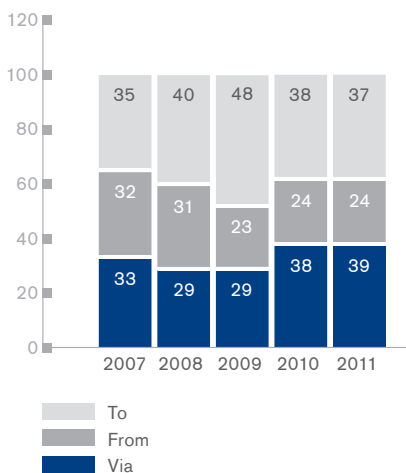
Icelandair has announced significant growth in 2012. The company will add two aircraft to the fleet and deploy 16 Boeing 757's in its network next summer. Next winter, 2012–2013, the Icelandair winter schedule will be as extensive as the summer schedule was two years ago. Almost two million passengers are anticipated in 2012, up to approximately 10 thousand passengers per day in the summer peak season.

## Icelandair, continued:

**Number of Passengers (thousands) and load factor | 2007–2011**



**Passenger mix (%) | 2007–2011**



### Denver, Colorado

In 2012 Icelandair is introducing a new destination: Denver, Colorado. The inaugural flight will take place on 10 May and Icelandair will operate four flights a week, year-round. Denver is located virtually in the centre of the United States, at the roots of the Rocky Mountains, a unique outdoors recreation area featuring some of the world's best skiing areas, in Aspen and Vail. There are over three hundred sunshine days in the year. Denver is a central hub for air travel, and Denver airport is the tenth largest airport in the world and the fifth largest in the United States. The area is quite prosperous, the level of education is high and interest in nature and the outdoors is more widespread than in most other places. Icelandair has plans to attract tourists in great numbers to Iceland from this area. The popular skiing areas offer opportunities for winter flights equalling the summer flights in number, which is unusual and extremely positive. It is also clear that the Icelandair service, with its connections in Iceland, is an excellent option for passengers who need to travel between Denver and various European cities.

### Iceland Airwaves an “Established Good Time”

The now well-established Iceland Airwaves music festival founded by Icelandair a decade ago is continuing to set records and attract the best and freshest talents in the music scene. Last year's festival, held in Reykjavik in October, was the biggest ever, filling all venues, large and small, and bringing to Iceland thousands of music lovers from all corners of the world. “Iceland Airwaves is an established good time”, said Rolling Stone Magazine of last year's event. The dates for the year 2012 have already been set (October 31–November 4) and the tickets are going fast.

### Marketing company of the year

Icelandair was granted a distinguished award in November when the company was elected the Marketing Company of the Year in Iceland by IMARK, the association of marketing executives in Iceland.

### We Think Clients

This year has revealed once again what a valuable resource Icelandair possesses in its staff. Icelandair has now mapped a five-year strategy of strengthening substantially its training and education activities, both specialised job training and general education for personal development. The campaign is entitled “We Think Clients” in line with the values of Icelandair Group. ■

## Loftleidir

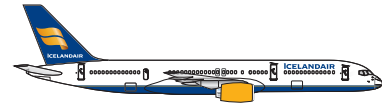
Loftleidir-Icelandic is a capacity solution company for international passenger airlines and tour operators. Loftleidir-Icelandic was formed as a subsidiary of Icelandair in 2002, although international charter operations had been part of the general operations of the airline and its predecessors for decades. It 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. The company has expanded its horizon beyond the aircraft types traditionally operated under the Icelandair AOC.

The company currently operates AM (Aircraft and Maintenance), ACMI (Aircraft, Crew, Maintenance and Insurance) and full charter contracts. Furthermore, Loftleidir-Icelandic has established itself as a business class specialist by operating first-class flights around the world in an all-VIP business class configuration. The company had four Boeing 757-200 and five Boeing 767-300 aircraft in 2011, one of which is operated under Icelandair's AOC.

In mid-2003 Loftleidir-Icelandic added its first wide-body aircraft when it introduced a Boeing 767 in its fleet, which opened up new markets. This led to an increase in the proportion of ACMI projects at the expense of all-inclusive projects, which has helped to increase profitability and reduce sensitivity to external fluctuations. This trend has continued, with longer term AM leases becoming ever more prominent in the company's contract portfolio. The company has been successful in establishing itself on the European market and enjoys increasing visibility in both the North and South American markets. Furthermore, the company has been successful in penetrating the CIS (Commonwealth of Independent States) market where demand for western-built aircraft continues to grow.

However, Loftleidir-Icelandic will seek to utilise its extensive market knowledge to widen its spectrum of services further, in order to secure continued growth in revenue and profitability. ■

Number of aircraft by aircraft type  
**Loftleidir**

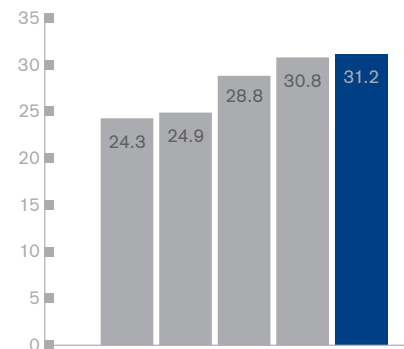


4 Boeing 757-200



5 Boeing 767-300

**Numbers of sold black hours (thousands) | 2007-2011**



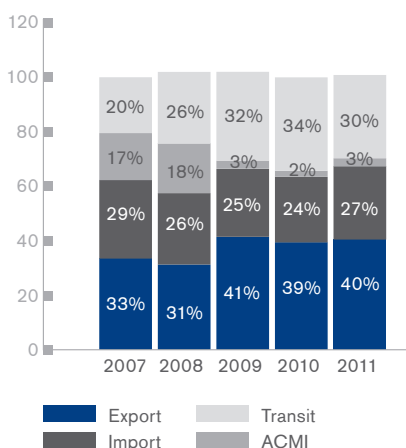
## Icelandair Cargo

Number of aircraft by aircraft type  
Icelandair Cargo

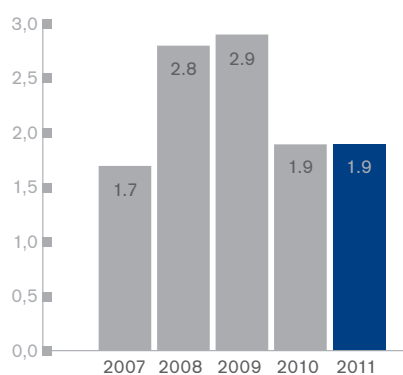


5 Boeing 757-200

Revenue split | 2007–2011



Number of produced servings  
(millions) | 2007–2011



Icelandair Cargo is an air freight company offering services to and from Iceland based on a strong route network. The freighters are registered to Icelandair's Air Operators Certificate (AOC) and crews are leased from Icelandair. Aircraft maintenance, warehousing, cargo handling and a part of cargo sales are outsourced.

Icelandair Cargo was established in late 1999 and is the largest air freight service provider in Iceland.

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 has five Boeing 757-200 freighters in its fleet. The company uses two cargo aircraft to operate its schedule and three cargo aircraft to operate its ACMI product offerings.

The company offers its customers competitive and quick global services through extensive interline and special pro rata agreements with other airlines. The operation is supported by trucking networks in Europe and in the USA. Sales are mainly handled by Icelandair Cargo staff in Iceland. The New York branch takes care of sales for all the Americas. The company has its own subsidiary, Icelandair Logistic, which handles sales in the Benelux countries, while General Sales Agents (GSAs) oversee other markets. The company has GSAs in all larger and growing markets in Asia and most of Europe.

Approximately 90% of exports from Iceland consist of fresh seafood, whereas imports include perishable products, fashion products, high-tech products and spare parts. ■

## Icelandair Ground Services

Icelandair Ground Services (IGS) provides comprehensive airport ground handling services for airlines and passengers at Keflavík International Airport. IGS was formed in 2001, but airport and ground operations in Iceland have been a part of the airline operation since the foundation of Icelandair Group's predecessors.

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 and bar division in the Leifur Eiriksson Air Terminal. IGS is a service provider that enables airlines and other customers to receive all the services they require from a single source. Icelandair is by far the largest client of IGS, although the company has also been contracted by other airlines. Opportunities for growth go hand in hand with the growth in the number of flights and the number of passengers passing through the airport. ■

## Air Iceland

Air Iceland is a dynamic airline which has set for itself the goal of creating a flexible and powerful airline servicing the West Nordic countries and assuming responsibility for scheduled domestic flights within Iceland as well as routes from Iceland to Greenland. The airline was formed in 1997, when Icelandair Domestic merged with Flugfélag Nordurlands; the airline traces its roots back to 1937.

Air Iceland offers flights to four destinations within Iceland. With its flights from Reykjavík to Akureyri, Egilsstaðir and Ísafjörður it covers all the major towns in Iceland, as well as a number of the smaller settlements through a general sales agent agreement with Norlandair, a Twin Otter operator in Akureyri. Air Iceland offers flights to five destinations in Greenland, with year-round routes to Kulusuk Constable Pynt and Nuuk, the capital of Greenland. In the summer, Air Iceland offer flights to

Narsarsuaq, and Ilulissat. In cooperation with Atlantic Airways Air Iceland offers flights between Iceland and the Faroe Islands all year round. The fleet consisted at year end 2011 of six Fokker 50 and one DASH 8-100 aircraft. In 2012 two DASH 8-200 will replace the DASH 8-100 aircraft.

Air Iceland holds a strong position on the Icelandic domestic air transport market. Demand has been stable on the company's main routes with the busiest ones being from Reykjavík to Egilsstaðir and Akureyri.

Air Iceland plans to grow and increase profitability by offering the best available services in the Icelandic market and the tourist market in Iceland. Demand is good for all destinations in Iceland and in Greenland, the company's most promising external market. Air Iceland aims to bolster its position as an airline servicing the West Nordic region. ■

## Iceland Travel

Iceland Travel is a leading tour operator in Iceland offering a wide range of high-quality services for travelers from all over the world. Iceland Travel organizes a variety of vacation packages, scheduled tours, day tours and activities, as well as planning conferences, events and incentive programs. For over 30 years the company has grown and prospered. Iceland Travel is a member of a number of domestic and international associations, including the Icelandic Travel Industry Association, the Iceland Convention and Incentive Bureau, the United States Tour Operators Association (USTOA), the Japan Association of Travel Agents (JATA), and many more.

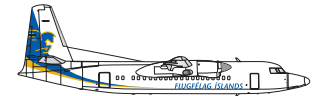
Iceland Travel also operates VITA travel and Ferd.is. VITA's mission is to offer a variety of leisure tours to Icelanders travelling abroad through high-quality services offered at a competitive price.

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 for organised groups and individual tours, such as vacation tours, golf and ski trips and city breaks.

Ferd.is is an online tour operator focusing on low cost packages and seat-only sales on charter flights. Ferd.is was launched in the autumn of 2011.

From the beginning of 2012 Iceland Travel will be divided into two independent subsidiaries. Iceland Travel will focus on incoming operations, and a new subsidiary, FERIA, will focus on the outgoing operations of VITA and Ferd.is ■

Number of aircraft by aircraft type  
**Air Iceland**

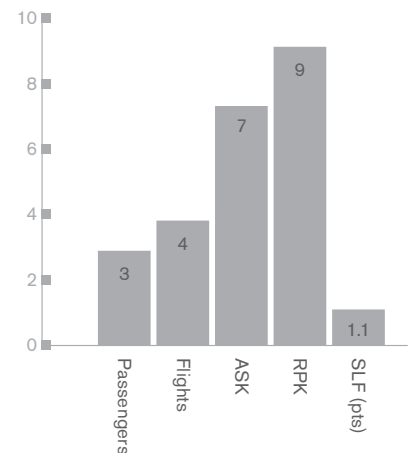


6 Fokker Friendship

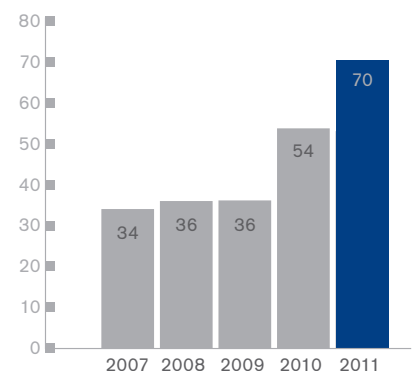


1 Dash 8-100

**Traffic Data Air Iceland** | YOY change in %

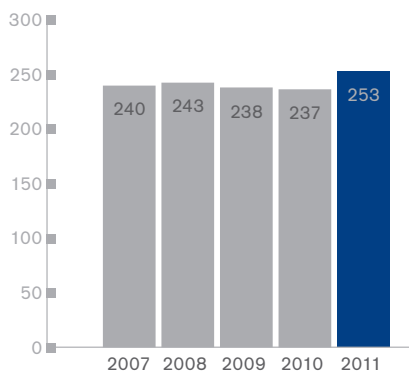


**Number of tourists to Iceland through IT (thousands)** | 2007-2011

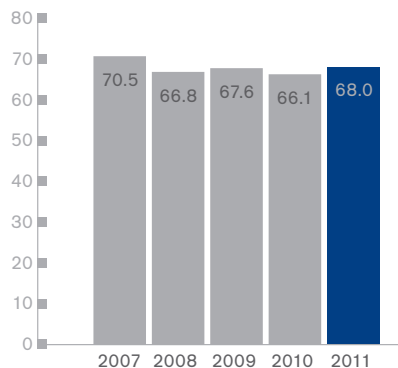


## Icelandair Hotels

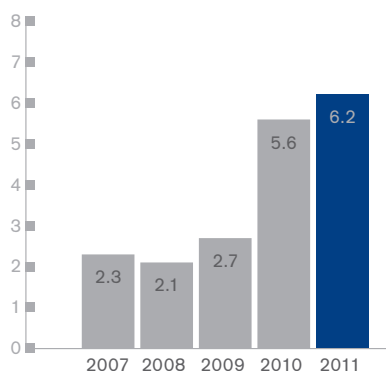
Available hotel room nights (thousands) | 2007–2011



Occupancy (%) | 2007–2011



Number of pax tickets processed ISK millions | 2007–2011



Icelandair Hotels is Iceland's premier hotel chain. Icelandair Hotels deliver hospitality through a coherent family of international and local brands. The hotel chain fuses hotel tradition with an innovative development, in services corresponding to modern-day requirements and the lifestyles and individual needs of our Iceland visitors. The vision of Icelandair Hotels is to create an authentic Icelandic experience, thereby providing owners and sister companies with added value in their promotion of Iceland as a destination.

Icelandair Hotels run the Hilton Reykjavík Nordica, four Icelandair hotels and twelve Edda hotels. In addition, five Icelandair Hotels outside Reykjavík are franchised - bringing the total number of hotels to twenty two.

2011 was a milestone year for the Icelandair hotels operation. The Iceland-

air Hotels were rebranded. The oldest hotel, Loftleidir was refurbished extensively and is now the Icelandair Hotel Reykjavik Natura. A new hotel was built in Akureyri and opened in June 2011: Icelandair Hotel Akureyri. Preparations are in progress for another addition to the chain: Icelandair Hotel Reykjavik Marina, a new downtown hotel, will open its doors in April 2012. Icelandair Hotels also celebrated the 50th anniversary of its chain of Edda Hotels.

Edda Hotels is a chain of 12 summer hotels, all located on the doorsteps of the country's most visited natural wonders and historic sites. Most of the Edda Hotels' facilities serve as student housing at boarding schools during the winter. ■

## Icelandair Shared Services

Icelandair Shared Services offers "one stop" financial services to its customers with flexibility of giving extra support or reducing services quickly when needed. Services include accounting, credit management, reporting and HR processes for customers in Iceland and revenue accounting to foreign airline customers. The company was established in 2002 as a finance support department for

Icelandair Group companies with the shared services concept as a cornerstone but in 2006 the company bought Airline Services Estonia and started offering services outside the Group. Icelandair Shared Services has shown steady growth from the beginning with the international airlines, Icelandair and Air Baltic as the currently largest customers. ■

## Continued Growth in Number of Tourists

EXTENDED ROUTE NETWORK SUPPORTS CONTINUED GROWTH IN NUMBER OF TOURISTS

The number of tourists visiting Iceland has grown rapidly in recent years, and over the past decade the number of visitors to Iceland has more than doubled.

### 2010

Icelandair increased available seat kilometres by 10%. The company operated direct flights from Iceland to 26 cities in Europe and the US and increased the weekly flight schedule from 140 to 155 flights, with 23 direct flights per day over the high season. Icelandair added a Boeing 757 to its fleet, which comprises 12 aircraft, and introduced new destinations in Brussels, Belgium and Trondheim, Norway.

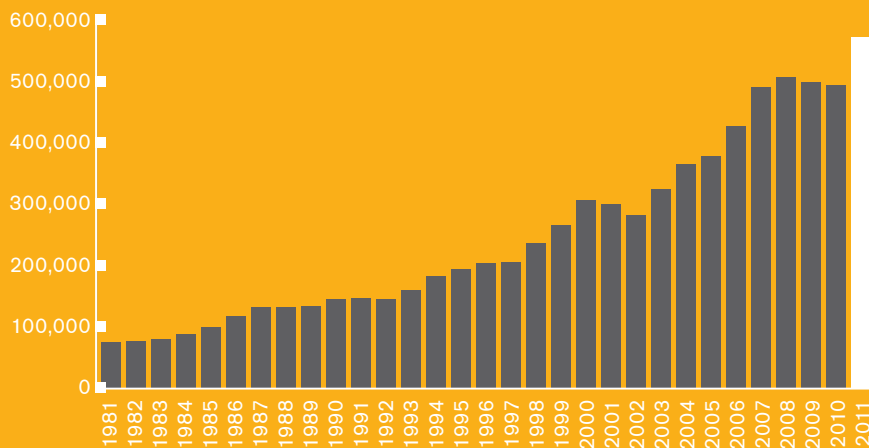
### 2011

Icelandair increased its route network by 17% and flew direct flights to 31 destinations – the largest schedule in the Company's history. New destinations were added to the route network as the company started to fly to and from Washington, Billund, Gothenburg, Hamburg and Alicante. At the same time Icelandair increased the frequency of flights to New York, Boston, Paris, Frankfurt, Amsterdam, Stockholm, Brussels, Seattle, Halifax, Manchester, Glasgow, Trondheim, Bergen and Helsinki.

Over the summer, Icelandair operated 183 weekly flights, with 26 take-offs and 26 landings in Keflavik every day. Icelandair expanded its fleet to 14 Boeing 757's – an increase of 2 aircraft from the previous summer.

Icelandair Group remains one of the most important contributors to attracting tourists to the country and is in a key position to meet the ever-growing numbers of tourists visiting Iceland annually.

Number of Tourists Visiting Iceland 1981–2011





**DID YOU KNOW ...** that the Icelandic horse has an amazing variety of colours and is known for its five gaits



## Corporate Governance

### AUDIT COMMITTEE:

---

Katrín Olga Jóhannsdóttir,  
Chairman

---

Herdís Dröfn Fjeldsted

---

Úlfar Steindórsson

---

### COMPENSATION COMMITTEE:

---

Sigurður Helgason, Chairman

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Finnbogi Jónsson

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### THE FRAMEWORK

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

The Company complies in all main respect to the rules mentioned above. The Company however does not have a Nomination Committee as the Board of Directors has not seen the need for it. That decision will however be reconsidered in 2012. No government organization has found the Company to be in breach with any rule or regulation.

### INTERNAL AUDIT AND RISK MANAGEMENT

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

### VALUES AND CODE OF ETHICS AND CORPORATE RESPONSIBILITY

The company's values are:

**WE CARE** for our customers, employees, environment and shareholders.

**WE THINK CLIENTS** through consistency, reliability, clear product alternatives and friendly service.

**WE DRIVE RESULTS** via teamwork, shared information and values, accountability and profitability.

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

### COMPENSATION COMMITTEE

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

## The Board of Directors



### ■ SIGURÐUR HELGASON, CHAIRMAN

Sigurður Helgason was born in 1946 and has been a Member of the Board of Directors at Finnair since 2007. He was President & CEO of Flugleidir/FL-Group/Icelandair 1985–2005. He was Director Cash Management 1974–1980, Senior Vice-President Finance 1980–1983, General Manager The Americas 1983–1985 for Flugleidir/Icelandair. He was Chairman of the Board of The Icelandic International Development Fund 2005–2008. He is the Chairman of the Icelandair Special Children Travel Fund since 2005. He was a member of the IATA board of Governors 2004/2005. He graduated with a MBA degree from The University of North Carolina, Chapel Hill, USA in 1973 and a Cand. Oecon. degree from the University of Iceland in 1971. He joined the Board on 6 August 2009.



### ■ FINNBOÐI JÓNSSON, DEPUTY CHAIRMAN

Finnboði Jónsson was born in 1950 and is the former CEO of the Icelandic Enterprise Fund. He was the CEO of the The New Business Venture Fund from 2006. Finnboði was the CEO of SR-Mjöl from 2003–2006. Finnboði has for the past 25 years held various managerial positions within the Icelandic fishing industry. Finnboði has also held various board positions, mainly within the fishing industry and related businesses. Finnboði is the Chairman of the Board of Eignarhaldsfélagið Vestia ehf. and Gogo Holding slhf. He holds a degree in engineering and business from the University of Lund in Sweden. He joined the Board on 15 September 2010.



### ■ HERDÍS DRÖFN FJELDSTED

Herdís Dröfn Fjeldsted was born in 1971 and is the Investment Manager at Framtakssjodur Islands, holds a BSc degree in business administration and a MSc degree in corporate finance from Reykjavik University 2010. She is also a certified securities broker. Herdis joined Framtakssjodur Islands after about six years in the private equity industry. Most recently, Herdis was a member of the investment team at Thule Investments. Her job there consisted of investment analysis, negotiations and active participation in individual companies owned by the fund. Herdis is Chairman of the Board of Wave Operations and Board Director of Icelandair Group. She joined the Board on 14 December 2010.



### ■ KATRÍN OLGA JÓHANNESDÓTTIR

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



### ■ ÚLFAR STEINDÓRSSON

Úlfar Steindórsson was born in 1956 and is the CEO of Toyota in Iceland and Jú ehf. He was the CEO of Primex ehf. in Siglufjordur from 2002–2004, and the CEO of the New Business Venture Fund from 1999–2002. Úlfar is the Chairman of the Board of Bifreiðainnflutningur ehf., Bílaútleigan ehf., Okkar bílaleiga ehf., and TK bílar ehf. Úlfar is a board member of Blue Lagoon International Ltd, Bláa Lónið hf., Blue Lagoon international ehf., Eldvörp ehf., Hótel Bláa lónið ehf., Hreyfing Eignarhaldsfélag ehf., Johan Rönning hf., Kraftvélar ehf., Motormax ehf., S.Guðjónsson ehf., Skorri ehf., and UK fjárfestingar ehf. Úlfar holds a Cand. Oecon from the University of Iceland and a MBA from Virginia Commonwealth University. He joined the Board on 15 September 2010.

**Alternate Board Members:** Anna Guðný Aradóttir, Auður Björk Guðmundsdóttir, Magnús Magnússon.

## The Board of Directors, continued:

### EXECUTIVE COMMITTEE:

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Björgólfur Jóhannesson,  
President and CEO

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Bogi Nils Bogason, CFO

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Magnea Pórey Hjálmarsdóttir,  
Managing Director  
of Icelandair Hotels

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Birkir Hólm Guðnason,  
CEO of Icelandair

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

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

The Company's Board of Directors must at all times ensure that there is adequate supervision of the Company's accounts and the 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 President and CEO has charge of the day-to-day operation of the Company and is required in his work to observe the policy and instructions set out by the Company's Board of Directors. Day-to-day operation does not include measures which are unusual or extraordinary. Such measures can only be taken by the President and CEO with the specific authorization of the Board of Directors, unless it is impossible to await the decision of the Board without seriously disadvantaging the operation of the Company. In such instances, the President and CEO is required to consult with the Chairman of the Board, if possible, after which the Board of Directors must immediately be notified of the measures. The President and CEO shall ensure that the accounts and finances of the Company conform to the law and accepted practices and that all assets belonging to the Company are

securely safeguarded. The President and CEO is required to provide the members of the Board of Directors and Company auditors with any information pertaining to the operation of the Company which they may request, as required by law.

The Company's Board of Directors consists of five members and three 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 Deputy 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 President and CEO. Meetings of the Board are valid if attended by a majority of its members. However, important decisions shall not be taken unless all members of the Board have had an opportunity to discuss the matter, if possible. The outcome of issues is decided by force of vote, and in the event of an equality of votes, the issue is regarded as rejected.

President and CEO attends meetings of the Board of Directors, even if he or she is not a member of the Board, and has the right to participate in discussions and submit proposals unless otherwise decided by the Board in individual cases. A book of minutes is kept of proceedings at meetings and must be signed by participants in the meeting. A Board member who disagrees with a decision made by the Board of Directors is entitled to have his or her dissenting opinion entered in the book of minutes. The same applies to the President and

CEO. The Chairman is responsible for the Board's relations with the shareholders and he shall inform the Board on the views of the shareholders.

On 12 September 2007 the Board of Directors approved Rules on Working Procedures for the Board of Directors that was amended on 15 November 2010. The Rules on Working Procedures are accessible to the Board of Directors and the management through the Board's intranet, Coredata. In accordance with article 14 of the Rules on Working Procedures the Board of Directors must annually evaluate its work, size, composition and practices, and must also evaluate the performance of the CEO and others responsible for the day-to-day management of the Company and its development. The annual performance assessment is intended to improve working methods and increase the efficiency of the Board. The assessment entails e.g. evaluation of the strengths and weaknesses of the Board's work and practices and takes into consideration the work components which the Board believes may be improved.

The Board of Directors elects the members of the two sub-committees; the Compensation Committee and the Audit Committee. The sub-committees adhere to the Rules on Working Procedures. The Board of Directors convenes on average twelve times a year. The Board of Directors however convened eleven times in the year and all Board Members attended almost all meetings. All the Members of the Board of Directors are independent from the Company. Sigurdur Helgason, Katrin Olga Johannesdottir and Ulfar Steindorsson were independent from the Company's major shareholders in 2011. ■

■ *The annual performance assessment is intended to improve working methods and increase the efficiency of the Board. The assessment entails e.g. evaluation of the strengths and weaknesses of the Board's work and practices and takes into consideration the work components which the Board believes may be improved.*

## Shareholder Information

Icelandair Group's objective is to create value for its shareholders. In 2011 the Company's shares increased in value by 60% and earnings per share were ISK 0.89. The market capitalization of the Company was ISK 25.2 billion at year end.

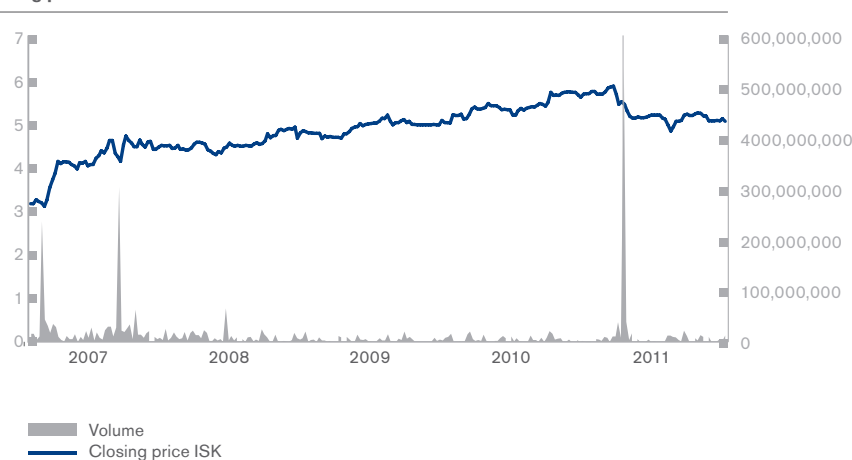
### SHARE CAPITAL

Icelandair Group's share capital on 31 December 2011 amounted to ISK 5,000 million in nominal value. All shares are of the same class and hold equal rights; each share has a nominal value of ISK 1 and entitles its holder to one vote. The Company held own shares in the amount of ISK 25 million at year-end 2011. The shareholders' capital was increased by ISK 4,000 million shares during 2010. The Group shares are listed under the code ICEAIR on the NASDAQ OMX Iceland.

### SHARE PRICE AND MARKET CAPITALIZATION

Over the year the Icelandair Group share price rose from ISK 3.15 to ISK 5.03, an increase of 60%. The highest closing price in 2011 was ISK 5.84 per share, the lowest closing price was ISK 3.09 per share and the average closing price over the year was ISK 4.85 per share. Icelandair Group's market capitalization by the end of 2011 reached ISK 25.2 billion.

Closing price and traded volume | 2007–2011



	2007	2008	2009	2010	2011
Market Capitalization million .....	27,750	13,250	3,650	15,750	25,150
Share price at year-end .....	27.8	13.3	3.7	3.2	5.0
Highest closing price .....	31.1	28.0	13.4	3.9	5.8
Lowest closing price .....	22.3	12.9	1.8	2.8	3.1
No. of issued shares million .....	1,000	1,000	1,000	5,000	5,000
No. of outstanding shares million .....	981	975	975	4,975	4,975
<b>Average no. of outstanding shares million .....</b>	<b>991</b>	<b>978</b>	<b>975</b>	<b>1,486</b>	<b>4,975</b>

**KEY RATIOS**

Icelandair Group reported net shareholder earnings of ISK 4.5 billion in 2011, corresponding to ISK 0.89 earnings per share. The Company's total equity at year-end was ISK 32.3 billion. The P/E ratio at the same time was 5.7 and the P/B ratio was 0.8.

All amounts in ISK	2007	2008	2009	2010	2011
Earnings per share ISK .....	0.3	-7.6	-10.9	3.1	0.9
Equity per share ISK .....	25.5	20.6	15.0	5.7	6.5
P/B ratio .....	1.1	0.7	0.2	0.6	0.8
P/E ratio .....	111.0	-1.7	-0.3	1.0	5.7
Number of shareholders .....	1,273	851	834	871	1,269

**SHAREHOLDERS**

At the end of 2011 the number of shareholders was 1,269, as compared to 871 at the beginning of the year. 0.8% of the total shareholder base held 78.3% of the shares in the Company.

Shareholding	No. of shareholders	% of total shareholders	No of shares	% of total share capital
1-10,000 .....	434	34.2%	1,934,339	0.0%
10,001-100,000 .....	435	34.3%	12,553,414	0.3%
100,001-1,000,000 .....	285	22.5%	92,538,620	1.9%
1,000,001-10,000,000 .....	79	6.2%	251,829,610	5.0%
10,000,001-100,000,000 .....	26	2.0%	728,206,507	14.6%
100,000,001 + .....	10	0.8%	3,912,937,510	78.3%
<b>Total .....</b>	<b>1,269</b>	<b>100.0%</b>	<b>5,000,000,000</b>	<b>100.0%</b>

**DIVIDEND AND DIVIDEND POLICY**

Icelandair Group's goal is to pay 20-40% of each year's net profit as dividend. Final annual dividend payments will be based on the financial position of the Company, operating capital requirements and market conditions. The Board of Directors of Icelandair Group proposes to pay a dividend of ISK 0.8 billion to shareholders in 2012.

**INVESTOR RELATIONS**

It is the objective of Icelandair Group to ensure that timely and correct information about the Company is made available to all interested parties simultaneously, regularly and consistently. All press releases, financial disclosures and company announcements are published through GlobeNewswire, a NASDAQ OMX company.

The Investors' website at [www.icelandairgroup.com/Investors](http://www.icelandairgroup.com/Investors) provides extensive news and background information on Icelandair Group for both analysts and investors. The site contains archived regulatory announcements, financial reports and presentations, shareholder information, share price information, dividend policy and the financial calendar. ■

**FINANCIAL CALENDAR**


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Q1 2012 – week 18 2012

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Q2 2012 – week 32 2012

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Q3 2012 – week 44 2012

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Q4 2012 – week 06 2013

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**DID YOU KNOW ...** that there are 13,000 km of roads that will take you deep into the uncharted wilderness of Iceland



## Icelandair Group and the Community

Icelandair Group companies support a wide variety of projects throughout the year. They are the main sponsors of various events and directly support the activities of a number of organizations. Beyond these they also support many smaller organizations and events each year.

### SPECIAL CHILDREN TRAVEL FUND

The main objective of this fund is to help children suffering from long-term illness or other difficult circumstances to see something of the world. The fund is supported both directly by Icelandair and through the generous gifts of our customers. We estimate that each year the Icelandair Travel Fund will enable 20 children and their families, from all over the world, to go on their "dream journey". Vigdis Finnbogadóttir, former president of Iceland, is the protector of the fund. For more details see [www.vildarborn.is](http://www.vildarborn.is)

### ICELAND MUSIC EXPERIMENTS

Icelandair is proud to offer young and talented musicians an opportunity to shine through Iceland Music Experiments (IME). IME is a musical event where young people make their musical debut and get their first chance to step into the limelight and play their music. Icelandair rewards IME victors by offering them the opportunity to perform at the annual Iceland Airwaves festival.

### ICELAND AIRWAVES

Icelandair is the founder and main sponsor of the Iceland Airwaves (or Icelandair waves as some of us like to spell it) music festival held in October each year in Reykjavik. Iceland Airwaves is an annual music event that started out in 1999 as a talent show for foreign record company executives; since then Airwaves has grown and blossomed and is now an integral part of the cultural life in Reykjavík. The fruits of the festival's labour have been ripening and today many Icelandic artists, such as Quarashi, Sigur Ros, Apparat Organ Quartet, Trabant, Of Monsters and Men and more, have made their way to the international music scene.

For more details see the festival website [www.icelandairwaves.com](http://www.icelandairwaves.com)

### REYKJAVIK AIRBRIDGE

Icelandair supports Icelandic musical talent beyond Iceland Airwaves. Through cooperation with the city of Reykjavik, Icelandair has established a fund that helps Icelandic musicians to market themselves abroad. This allows them to tour and/or engage in other marketing activities outside Iceland.

### FOOD AND FUN

Food and Fun is an event which combines outstanding culinary skills, fresh natural ingredients, Icelandic outdoor adventure and the world-famous Reykjavik nightlife to create the ultimate recipe for fun. The core element of the festival involves world acclaimed chefs who collaborate with Reykjavik's best restaurants. Each chef is assigned to one of the participating restaurants, where they prepare a special menu, made out of Icelandic ingredients only. The menu is presented at all the restaurants for an entire week. In addition, the chefs themselves are on site for three nights during the festival week. Icelandair is the founder and owner of the Food and Fun event. More details online at [www.foodandfun.is](http://www.foodandfun.is)

### EYRARRÓSIN

Air Iceland is the principal sponsor of Eyrarrós – a prize given annually to enterprises or persons who have made outstanding contributions to cultural activities in rural Iceland.

### WORLD CHAMPIONSHIP OF THE ICELANDIC HORSE

Icelandair Cargo is the principal sponsor of the World Championship of the Icelandic Horse, which is held annually at various locations in Europe.

### THE NATIONAL OLYMPIC AND SPORTS ASSOCIATION OF ICELAND

The National Olympic and Sports Association of Iceland (ISI) is the only comprehensive organisation of the sports movement in Iceland and the supreme authority in all voluntary sports activities in Iceland under the Sports Act. ISI organises and oversees Iceland's participation in the Olympic Games, Games of the Small States of Europe and other sports events held under the auspices of the International Olympic Committee (IOC). Icelandair has been a long-time supporter of ISI and is one of the four companies forming the ISI Olympic Family.

### ICELANDIC HANDBALL FEDERATION

The Icelandic Handball Federation has sent its athletes across the world in team colours that prominently feature the Icelandic flag and the Icelandair Logo. Team handball is an extremely popular sport in Iceland, and Icelandic players have achieved outstanding results, both in Iceland and abroad. The Icelandic men's team took the silver at the Beijing Olympics in 2008 and the bronze at the European Championship in Austria in 2010.

### ICELAND FOOTBALL ASSOCIATION

The Iceland Football Association (KSI) was founded in 1947 and Icelandair has been a long-time reliable sponsor of the Association. The Icelandic national teams, the men's and women's A-teams and the U21, U19 and U17 teams fly with Icelandair with the company's logo on their travel attire.

### ICELAND BASKETBALL ASSOCIATION

The Iceland Basketball Association is responsible for all basketball activities in Iceland, and Icelandair sponsors the Association and its affiliated basketball teams in competitions in Iceland and abroad. Basketball is one of the world's most popular sports; it is also popular in Iceland and the national team has been competing with growing success.

### ICELANDIC GOLF ASSOCIATION

Golf is an extremely popular sport in Iceland, and the Icelandic Golf Association is one of the largest sports associations in Iceland. Icelandair has actively supported the work of the association in recent years and Icelandic elite golfers have flown with Icelandair and borne the company's logo on their competition attire. Icelandair has focused on providing golfers with the services that they need and the successful co-operation with the Icelandic Golf Association is a good example of these services.

### ICELAND SPORTS ASSOCIATION FOR THE DISABLED

The Iceland Sports Association for the Disabled (IF) is the supreme authority in sports for the disabled under the auspices of the National and Olympic Sports Association of Iceland IF organises and oversees Iceland's participation in the Paralympics, the Special Olympics and other major sports events for disabled athletes. Icelandair has supported the IF for 25 years and is one of the associations five largest sponsors and partners. ■

■ *We estimate that each year the Icelandair Travel Fund will enable 20 children and their families, from all over the world, to go on their "dream journey". Vigdis Finnbogadóttir, former president of Iceland, is the protector of the fund.*

## Environment

Icelandair Group aims to create long-term growth in shareholder value through sustainability. The Company's focus is therefore on high quality resource management in all its operations, which leads to a reduced environmental impact and lower costs.

For airlines, improvements in environmental matters can be made primarily in three key areas. The first is aircraft fuel consumption, as fuel combustion causes a rise in carbon dioxide levels, which is associated with global climate change. The second is the noise generated by air traffic at airports, which can impair the quality of life of residents on the ground. The third is the emission of pollutants by aircraft engines.

### FUEL CONSUMPTION AND FUEL EFFICIENCY

Icelandair is aware of the importance of conserving fuel and minimizing CO<sub>2</sub> emissions. Icelandair monitors and evaluates all new ideas and solutions in this regard and all departments participate in this activity. The main goal of the Icelandair Fuel Management Committee is to reduce fuel burn and thereby emissions of CO<sub>2</sub>. During the past few years numerous changes have been made to both the company's operation and its aircraft. For example, most aircraft are now fitted with winglets that reduce fuel burn by approximately 3.5%. For weight reduction purposes, paper has been removed, new, lighter flight instruments have been installed, lighter trolleys are used and less water is carried in the water tanks. Lighter aircraft means less fuel consumption. The aircraft are thoroughly cleaned on a regular basis to reduce drag. Last year, the Icelandair Fuel Management Committee published a booklet for pilots with improved procedures for fuel saving.

### AIRCRAFT NOISE

International requirements in this field are laid down in ICAO Annex 16, "Environmental Protection", Vol. I, which prescribes certain maximum noise levels for aircraft at three designated noise-measuring points. All aircraft operated by Icelandair have since October 1990 fully complied with the most stringent

international requirements of ICAO Annex 16, Vol. I.

### AIRCRAFT ENGINE EMISSIONS

According to ICAO Annex 16, "Environmental Protection", Vol. II, unburned hydrocarbons (HC), carbon monoxide (CO), oxides of nitrogen (Nox) and smoke emitted by aircraft engines must be controlled. All aircraft operated by Icelandair have since October 1990 fully complied with the most stringent requirements of ICAO Annex 16, Vol. II concerning aircraft engine emissions.

### ENVIRONMENTAL CERTIFICATION OF ICELANDAIR HOTELS

Environmental certification demonstrates that Icelandair Hotels take its environmental and social responsibility seriously. Icelandair Hotel Reykjavik Natura has been selected as the pilot hotel for the ISO 14001 certification, certified by BSI.

This certification recognizes our actions in the following areas:

- Reduction of our water consumption
- Reduction of our energy consumption and promotion of renewable energy
- Implementation of waste sorting
- Raising awareness among our team members, suppliers and customers of respect for the environment and of the need to take concrete action in everyday life.

The second and final phase of implementation will be completed in May 2012. The ISO will then be rolled out across all of the other hotels within the chain. ■

## Iceland Tops the World in Air Connectivity

The Oxford Economics report focuses on the 'economic footprint' of the industry, measured by its contribution to GDP, jobs and tax revenues generated by the sector and its supply chain, and also the benefits created for the customers, passengers and shipper using the air transport service – in addition to the assets generated by connections between cities and markets.

On the whole, the results show that the importance of the aviation sector to the Icelandic economy is unmatched anywhere in the world. Icelandic-based airlines, Icelandair, Icelandair Cargo and Air Iceland, represent 78% of the air services of Iceland, and Icelandair's hub and spoke network to North-American and European cities is the key to the country's thriving aviation and tourism industries. The wages, profits and tax revenues created by these airlines flows through the Icelandic economy, generating multiplier effects on Icelandic national income or GDP.

### **BRIAN PEARCE, IATA CHIEF ECONOMIST COMMENTED ON THE REPORT:**

"Iceland's economic recovery since the banking crisis has been encouraging, and the Benefits of Aviation study shows that air transport is integral to economic growth and employment in Iceland. With a percentage GDP contribution to the economy considerably beyond that of any other nation, it is clear that Iceland will

benefit from policies that place aviation at the very centre of the nation's economy. Each 10% improvement in connectivity relative to GDP increases the long-term productive capacity of the Icelandic economy by ISK 983 million, so it is clear that a healthy aviation sector will be crucial to Iceland's continuing recovery."


### **SUBSTANTIAL ECONOMIC FOOTPRINT OF AVIATION IN ICELAND**

Aviation leaves a significant footprint on Iceland's economy, supporting 6.6% of Icelandic GDP and 9,200 jobs, or 5.5% of the Icelandic workforce. If the sector's contribution to the tourism industry is included, these figures rise to 12.9% of Icelandic GDP and 20,600 jobs, or 12.3% of the workforce. In comparison to this 12.9% figure in Iceland, Norway's aviation industry represents 2.6% of GDP, Sweden's 3.9% and Denmark's 2.3%.

Also significant is the fact that these are high-productivity jobs. The annual value added (or GVA) of each employee in air transport services in Iceland is ISK 16.0 million, approximately 1.7 times higher than the Icelandic average of ISK 9.2 million. Altogether, these points demonstrate that aviation provides significant economic benefits to the Icelandic economy and to Icelandic citizens. ■

IATA recently published a new report prepared by the research company Oxford Economics on the importance of aviation for the Icelandic economy. The report shows that as regards air connectivity Iceland scores the highest among 52 countries measured on the same scale. In addition, the number of jobs created by the industry and the impact of air transport on the economy of Iceland seems unique in its scope, relative to GDP.





**DID YOU KNOW ...** that Iceland was the first country in the world to have a democratically elected female head of state

## Employees

One of the principal strengths of Icelandair Group is the quality and dedication of its employees and their shared sense of being part of a team. The diverse nature of our operations requires a broad range of skills and knowledge that benefits the Group as a whole. In order to continue to grow and remain successful we must provide our employees with attractive and challenging opportunities to contribute to the team.

Recent years have provided an ample demonstration of what a great asset we have in our employees. Ever since the financial crisis of 2008, which hit Iceland especially hard, and through two volcanic eruptions that put a strain on our services, our employees have shown admirable resilience. Through hard work, flexibility, drive, initiative and, above all, great team spirit, they have shown their commitment to the Company. We, in turn, are equally committed to our employees.

We constantly try to maintain the strong culture that is needed to link different corporate units and employees and instil a team spirit. Iceland has always been and still remains our home base. We make every effort to bring all our employees, from all companies within the Group, in Iceland and abroad, into our family.

After the financial crisis of 2008 forced us to make severe cuts in the size of our staff we quickly started growing again. The number of employees (full-time equivalents or FTEs) at Icelandair Group is around 200 FTEs less than in 2007, with most of the decrease at Icelandair, or 113 FTEs.

### Icelandair Group employees, full-time equivalents (FTEs), by company

	FTEs Jan. 2011	FTEs Jul. 2011
Icelandair .....	1,041	1,390
IGS .....	306	522
Icelandair Cargo .....	35	42
Icelandair Hotels ...	210	524
Iceland Travel .....	69	82
Loftleiðir .....	11	11
Air Iceland .....	208	257
Icelandair Shared Services .....	102	108
Icelandair Group ...	12	14
<b>Total .....</b>	<b>1,995</b>	<b>2,950</b>

### Icelandair Group employees (average FTEs) by company | 2007–2011

	2007	2008	2009	2010	2011
Icelandair .....	1,292	1,179	1,028	981	1,179
IGS .....	491	435	343	354	386
Icelandair Cargo .....	64	57	49	37	44
Icelandair Hotels .....	242	247	218	234	313
Iceland Travel .....	53	63	64	71	76
Loftleiðir .....	9	8	10	11	11
Air Iceland .....	276	269	231	225	224
Icelandair Shared Services .....	102	97	95	101	105
Icelandair Group .....	15	15	15	14	13
<b>Total .....</b>	<b>2,544</b>	<b>2,369</b>	<b>2,053</b>	<b>2,028</b>	<b>2,350</b>

**RECRUITMENT**

We are one of Iceland's largest private employers and offer a broad range of jobs for highly trained professionals at competitive salaries in an international working environment. We enjoy a great deal of goodwill among Icelanders and inspire loyalty and pride in those that land a job with us. We have therefore been able to recruit well-qualified personnel from a large pool of talented and dedicated individuals who are eager to work for the Company.

To meet our special needs we have designed a thorough and tailored recruitment process to ensure that we select the people who are best suited for each specific type of job, not only based on professional qualifications, but also on our perception of how they will fit into our results-driven corporate culture. Because of the seasonality of our business we need to take on more than 900 extra staff over the high tourist season in Iceland. It's an indication of their commitment and pride that the same people return to work for us year after year. Many later join us as full-time employees, having already acquired a measure of knowledge of the business and gained faith in the Company.

**PROFESSIONAL DEVELOPMENT**

The Company places a high priority on the professional development of its employees. We want to make the best use of the talents of the people we have recruited and we want to employ the kind of people who find satisfaction in developing their skills, adding to their knowledge, and then putting these skills and knowledge to meaningful use in their work. To this end we provide our employees with a variety of training opportunities and courses that suit their needs. One aspect of our policy is to recruit a large part of our management team from within the Company. This ensures that our managers are steeped

in our culture and possess a thorough knowledge of the Company from the outset. Over the last three years more than 70% of new managers have been promoted from within our own ranks.

**JOB SATISFACTION**

The Company scores very high in employee surveys conducted biannually by an independent firm, Capacent Gallup. In both job satisfaction and employee loyalty and pride (commitment) we are among the top companies in our market. This is borne out by the low employee turnover rate for Icelandair, or 4.2% (which includes 3.2% due to retirement and other 'natural' causes). At present, the average employee has worked for Icelandair Group for 12 years, while for Icelandair the figure is 17 years. All of this despite our having gone through some extremely difficult times in recent years, which have severely tested the mettle of our employees.

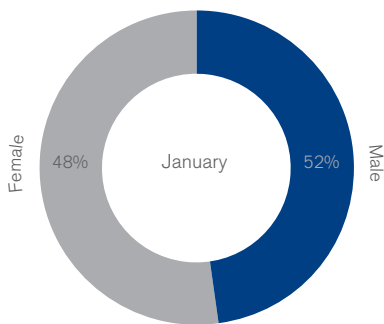
**Employees, by job tenure**

31.12.2011	Average employment
Icelandair .....	16.7
IGS .....	8.5
Icelandair Cargo .....	14.9
Icelandair Hotels .....	4.0
Iceland Travel .....	8.4
Loftleiðir .....	11.5
Air Iceland .....	9.6
Icelandair Shared	
Services .....	14.7
Icelandair Group .....	11.9
<b>Average employment</b>	
<b>in years IG: .....</b>	<b>12.2</b>

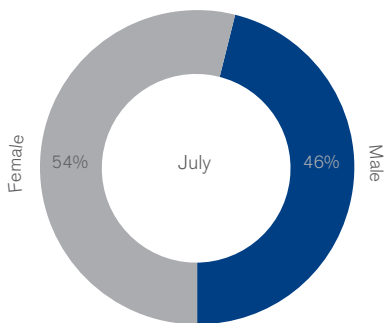
■ *We are one of Iceland's largest private employers and offer a broad range of jobs for highly trained professionals at competitive salaries in an international working environment. We enjoy a great deal of goodwill among Icelanders and inspire loyalty and pride in those that land a job with us.*

## Employees, continued:

Male / female ratio Icelandair Group  
January 2011



Male / female ratio Icelandair Group  
July 2011



### COMMUNICATION

Communicating information is an important factor in achieving employee commitment and maintaining a team spirit within the company. This is especially important in our case, because our operations are so diverse and dispersed over so many countries. Constantly providing employees with timely and accurate information on the Company affairs demonstrates our commitment to them. Information is shared through newsletters, employee meetings and over the company intranet, MyWork, which also acts as a conduit for sharing work-related knowledge between employees.

The Company's employees represent a great reservoir of experience and knowledge. In MyWork we have created a way to store this reservoir and channel it efficiently so that those who need it can tap into it at will. MyWork is steadily being enhanced and improved. By giving employees easy access to the information they need, when they need it, efficiency is improved and greater job satisfaction achieved, saving both time and money.

In addition to this, we hold regular meetings with employees where they can discuss their ideas and concerns directly with top management, including the CEO. Through such exchanges we are able to build trust between employees and management, which in turn is the basis for achieving maximum results.

### HR STRATEGY

The Company seeks to attract qualified personnel who can help us meet the challenges of the future, yet possess the same qualities as those employees who have served us so well in the past. We try to create a superior workplace, challenging and demanding, yet also welcoming and satisfying, that will attract ambitious and qualified people so that we are always able select the best person for

every job. We welcome diversity in our workforce, with equality and non-discrimination being an integral part of our HR strategy. We place great emphasis on all employees respecting our non-discrimination policy and conducting themselves accordingly and have put in place detailed action plans to ensure that our goals are met. We will encourage and assist our employees in maintaining their strengths as they acquire more skills and knowledge through training and experience. We will ensure that they receive equal opportunities to further their career. And, above all, we will make sure that all our employees will feel they are part of a team.

### CORPORATE CULTURE

The corporate culture of Icelandair Group is based on the awareness that the Company is engaged in providing an essential service, with every employee being important and part of a team and every customer of great value. We are also aware of being a big player in a small market and, at the same time, a small but unique player on the global scale. Our strengths have been flexibility, efficiency, responsiveness, drive and quick decision-making. Our culture is imbued with a can-do attitude, so that all our employees are able to flourish and achieve their highest potential. We know we need to be at our best so that we may serve our customers best.

Our conduct is the outward manifestation of our brand. What we do, what we say, and how we behave determines how our clients see us. ■

## Executive Committee

### ■ BJÖRGÓLFUR JÓHANNSSON,

PRESIDENT AND CEO OF ICELANDAIR GROUP

Before joining Icelandair Group Björgólfur was the CEO of Icelandic Group from March 2006. From 1992–1996 Björgólfur was the CFO of UA in Akureyri. He became the CEO of Síldarvinnslan in 1999 and served as the Director of Innovation and Development at Samherji from 1996, having worked as a chartered accountant for two auditing firms from 1980. Björgólfur served as the Chairman of the Board of the Federation of Icelandic Fishing Vessel Owners from 2003–2008. He graduated with a degree in Business Administration from the University of Iceland in 1983 and became licensed as a chartered accountant in 1985.



### ■ BOGI NILS BOGASON,

CFO OF ICELANDAIR GROUP

Bogi Nils started his career within Icelandair Group in October 2008. He was the CFO of Askar Capital from January 2007 until he joined Icelandair Group and the CFO of Icelandic Group from 2004–2006. Bogi Nils served as an auditor and partner at KPMG in Iceland during the years from 1993–2004. Bogi Nils holds a Cand. Oecon. degree in Business from the University of Iceland and became licensed as a chartered accountant in 1998.



### ■ BIRKIR HÓLM GUÐNASON,

CEO OF ICELANDAIR

Birkir Hólm Guðnason was appointed CEO of Icelandair in May 2008. Birkir has been with Icelandair since 2000, following his graduation from Aalborg University, Denmark. Birkir started out as Sales Manager in Iceland, then as Sales Manager in North America, and from there he transferred to Central Europe as General Manager, situated in Frankfurt. From 2006–2008 Birkir was the General Manager for Scandinavia, situated in Copenhagen. He graduated with an MBA degree in International Business Economics from Aalborg University, Denmark, in 2000.



### ■ MAGNEA ÞÓREY HJÁLMARSDÓTTIR

MANAGING DIRECTOR OF ICELANDAIR HOTELS

Magnea was appointed Managing Director in July 2005. She joined Icelandair Hotels in 1994 and held various positions with the hotels. Magnea has worked in the hotel industry since 1991 and held management positions at hotels in Iceland, Switzerland and Japan. She received her MBA from the University of Surrey, UK, in 2003.



## Subsidiaries Management



### ■ ÁRNI GUNNARSSON

MANAGING DIRECTOR OF AIR ICELAND

Árni was appointed Managing Director of Air Iceland in March 2005. He previously worked as Director of Sales and Marketing at Air Iceland, Managing Director at Ferdaskrifstofa Íslands / ITB, Managing Director of Iceland Travel and Director of Icelandair Holidays. He worked for the German Tour Operator FTI in Munich as director of Risk Management in 1993–1997. Árni holds an M.Sc. in Economics from Augsburg University, Germany.



### ■ GUÐNI HREINSSON

MANAGING DIRECTOR OF LOFTLEIDIR ICELANDIC

Guðni was appointed Managing Director of Loftleiðir Icelandic in July 2006. He joined Icelandair Group in 1997 as a marketing representative in Sales Control and from 2000–2003 he worked at the Icelandic Web Agency. In 2003 Guðni was appointed Director of Marketing at Loftleiðir Icelandic. Guðni holds a Bachelors degree in Humanistic Informatics & Communication from Aalborg University, Denmark.



### ■ GUNNAR MÁR SIGURFINNSSON

MANAGING DIRECTOR OF ICELANDAIR CARGO

Gunnar Már was appointed Managing Director of Icelandair Cargo in May 2008. Before that he was SVP of Sales and Marketing at Icelandair since 2005. Gunnar Már started at Icelandair Domestic in Vestmannaeyjar in 1986, and in 1994 he became Sales and Marketing Manager for Air Iceland. In 1997 he became Sales Manager for Icelandair in Germany, based in Frankfurt. Gunnar Már became Director of Sales Planning and Control in 2000 and in 2001 he became General Manager of the Germany, Netherlands & Central Europe regions, situated in Frankfurt. Gunnar Már has a degree in Business from the University of Iceland.

#### ■ GUNNAR S. OLSEN

##### MANAGING DIRECTOR OF ICELANDAIR GROUND SERVICES

Gunnar was appointed Managing Director of Icelandair Ground Services when an independent company was formed around Icelandair's ground services in Keflavík in 2001. Gunnar has been working for companies within the Group for decades, and has held various managerial positions, both in Iceland and abroad.



#### ■ HELGI EYSTEINSSON

##### MANAGING DIRECTOR OF FERIA

From January 2012 Helgi became the Managing Director of Feria which took over the outgoing operations of Iceland Travel, namely the brand names Vita and Ferd.is Helgi was appointed Managing director of Iceland Travel in June 2008. From 2006–2008 he worked at Glitnir Bank as a securities broker. Helgi was Director Sales & Marketing at Iceland Travel from 2004–2006. Before that he worked as an account manager at Íslenska Auglýsingastofan and Glitnir Bank. Helgi graduated with a degree in Business Administration from the University of Iceland in 1999.



#### ■ HÖRÐUR GUNNARSSON

##### MANAGING DIRECTOR OF ICELAND TRAVEL

Hörður Gunnarsson was appointed Managing Director of Iceland Travel in January 2012, but he has been working for subsidiaries of Icelandair Group for over 20 years. He first joined in 1990 as a Managing Director of Úrval Útsyn (later Ferdaskrifstofa Islands), an tour operator owned by the Group and held that position until 2006. From the year 2008 he was the chairman of the board of Iceland Travel, with the main task to build up the brand VITA, which since January 2012 is a independent subsidiary of Icelandair Group.




#### ■ MAGNÚS KR. INGASON

##### MANAGING DIRECTOR OF ICELANDAIR SHARED SERVICES

Magnús has been Managing Director of Icelandair Shared Services since its incorporation at the year-end 2002. He joined Icelandair Group in 1998 and previously served as Director of Icelandair Group's accounting department. Magnús received his Cand.Oecon. degree from the University of Iceland in 1993 and became chartered accountant in 1999.





A landscape photograph showing a valley with green hills and mountains under a cloudy sky. The foreground is a calm body of water reflecting the sky. The middle ground features rolling green hills and a prominent dark, conical mountain. The background shows a range of rugged mountains under a heavy, grey sky.

**DID YOU KNOW ...** that among OECD nations, Iceland has the highest number of Internet connections per capita

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

■ *According to the consolidated statement of comprehensive income, profit for the year 2011 amounted to ISK 4,452 million. Total comprehensive income for the year amounted to ISK 3,934 million. According to the consolidated statement of financial position, equity at the end of the year amounted to ISK 32,291 million, including share capital in the amount of ISK 4,975 million.*

### Operations in the year 2011

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

According to the consolidated statement of comprehensive income, profit for the year 2011 amounted to ISK 4,452 million. Total comprehensive income for the year amounted to ISK 3,934 million. According to the consolidated statement of financial position, equity at the end of the year amounted to ISK 32,291 million, including share capital in the amount of ISK 4,975 million. Reference is made to the notes to the consolidated financial statements regarding information on changes in equity.

The Board of Directors proposes a ISK 800 million dividend payment to shareholders in the year 2012.

### Share capital and Articles of Association

The share capital amounted to ISK 5,000 million at the end of the year, from which the Company held treasury 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 Company can purchase up to 10% of the nominal value of the shares of the Company according to the Company's Act.

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.

The number of shareholders at the end of the year 2011 was 1,269, a decrease of 209 from the beginning of the year. Three shareholders held more than 10% of outstanding shares each at year end 2011, Íslandsbanki hf. with 20.9% share, Framtakssjóður Íslands slhf. with 19.0% share and Lífeyrissjóður Verslunarmanna with 14.4% share.

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

### Corporate Governance

The Group's management is of the opinion that practicing good Corporate Governance is vital for the existence of the Group and is in the best interests of the shareholders, Group companies, employees and other stakeholders and will in the long run produce satisfactory profits on shareholders' investment.

The framework for Corporate Governance practices within the Group consists of the provisions of law, the parent company's Articles of Association, general securities regulations and the Icelandic Corporate Governance guidelines issued in 2009 by the Iceland Chamber of Commerce, Nasdaq OMX Iceland and the Confederations of Icelandic Employers. Corporate Governance practices ensure open and transparent relationships between the Company's management, its Board of Directors, its shareholders and other stakeholders.

Corporate Governance exercised in Icelandair Group hf. ensures sound and effective control of the Company's affairs and a high level of business ethics.

The Board of Directors has prepared a Corporate Governance statement in compliance with the Icelandic Corporate Governance guidelines which are described in full in the Corporate Governance Statement in the Financial Statements.

It is the opinion of the Board of Directors that Icelandair Group hf. complies with the Icelandic guidelines for Corporate Governance.

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

The annual consolidated financial statements for the year ended 31 December 2011 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 2011, its assets, liabilities and consolidated financial position as at 31 December 2011 and its consolidated cash flows for the financial year 2011.

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 2011 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, 9 February 2012

Board of Directors:

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Sigurður Helgason,  
Chairman of the Board

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Finnbogi Jónsson

---

Herdís Dröfn Fjeldsted

---

Katrín Olga Jóhannesdóttir

---

Úlfar Steindórsson

---

Anna Guðný Aradóttir

---

Auður Björk Guðmundsdóttir

CEO:

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Björgólfur Jóhannsson

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## 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., which comprise the consolidated statement of financial position as at 31 December 2011, the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### 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, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### 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 ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated 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 assess-

ments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated 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 31 December 2011, 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.

### Report on the Board of Directors report

Pursuant to the legal requirement under Article 106, Paragraph 1, Item 5 of the Icelandic Financial Statement Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the Financial Statements. ■

Reykjavík, 9 February 2012

KPMG ehf.

Alexander Eðvarðsson

Guðný H. Guðmundsdóttir

## **Consolidated Financial Statements**

## Consolidated Statement of Comprehensive Income for the year 2011

	Notes	2011	2010
<b>Continuing operation</b>			
<b>Operating income</b>			
Transport revenue .....	9	62,215	53,944
Aircraft and aircrew lease .....		16,749	19,972
Other operating revenue.....	9	17,970	14,099
		<u>96,934</u>	<u>88,015</u>
<b>Operating expenses</b>			
Salaries and other personnel expenses .....	10	22,809	20,415
Aircraft fuel .....		22,014	14,927
Aircraft and aircrew lease .....		10,290	11,866
Aircraft handling, landing and communication .....		7,121	6,103
Aircraft maintenance expenses .....		7,174	6,475
Other operating expenses .....	10	17,113	15,651
		<u>86,521</u>	<u>75,437</u>
<b>Operating profit before depreciation and amortisation (EBITDA)</b> .....		10,413	12,578
Depreciation, amortisation and impairment losses .....	12	( 5,678 )	( 6,324 )
<b>Operating profit (EBIT)</b> .....		4,735	6,254
Gain on disposals in relation to financial restructuring .....		0	4,245
<b>Profit before net finance costs</b> .....		4,735	10,499
Finance income .....		883	255
Finance costs .....		( 2,107 )	( 3,787 )
<b>Net finance costs</b> .....	13	( 1,224 )	( 3,532 )
Share of loss of associates, net of tax .....	20	( 11 )	( 391 )
<b>Profit before tax</b> .....		3,500	6,576
Tax income (expense) .....	23	584	( 1,458 )
<b>Profit from continuing operations</b> .....		4,084	5,118
<b>Discontinued operation</b>			
Profit (loss) from discontinued operation, net of tax .....	7	368	( 562 )
<b>Profit for the year</b> .....		<u>4,452</u>	<u>4,556</u>
<b>Other comprehensive income</b>			
Foreign currency translation differences of foreign operations .....		470	( 615 )
Foreign currency translation differences reclassified to profit or loss .....		( 1,199 )	( 2,120 )
Net profit on hedge of net investment in foreign operation, net of tax .....		142	49
Effective portion of changes in fair value of cash flow hedge, net of tax .....		69	274
<b>Other comprehensive loss for the year</b> .....		( 518 )	( 2,412 )
<b>Total comprehensive income for the year</b> .....		<u>3,934</u>	<u>2,144</u>

The notes on pages 91 to 121 are an integral part of these consolidated financial statements.

## Consolidated Statement of Comprehensive Income for the year 2011, continued:

	Notes	2011	2010
<b>Profit attributable to:</b>			
Owners of the Company .....		4,451	4,564
Non-controlling interests .....		1	( 8 )
<b>Profit for the year</b> .....		<u>4,452</u>	<u>4,556</u>
<b>Total Comprehensive income attributable to:</b>			
Owners of the Company .....		3,933	2,152
Non-controlling interests .....		1	( 8 )
<b>Total comprehensive income for the year</b> .....		<u>3,934</u>	<u>2,144</u>
<b>Earnings per share:</b>			
Basic earnings per share (ISK) .....	29	0.89	3.07
Diluted earnings per share (ISK) .....	29	0.89	3.07
<b>Earnings per share from continuing operations:</b>			
Basic earnings per share (ISK) .....	29	0.82	3.45
Diluted earnings per share (ISK) .....	29	0.82	3.45

The notes on pages 91 to 121 are an integral part of these consolidated financial statements.

## Consolidated Statement of Financial Position as at 31 December 2011

	Notes	2011	2010
<b>Assets:</b>			
Operating assets .....	14–17	33,859	27,594
Intangible assets and goodwill .....	18–19	21,659	21,212
Investments in associates .....	20	173	178
Long-term cost .....	21	761	918
Other long-term receivables and deposits .....	22	2,772	2,768
Non-current assets		59,224	52,670
Inventories .....	24	1,849	1,580
Trade and other receivables .....	25	14,518	14,180
Marketable securities .....	26	3,345	1,306
Cash and cash equivalents .....	27	9,735	11,688
Assets held for sale .....	8	795	2,815
Current assets		30,242	31,569
<b>Total assets</b>		89,466	84,239
<b>Equity:</b>			
Share capital .....		4,975	4,975
Share premium .....		18,967	19,013
Reserves .....		3,869	4,387
Retained earnings .....		4,451	0
Equity attributable to equity holders of the Company	28	32,262	28,375
Non-controlling interests .....		29	28
Total equity		32,291	28,403
<b>Liabilities:</b>			
Loans and borrowings .....	30–31	19,999	21,356
Other payables .....	32	3,332	4,745
Deferred tax liabilities .....	23	771	1,267
Non-current liabilities		24,102	27,368
Loans and borrowings .....	31	4,137	3,248
Trade and other payables .....	34	16,551	14,048
Deferred income .....	35	12,385	8,807
Liabilities held for sale .....	8	0	2,365
Current liabilities		33,073	28,468
Total liabilities		57,175	55,836
<b>Total equity and liabilities</b>		89,466	84,239

The notes on pages 91 to 121 are an integral part of these consolidated financial statements.

## Consolidated Statement of Changes in Equity for the year 2011

	Attributable to equity holders of the Company					Non-controlling interest	Total equity
	Share capital	Share premium	Other reserves	Retained earnings	Total		
<b>2010</b>							
Balance at 1.1.2010 . . . . .	975	25,450	6,899	( 18,755 )	14,569	36	14,605
<b>Total comprehensive income</b>							
Profit for the year . . . . .				4,564	4,564	( 8 )	4,556
Other comprehensive income			( 2,412 )		( 2,412 )		( 2,412 )
Total comprehensive income .	<u>0</u>	<u>0</u>	<u>( 2,412 )</u>	<u>4,564</u>	<u>2,152</u>	<u>( 8 )</u>	<u>2,144</u>
<b>Transactions with owners of the Company, recognised directly in equity Contributions by and distributions to owners of the Company</b>							
Share premium transferred to accumulated deficit . . . . .		( 14,091 )		14,091	0		0
Share capital increase . . . . .	4,000	7,654			11,654		11,654
Share based payments reversed			( 100 )	100	0		0
Total transactions with owners of the company . . . . .	<u>4,000</u>	<u>( 6,437 )</u>	<u>( 100 )</u>	<u>14,191</u>	<u>11,654</u>		<u>11,654</u>
Balance at 31 December 2010	<u>4,975</u>	<u>19,013</u>	<u>4,387</u>	<u>0</u>	<u>28,375</u>	<u>28</u>	<u>28,403</u>
<b>2011</b>							
Balance at 1.1.2011 . . . . .	4,975	19,013	4,387	0	28,375	28	28,403
<b>Total comprehensive income</b>							
Profit for the year . . . . .				4,451	4,451	1	4,452
Other comprehensive income			( 518 )		( 518 )		( 518 )
Total comprehensive income .	<u>0</u>	<u>0</u>	<u>( 518 )</u>	<u>4,451</u>	<u>3,933</u>	<u>1</u>	<u>3,934</u>
<b>Transactions with owners of the Company, recognised directly in equity Contributions by and distributions to owners of the Company</b>							
Share capital increase . . . . .		( 46 )			( 46 )		( 46 )
Total transactions with owners of the Company . . . . .		<u>( 46 )</u>			<u>( 46 )</u>		<u>( 46 )</u>
Balance at 31 December 2011	<u>4,975</u>	<u>18,967</u>	<u>3,869</u>	<u>4,451</u>	<u>32,262</u>	<u>29</u>	<u>32,291</u>

Changes in other reserves are provided in note 28.

The notes on pages 91 to 121 are an integral part of these consolidated financial statements.

## Consolidated Statement of Cash Flows for the year 2011

	Notes	2011	2010
<b>Cash flows from operating activities:</b>			
Profit for the year .....		4,452	4,556
Adjustments for:			
Depreciation and amortisation .....	12	5,678	6,324
Other operating items .....	44	2,411	2,009
		Working capital from operations	12,889
Net change in operating assets and liabilities .....	45	1,845	2,784
		Net cash from operating activities	15,673
<b>Cash flows to investing activities:</b>			
Acquisition of operating assets .....	14	( 8,117 )	( 2,190 )
Proceeds from the sale of operating assets .....		805	3,487
Acquisition of intangible assets .....	18	( 175 )	( 214 )
Prepaid aircraft acquisitions, increase .....		0	( 38 )
Cash of disposed subsidiaries, change .....		0	( 1,530 )
Cash of subsidiaries held for sale, change .....		5	( 22 )
Acquisition of long-term cost .....		( 3,574 )	( 2,573 )
Long-term receivables .....		70	( 1,126 )
Marketable securities .....		( 2,031 )	( 1,306 )
		Net cash used in investing activities	( 5,512 )
<b>Cash flows to financing activities:</b>			
Paid in share capital .....		2,601	5,407
Proceeds from long term borrowings .....		2,109	0
Repayment of long term borrowings .....		( 8,094 )	( 5,063 )
Proceeds from long term payables .....		0	252
Repayment of short term borrowings .....		0	( 645 )
		Net cash used in financing activities	( 49 )
<b>(Decrease) increase in cash and cash equivalents .....</b>		( 2,015 )	10,112
<b>Effect of exchange rate fluctuations on cash held .....</b>		62	( 333 )
<b>Cash and cash equivalents at beginning of the year .....</b>		11,688	1,909
<b>Cash and cash equivalents at 31 December .....</b>	27	9,735	11,688
<b>Investment and financing without cash flow effect:</b>			
Issued share capital .....		0	6,247
Changes in borrowings .....		0	( 11,199 )
Disposals of subsidiaries .....		0	7,600
Other receivables .....		0	( 2,648 )
Acquisition of operating assets .....		( 3,460 )	0
Change in trade and other payables .....		( 460 )	0
Proceeds from long term borrowings .....		3,920	0

Information on interest paid and received are provided in note 46.

The notes on pages 91 to 121 are an integral part of these consolidated financial statements.

Amounts are in ISK millions

## Notes

### 01 Reporting entity

Icelandair Group hf. (the "Company") is a public limited liability company incorporated and domiciled in Iceland. The address of the Company's registered office is at Reykjavíkurlugvöllur in Reykjavík, Iceland. The consolidated financial statements of the Company as at and for the year ended 31 December 2011 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 is primarily involved in the airline and tourism industry. The Company is listed on the Nasdaq OMX Iceland.

### 02 Basis of preparation

#### a. Statement of compliance

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

The consolidated financial statements were approved and authorised for issue by the Board of Directors on 9 February 2012.

#### 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 5.

#### c. Functional and presentation currency

These consolidated financial statements are 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, except when otherwise indicated.

#### 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 are revised and in any future periods affected.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are included in the following notes:

Note 19 | measurement of the recoverable amounts of cash-generating units

Note 21 | long-term cost

Note 23 | utilisation of tax losses

Note 36 | provisions and valuation of financial instruments

### 03 Significant accounting policies

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

#### a. Basis of consolidation

##### (i) Subsidiaries

Subsidiaries are entities controlled by the Group. 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) Loss of control

On the loss of control, the Group derecognises the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in profit or loss. If the Group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently it is accounted for as an equity-accounted investee.

## Notes, continued:

### 03 a. continued:

#### (iii) *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. Investment in associates are accounted for using the equity method and are recognised initially at cost. The cost of the investment includes transaction costs. The consolidated financial statements include the Group's share of the profit or loss and other comprehensive income 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 carrying amount of the interests that form part thereof, including any long-term investments is reduced to zero, and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the investee.

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

### b. 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. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortised cost in foreign currency translated at the exchange rate at the end of the year.

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

#### (ii) *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 operation is disposed of, in part or in full, the relevant amount in the foreign currency translation reserve within equity is transferred to profit or loss as part of the profit or loss on disposal.

Foreign currency differences are recognised in other comprehensive income, and presented in the foreign currency translation reserve (translation reserve) in equity. However, if the operation is a non-wholly owned subsidiary, then the relevant proportion of the translation difference is allocated to the non-controlling interests.

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 presented in the translation reserve in equity.

#### (iii) *Hedge of net investment in foreign operations*

The Group applies hedge accounting to foreign currency differences arising between the functional currency of the foreign operation and the Company's functional currency (ISK), regardless of whether the net investment is held directly or through an intermediate parent.

Foreign currency differences arising on the retranslation of a financial liability designated as a hedge of a net investment in a foreign operation are recognised in other comprehensive income to the extent that the hedge is effective, and are presented in the translation reserve within equity. 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 translation reserve is transferred to profit or loss as part of the gain or loss on disposal.

## Notes, continued:

### 03 continued:

#### c. Financial instruments

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

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

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

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

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

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

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

##### **Loans and receivables**

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

Loans and receivables comprise cash and cash equivalent and trade and other receivables.

##### **Cash and cash equivalents**

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

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

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

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

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

##### (iii) *Share capital*

###### *Ordinary shares*

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

###### *Repurchase and reissue of share capital*

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

## Notes, continued:

### 03 c. continued:

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

The Group holds derivative financial instruments to hedge its foreign currency, fuel price and interest rate risk exposures (see note 45). Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss as incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below. The Group holds no trading derivatives.

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

#### *Cash flow hedges*

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

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

#### *Other non-trading derivatives*

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

### d. Operating assets

#### (i) *Recognition and measurement*

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

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

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

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

#### (ii) *Aircraft and flight equipment*

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

#### (iii) *Subsequent costs*

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

#### (iv) *Depreciation*

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

## Notes, continued:

### 03 d. continued:

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

	<b>Useful life</b>
Aircraft and flight equipment .....	4–20 years
Engines .....	Cycles flown
Buildings .....	17–50 years
Other property and equipment .....	3–20 years

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

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

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

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

#### (ii) **Other intangible assets**

Other intangible assets acquired by the Group and have finite useful lives are measured at cost less accumulated amortisation and 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 years are as follows:

	<b>Useful life</b>
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 reporting date and adjusted if appropriate.

#### (iii) **Subsequent expenditure**

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

### f. Leased assets

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

### g. Inventories

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

## Notes, continued:

### 03 continued:

#### h. Impairment

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

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

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

##### (ii) *Non-financial assets*

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

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

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

An impairment loss is recognised if the carrying amount of an asset or 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.

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

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

##### i. *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 or distribution, 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 costs to sell. Any impairment loss on a disposal group is first 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 and losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss. Once classified as held for sale, intangible assets and operating assets are no longer amortised or depreciated.

Intangible assets and operating assets once classified as held for sale or distribution are not amortised or depreciated. In addition, equity accounting of equity-accounted investees ceases once classified as held for sale or distribution.

## Notes, continued:

### 03 continued:

#### j. Provisions

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

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

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

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

#### k. Deferred income

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

##### *Icelandair's frequent flyer program*

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

#### l. Operating income

##### (i) *Transport revenue*

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

##### (iii) *Other operating revenue*

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

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.

#### m. Lease payments

##### *Operating lease payments*

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

#### n. Finance income and finance costs

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

Finance costs comprise interest expense on borrowings, unwinding of 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.

## Notes, continued:

### 03 n. continued:

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

#### o. Income tax

Income tax on the profit or loss for the year comprises only deferred tax despite profit due to usage of carry forward tax losses. 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.

#### p. 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 on 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 year.

#### q. Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the year, 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.

#### r. Segment reporting

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

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

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

Segment capital expenditure is the total cost incurred during the period to acquire operating assets and intangible assets other than goodwill.

### 04 New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for periods beginning after 1 January 2012, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group.

## Notes, continued:

### 05 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 aircraft 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) *Trade and other receivables*

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

#### (iv) *Derivatives*

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

The fair value of interest rate swaps is based on broker quotes. 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.

#### (v) *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.

#### (vi) *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 services for which the points, granted through a customer loyalty programme, can be redeemed takes into account the expected redemption rate and the timing of such expected redemptions. Such amount is recognised as deferred income.

## Notes, continued:

### 06 Operating segments

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

The subsidiaries Bluebird Cargo ehf., IG Invest ehf. and 67% share in Icelase ehf. were divested at year end 2010 and are therefore only included in the segment reporting for 2010. A 30% share in Travel Service is defined as non-core operation and classified as held for sale. Investment in SmartLynx, previously classified as held for sale was sold in December 2011.

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

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

#### Route network

Six companies are categorised as being part of the Route Network: Icelandair, Icelandair Cargo, Loftleidir, Air Iceland, Icelandair Ground Services and Icelandair Shared Services. Bluebird Cargo, Icelase and IG Invest are also included in 2010 amounts.

#### Tourism services

Two companies are categorized as being part of the Tourism Services: Iceland Travel and Icelandair Hotels.

### Information on reportable segments

	Route network		Tourism services		Total	
	2011	2010	2011	2010	2011	2010
External revenue .....	87,270	81,235	9,265	6,691	96,535	87,926
Inter-segment revenue .....	19,545	18,652	160	135	19,705	18,787
Segment EBITDAR* .....	16,703	20,763	932	835	17,635	21,598
Segment EBITDA .....	10,164	12,793	133	129	10,297	12,922
Finance income .....	300	783	16	228	316	1,011
Finance costs .....	( 1,375 )	( 2,173 )	( 109 )	( 99 )	( 1,484 )	( 2,272 )
Depreciation and amortisation .....	( 5,341 )	( 6,111 )	( 196 )	( 206 )	( 5,537 )	( 6,317 )
Share of profit of equity accounted investees .....	1	( 391 )	( 9 )	0	( 8 )	( 391 )
Reportable segment profit (loss) before income tax .....	3,749	4,901	( 165 )	52	3,584	4,953
Reportable segment assets .....	70,530	62,105	2,846	2,130	73,376	64,235
Investment in associates .....	68	72	50	56	118	128
Capital expenditure .....	13,501	4,721	638	99	14,139	4,820
Reportable segment liabilities .....	54,331	47,981	2,411	1,557	56,742	49,538

\*EBITDAR means EBITDA before operating lease expenses.

## Notes, continued:

## 06 continued:

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

	2011	2010
<b>Revenue</b>		
Total revenue for reportable segments .....	116,240	106,713
Other revenue .....	399	89
Elimination of inter-segment revenue .....	( 19,705 )	( 18,787 )
Consolidated revenue .....	<u>96,934</u>	<u>88,015</u>
<b>Profit or loss</b>		
Total profit of reportable segments .....	3,584	4,953
Unallocated amounts:		
Gain on disposals in relation to financial restructuring .....	0	4,245
Corporate expenses .....	( 84 )	( 2,622 )
Consolidated profit from continuing operations before tax .....	<u>3,500</u>	<u>6,576</u>
<b>Assets</b>		
Total assets for reportable segments .....	73,376	64,235
Other assets .....	15,972	19,876
Investments in associates .....	118	128
Consolidated total assets .....	<u>89,466</u>	<u>84,239</u>
<b>Liabilities</b>		
Total liabilities for reportable segments .....	56,742	49,538
Other liabilities .....	433	6,298
Consolidated total liabilities .....	<u>57,175</u>	<u>55,836</u>

Other material items 2011	Reportable segment totals	Adjustments	Consolidated totals
Segment EBITDAR .....	17,635	116	17,751
Segment EBITDA .....	10,297	116	10,413
Finance income .....	316	567	883
Finance costs .....	( 1,484 )	( 623 )	( 2,107 )
Depreciation and amortisation .....	( 5,537 )	( 141 )	( 5,678 )
Share of loss of associates .....	( 8 )	( 3 )	( 11 )
Capital expenditure .....	14,139	1,187	15,326
<b>Other material items 2010</b>			
Segment EBITDAR .....	21,598	( 344 )	21,254
Segment EBITDA .....	12,922	( 344 )	12,578
Finance income .....	972	( 717 )	255
Finance costs .....	( 2,624 )	( 1,163 )	( 3,787 )
Depreciation and amortisation .....	( 6,317 )	( 7 )	( 6,324 )
Share of loss of associates .....	( 391 )	0	( 391 )
Capital expenditure .....	4,830	185	5,015

Amounts are in ISK millions

## Notes, continued:

### 07 Discontinued operation

On December 30th 2011 SmartLynx, previously classified as discontinued operations, was sold. SmartLynx's results for the year 2011 as discontinued operation are specified as follows:

Results of discontinued operation	2011	2010
Revenue	7,925	8,495
Expenses	( 8,268 )	( 9,767 )
Results from operating activities	( 343 )	( 1,272 )
Net finance costs	( 44 )	( 196 )
Income tax	( 1 )	0
Results from operating activities, net of income tax	( 388 )	( 1,468 )
Reversal of translation reserve	1,155	0
Guarantees of discontinued operation reversed	( 399 )	906
Profit (loss) for the year	<u>368</u>	<u>( 562 )</u>
Basic profit (loss) per share	0.07	( 0.38 )
Diluted profit (loss) per share	0.07	( 0.38 )
<b>Cash flows from discontinued operation</b>		
Net cash used in operating activities	( 265 )	( 789 )
Net cash used in investing activities	( 393 )	( 335 )
Net cash from financing activities	658	1,146
Net cash from discontinued operation	<u>0</u>	<u>22</u>

### 08 Assets and liabilities classified as held for sale

At year end 2011 assets held for sale consist of 30% share in Travel Service and one Dash 8 aircraft from Air Iceland.

Travel Service sale process started in 2011 and is expected to be finalized in the first half of 2012. The Group will receive the first ISK 0.5 million of the potential sale price, the creditors that participated in the financial restructuring of the balance sheet in 2010 will receive proceeds between ISK 0.5 billion ISK and ISK 1.6 billion ISK and the Group proceeds above ISK 1.6 billion.

In December 2011 an agreement on the sale of one Dash 8 aircraft was signed. The aircraft will be delivered in April 2012. Since the conditions for the sale have not been met in 2011, as the delivery of the aircraft has not taken place, the sale is not recognized in the 2011 Financial Statements. Assets held for sale are specified as follows:

Assets classified as held for sale	2011	2010
Operating assets	295	1,012
Intangible assets	0	20
Other non-current assets	0	682
Investment in other companies	500	500
Inventories	0	71
Trade and other receivables	0	436
Cash and cash equivalents	0	94
	<u>795</u>	<u>2,815</u>
<b>Liabilities classified as held for sale</b>		
Non-current loans and borrowings	0	1
Current loans and borrowings	0	517
Trade and other payables	0	1,700
Deferred income	0	147
	<u>0</u>	<u>2,365</u>

## Notes, continued:

**09 Operating income**

Transport revenue is specified as follows:

	2011	2010
Passengers .....	57,716	48,634
Cargo and mail .....	4,499	5,310
Total transport revenue .....	<u>62,215</u>	<u>53,944</u>

Other operating revenue is specified as follows:

Sale at airports and hotels .....	5,894	4,736
Revenue from tourism .....	5,712	3,996
Aircraft and cargo handling services .....	3,242	2,850
Revenue from maintenance and aircraft handling .....	1,021	1,092
Gain on sale of operating assets .....	316	0
Other operating revenue .....	1,785	1,425
Total other operating revenue .....	<u>17,970</u>	<u>14,099</u>

**10 Operating expenses**

Salaries and other personnel expenses are specified as follows:

Salaries .....	14,726	13,118
Contribution to pension funds .....	2,011	1,811
Other salary-related expenses .....	1,949	1,722
Other personnel expenses .....	4,123	3,764
Total salaries and other personnel expenses .....	<u>22,809</u>	<u>20,415</u>

Average number of full year equivalents .....	2,350	2,197
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Other operating expenses are specified as follows:

Operating cost of real estates and fixtures .....	1,957	1,780
Communication expenses .....	1,333	1,387
Advertising expenses .....	2,004	1,713
Booking fee and commission expenses .....	3,128	2,756
Cost of goods sold .....	1,899	1,401
Customer services .....	1,360	1,177
Tourism expenses .....	2,999	1,890
Other operating expenses .....	2,433	3,547
Total other operating expenses .....	<u>17,113</u>	<u>15,651</u>

**11 Auditors' fees**

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

Audit of financial statements .....	35	35
Review of interim accounts .....	4	10
Other services .....	9	15
Total auditors' fees .....	<u>48</u>	<u>60</u>

The above mentioned 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 3 million during the year 2011 (2010: ISK 10 million).

## Notes, continued:

### 12 Depreciation and amortisation

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

	2011	2010
Depreciation of operating assets, see note 14 .....	5,470	5,188
Amortisation of intangible assets, see note 18 .....	208	418
Impairment, see note 18 .....	0	718
Depreciation, amortisation and impairment losses recognised in profit or loss .....	5,678	6,324

### 13 Finance income and finance costs

Finance income and finance costs are specified as follows:

Interest income on bank deposits .....	154	102
Other interest income .....	729	153
Finance income total .....	883	255
Interest expense on loans and borrowings .....	1,355	3,239
Other interest expenses .....	73	134
Net foreign exchange loss .....	679	414
Finance costs total .....	2,107	3,787
Net finance costs .....	( 1,224 )	( 3,532 )

### 14 Operating assets

Operating assets are specified as follows:

	Aircraft and flight equipment	Buildings	Other property and equipment	Total
<b>Cost</b>				
Balance at 1 January 2010 .....	31,543	2,667	2,702	36,912
Additions through business combinations .....	6,861	0	0	6,861
Additions during the year .....	1,757	222	211	2,190
Sales and disposals during the year .....	( 4,592 )	( 53 )	( 595 )	( 5,240 )
Effect of movements in exchange rates .....	( 2,196 )	0	( 15 )	( 2,211 )
Balance at 31 December 2010 .....	33,373	2,836	2,303	38,512
Additions during the year .....	10,690	65	822	11,577
Sales and disposals during the year .....	( 2,774 )	0	( 31 )	( 2,805 )
Effect of movements in exchange rates .....	1,497	0	1	1,498
Assets classified as held for sale .....	( 469 )	0	0	( 469 )
Balance at 31 December 2011 .....	42,317	2,901	3,095	48,313
<b>Depreciation and impairment losses</b>				
Balance at 1 January 2010 .....	8,306	462	1,130	9,898
Depreciation for the year .....	4,649	148	391	5,188
Sales and disposals during the year .....	( 3,010 )	( 43 )	( 571 )	( 3,624 )
Effect of movements in exchange rates .....	( 533 )	0	( 11 )	( 544 )
Balance at 31 December 2010 .....	9,412	567	939	10,918
Depreciation for the year .....	4,899	163	408	5,470
Sales and disposals during the year .....	( 2,241 )	0	( 26 )	( 2,267 )
Effect of movements in exchange rates .....	520	0	2	522
Assets classified as held for sale .....	( 189 )	0	0	( 189 )
Balance at 31 December 2011 .....	12,401	730	1,323	14,454

## Notes, continued:

## 14 continued:

	Aircraft and flight equipment	Buildings	Other property and equipments	Total
At 1 January 2010 .....	23,237	2,205	1,572	27,014
At 31 December 2010 .....	23,961	2,269	1,364	27,594
At 31 December 2011 .....	29,916	2,171	1,772	33,859
Depreciation ratios .....	5–25%	2–6%	5–33%	

During the year the Group purchased four Boeing 757 aircraft of which three had been leased by the Group for a number of years. The Group also purchased two Dash 8 aircraft and an agreement was signed for significant improvement of the aircraft which involved replacing three engines. Of these improvements ISK 0,5 billion is still outstanding at year end 2011. The Dash 8 aircraft will be delivered for operation in February and April 2012.

## 15 Mortgages and commitments

The Group's operating assets including rotatable and consumable spare parts are mortgaged to secure debt. The remaining balance of the debt amounted to ISK 22,386 million at the end of the year 2011 (2010: ISK 22,834 million).

## 16 Insurance value of aircraft and flight equipment

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

	Insurance value		Carrying amount	
	2011	2010	2011	2010
Boeing – 12/8 aircraft .....	45,239	35,871	23,985	19,195
Other aircraft .....	7,601	6,805	2,211	1,164
Flight equipment .....	7,656	5,913	3,720	3,602
Total aircraft and flight equipment .....	60,496	48,589	29,916	23,961

## 17 Insurance value of buildings and other operating assets

The principal buildings owned by the Group at 31 December 2011 are the following:

	Official assessment		Insurance value		Carrying amount	
	2011	2010	2011	2010	2011	2010
Maintenance hangar, Keflavík .....	1,683	1,657	3,494	3,141	723	773
Freight building, Keflavík .....	392	388	846	736	321	334
Office building, Reykjavík .....	724	711	1,298	1,177	273	264
Service building, Keflavík .....	400	412	794	670	179	200
Other buildings in Reykjavík .....	550	570	1,123	1,025	266	285
Other buildings .....	386	370	1,127	1,008	409	413
Buildings total .....	4,135	4,108	8,682	7,757	2,171	2,269

Official valuation of the Group's leased land for buildings at 31 December 2011 amounted to ISK 818 million (2010: ISK 806 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 ISK 5,548 million at year end 2011 (2010: ISK 4,743 million). The carrying amount at the same time was ISK 1,915 million (2010: ISK 1,364 million).

## Notes, continued:

**18 Intangible assets and goodwill**

Intangible assets and goodwill are specified as follows:

	<b>Goodwill</b>	<b>Trademarks and slots</b>	<b>Customer relations</b>	<b>Other intangibles</b>	<b>Total</b>
<b>Cost</b>					
Balance at 1 January 2010 .....	23,038	4,805	639	1,138	29,620
Additions during the year .....	0	0	0	214	214
Sales and disposals during the year .....	( 4,395 )	( 315 )	( 19 )	( 190 )	( 4,919 )
Effect of movements in exchange rates .....	( 692 )	( 149 )	( 12 )	( 12 )	( 865 )
Balance at 31 December 2010 .....	17,951	4,341	608	1,150	24,050
Additions during the year .....	0	0	0	175	175
Sales and disposals during the year .....	0	0	0	( 106 )	( 106 )
Effect of movements in exchange rates .....	377	69	33	1	480
Balance at 31 December 2011 .....	18,328	4,410	641	1,220	24,599
<b>Amortisation and impairment losses</b>					
Balance at 1 January 2010 .....	4,726	319	380	597	6,022
Amortisation for the year .....	17	0	119	282	418
Amortisation for the year of discontinued operation .....	0	0	0	10	10
Impairment loss .....	322	370	26	0	718
Sales and disposals during the year .....	( 3,664 )	( 370 )	( 127 )	( 189 )	( 4,350 )
Effect of movements in exchange rates .....	0	0	29	( 9 )	20
Balance at 31 December 2010 .....	1,401	319	427	691	2,838
Amortisation for the year .....	0	0	41	167	208
Sales and disposals during the year .....	0	0	0	( 106 )	( 106 )
Balance at 31 December 2011 .....	1,401	319	468	752	2,940
<b>Carrying amounts</b>					
At 1 January 2010 .....	18,312	4,486	259	541	23,598
At 31 December 2010 .....	16,550	4,022	181	459	21,212
At 31 December 2011 .....	16,927	4,091	173	468	21,659

**19 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 acquisition dates. Goodwill and other intangible assets with indefinite live are specified as follows:

	<b>2011</b>	<b>2010</b>
Goodwill .....	16,927	16,550
Trademarks and airport slots .....	4,091	4,022
Total .....	21,018	20,572

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 cash generated unit (CGU) are as follows:

	<b>Goodwill</b>		<b>Trademarks and slots</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Route network .....	16,627	16,250	4,091	4,022
Tourism services .....	300	300	0	0
Total goodwill .....	16,927	16,550	4,091	4,022

## Notes, continued:

## 19 continued:

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

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

	Route network		Tourism services	
	2011	2010	2011	2010
Long term growth rate .....	3–4%	3–4%	4.0%	4.0%
Revenue growth:				
Weighted average 2011 / 2010 .....	12.5%	3.0%	26.2%	1.6%
2012–2016 / 2011–2015 .....	5.3%	5.6%	8.0%	15.0%
Budgeted EBITDA growth .....	3.4%	8.9%	16.8%	15.1%
WACC .....	7.5–13.4%	8.3–12.4%	10.4%	8.9–10.9%
Debt leverage .....	29–72%	27–73%	21.2%	54.7%
Interest rate .....	5.4–7.3%	6.0–7.0%	5.2%	3.3–5.3%

Changes in key assumptions would have the following impact on the carrying amount of goodwill:

	2011	2010
WACC +1% .....	( 276 )	0
EBITDA – 5% .....	0	0

No impairment loss is recognised in the Financial Statements.

## 20 Investments in associates

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

	Ownership	
	2011	2010
Ábyrg spilamennska ehf. ....	50%	50%
EBK ehf. ....	25%	25%
Gufa ehf. ....	28%	28%
Icelandair ehf. ....	33%	33%
Tjarnir ehf. ....	22%	22%
Assets .....	854	388
Liabilities .....	504	150
Revenues .....	167	66
Expenses .....	205	61
Net (loss) profit .....	( 38 )	5
Share of loss of associates .....	( 11 )	( 391 )

Amounts are in ISK millions

## Notes, continued:

### 21 Long-term cost

Long-term cost corresponds to amounts paid for engine overhauls and heavy maintenance of leased aircraft which is expensed over the lease period of the aircraft. Long-term cost is specified as follows:

	2011	2010
Long-term cost .....	1,398	1,498
Expensed in 2012 / 2011, classified as maintenance prepayments .....	( 637 )	( 580 )
Total long-term cost .....	<u>761</u>	<u>918</u>
Long-term cost will be expensed as follows:		
Expensed in 2011 .....	-	580
Expensed in 2012 .....	637	442
Expensed in 2013 .....	322	271
Expensed in 2014 .....	244	147
Expensed in 2015 .....	108	46
Expensed in 2016 .....	62	4
Subsequent .....	25	8
Total long-term cost, including current maturities .....	<u>1,398</u>	<u>1,498</u>

### 22 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 6.24% / 7.20% .....	33	70
Interest bearing receivable, interest rate 5% .....	994	1,344
Deposits .....	2,011	1,581
	<u>3,038</u>	<u>2,995</u>
Current maturities of long-term receivables .....	( 266 )	( 227 )
Long-term receivables and deposits total .....	<u>2,772</u>	<u>2,768</u>

Long-term receivables contractual repayments are specified as follows:

Repayments in 2011 .....	-	227
Repayments in 2012 .....	266	159
Repayments in 2013 .....	1,626	1,819
Repayments in 2014 .....	786	540
Repayments in 2015 .....	136	8
Repayments in 2016 .....	15	11
Subsequent .....	209	231
Total loans, including current maturities .....	<u>3,038</u>	<u>2,995</u>

Long-term receivables and deposits denominated in currencies other than the functional currency comprise ISK 3,020 million (2010: ISK 2,973 million).

## Notes, continued:

## 23 Taxes

Tax recognised in profit or loss	2011	2010
<i>Deferred tax expense</i>		
Origination and reversal of temporary differences .....	( 584 )	1,331
Increase in tax rate .....	0	127
Total tax expense recognised in profit or loss .....	<u>( 584 )</u>	<u>1,458</u>
<b>Tax recognised directly in equity</b>		
Operating assets .....	44	( 249 )
Total tax recognised directly in equity .....	<u>44</u>	<u>( 249 )</u>
<b>Tax recognised in other comprehensive income</b>		
Net profit on hedge of net investment in foreign operations .....	( 38 )	77
Effective portion of changes in fair value of cash flow hedge .....	( 20 )	40
Total tax recognised in other comprehensive income .....	<u>( 58 )</u>	<u>117</u>
Total tax recognised in equity .....	<u>( 14 )</u>	<u>( 132 )</u>

## Reconciliation of effective tax rate

	2011	2010
Profit before tax and discontinued operation .....	3,500	6,576
Income tax according to current tax rate .....	20.0% 700	18.0% 1,184
Change in tax rate from 18% to 20% .....	0.0% 0	1.9% 127
Tax exempt revenue .....	( 29.9% ) ( 1,047 )	( 4.0% ) ( 264 )
Non-deductible expenses .....	1.1% 38	9.1% 596
Other items .....	( 7.9% ) ( 275 )	( 2.8% ) ( 185 )
Effective tax rate .....	<u>( 16.7% ) ( 584 )</u>	<u>22.2% 1,458</u>

## Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are specified as follows:

	2011	2010
Deferred tax assets and liabilities 1.1. ....	( 1,267 )	140
Exchange rate difference .....	( 74 )	( 48 )
Income tax recognised in profit or loss .....	584	( 1,458 )
Income tax recognised in equity .....	( 14 )	132
Assets held for sale .....	0	( 33 )
Deferred tax liabilities 31.12. ....	<u>( 771 )</u>	<u>( 1,267 )</u>

Deferred tax assets and liabilities is attributable to the following:

	Assets		Liabilities		Net	
	2011	2010	2011	2010	2011	2010
Operating assets .....	0	0	( 2,630 )	( 2,091 )	( 2,630 )	( 2,091 )
Intangible assets .....	0	0	( 86 )	( 11 )	( 86 )	( 11 )
Derivatives .....	0	0	( 35 )	( 7 )	( 35 )	( 7 )
Deferred gains .....	0	0	0	( 555 )	0	( 555 )
Trade receivables .....	77	173	0	0	77	173
	<u>77</u>	<u>173</u>	<u>( 2,751 )</u>	<u>( 2,664 )</u>	<u>( 2,674 )</u>	<u>( 2,491 )</u>
Tax loss carry-forwards .....	1,765	1,314	0	0	1,765	1,314
Other items .....	138	0	0	( 90 )	138	( 90 )
Deferred income tax .....	<u>1,980</u>	<u>1,487</u>	<u>( 2,751 )</u>	<u>( 2,754 )</u>	<u>( 771 )</u>	<u>( 1,267 )</u>

Amounts are in ISK millions

## Notes continued:

## 23 continued:

## Movement in deferred tax balance during the year

	1 January 2011	Recognised in income statement	Exchange rate difference	Additions through business combination	Recognised in equity	31 December 2011
Operating assets	( 2,091 )	( 443 )	( 140 )	0	44	( 2,630 )
Intangible assets	( 11 )	( 75 )	0	0	0	( 86 )
Derivatives	( 7 )	7	0	0	( 35 )	( 35 )
Deferred gains	( 555 )	555	0	0	0	0
Trade receivables	173	( 80 )	( 16 )	0	0	77
Tax loss carry-forwards	1,314	412	39	0	0	1,765
Other items	( 90 )	208	43	0	( 23 )	138
	<u>( 1,267 )</u>	<u>584</u>	<u>( 74 )</u>	<u>0</u>	<u>( 14 )</u>	<u>( 771 )</u>
Operating assets	( 1,801 )	( 809 )	0	270	249	( 2,091 )
Intangible assets	( 195 )	184	0	0	0	( 11 )
Derivatives	67	0	3	0	( 77 )	( 7 )
Deferred gains	0	( 555 )	0	0	0	( 555 )
Trade receivables	6	168	0	( 1 )	0	173
Tax loss carry-forwards	2,096	( 503 )	( 46 )	( 233 )	0	1,314
Other items	( 33 )	57	( 5 )	( 69 )	( 40 )	( 90 )
	<u>140</u>	<u>( 1,458 )</u>	<u>( 48 )</u>	<u>( 33 )</u>	<u>132</u>	<u>( 1,267 )</u>

## 24 Inventories

Inventories are specified as follows:

	2011	2010
Spare parts	1,346	1,196
Other inventories	503	384
Inventories total	<u>1,849</u>	<u>1,580</u>

## 25 Trade and other receivables

Trade and other receivables are specified as follows:

Trade receivables	8,616	5,525
Maintenance prepayments	633	580
Other prepayments	300	370
Restricted cash	333	2,879
Share capital subscription	0	2,648
Current maturities of long term-receivables	266	227
Other receivables	4,370	1,951
Trade and other receivables total	<u>14,518</u>	<u>14,180</u>

At 31 December 2011 trade receivables are shown net of an allowance for doubtful debts of ISK 1.043 million (2010: ISK 1,074 million).

Prepaid expenses which relate to subsequent periods amounted to ISK 300 million (2010: ISK 370 million) at year end. The prepayments consist mainly of insurance expenses and prepaid rental expenses.

Receivables denominated in currencies other than the functional currency comprise ISK 3.950 million (2010: ISK 2,911 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 36.

## Notes continued:

### 26 Marketable securities

Marketable securities at year end consist of securities listed on the OMX Nordic and are accounted for at fair value at year end.

### 27 Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	2011	2010
Marketable securities .....	1,946	2,002
Bank deposits .....	7,753	9,645
Cash on hand .....	36	41
Cash and cash equivalents total .....	<u>9,735</u>	<u>11,688</u>

### 28 Equity

#### (i) Share capital

The Company's share capital amounts to ISK 5,000 million according to its Articles of Association. Shareholders are entitled to receive dividends as declared from time to time and are entitled to one vote per share of one ISK.

The Company held treasury shares in the amount of ISK 25 million at the year end 2011 (2010: ISK 25 million).

#### (ii) 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.

Expenses directly attributable to the share capital increase in 2011 amounted to ISK 46 million and are deducted from share premium.

#### (iii) Other reserves

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

The translation reserve comprises all 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 operation.

Other reserves are specified as follows:

	Share option reserve	Hedging reserve	Translation reserve	Total reserves
Balance 1 January 2010 .....	100	( 302 )	7,101	6,899
Foreign currency translation differences of foreign operations .....			( 615 )	( 615 )
Foreign currency translation differences reclassified to profit or loss .....			( 2,120 )	( 2,120 )
Net profit on hedge of net investment in foreign operation, net of tax .....			49	49
Effective portion of changes in fair value of cash flow hedges, net of tax ..		274		274
Share option reserve reversed .....	( 100 )			( 100 )
Balance at 31 December 2010 .....	<u>0</u>	<u>( 28 )</u>	<u>4,415</u>	<u>4,387</u>
Balance at 1 January 2011 .....	0	( 28 )	4,415	4,387
Foreign currency translation differences of foreign operations .....			470	470
Foreign currency translation differences reclassified to profit or loss .....			( 1,199 )	( 1,199 )
Net profit on hedge of net investment in foreign operation, net of tax .....			142	142
Effective portion of changes in fair value of cash flow hedges, net of tax ..		69		69
Balance at 31 December 2011 .....	<u>0</u>	<u>41</u>	<u>3,828</u>	<u>3,869</u>

Amounts are in ISK millions

## Notes, continued:

### 28 continued:

#### (iv) Dividends

The Board of Directors has agreed to the following dividend policy: "The goal is to pay 20–40% of annual net profit as dividend. Final decision on dividend payments will be based on the financial position of the Company, operating capital requirements and market conditions."

No dividend was paid during the years 2011 and 2010. The Board of Directors proposes that ISK 800 million will be paid to shareholders in the year 2012 as dividend.

### 29 Earnings per share

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

	2011	2010
<b>Basic earnings per share:</b>		
Profit for the year attributable to equity holders of the Parent .....	4,451	4,564
Average share capital .....	4,975	1,485
Profit per share of ISK 1 .....	0.89	3.07
<b>Profit attributable to ordinary equity holders of the parent company:</b>		
Profit for the year attributable to equity holders of the Parent .....	4,451	4,564
Discontinued operations .....	( 368 )	562
Total .....	<u>4,083</u>	<u>5,126</u>
<b>Weighted average number of shares</b>		
<i>in million shares</i>		
Issued shares at beginning of year .....	4,975	975
Effect of new shares sold in November 2010 .....	0	485
Effect of new shares sold in December 2010 .....	0	26
Weighted average number of shares for the year .....	<u>4,975</u>	<u>1,486</u>
<b>Earnings per share:</b>		
Earnings per share (ISK) .....	0.89	3.07
Diluted earnings per share (ISK) .....	0.89	3.07
<b>Earnings per share from continuing operations:</b>		
Basic earnings per share (ISK) .....	0.82	3.45
Diluted earnings per share (ISK) .....	0.82	3.45

### 30 LOANS AND BORROWINGS

This note provides information on the contractual terms of the Group's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 36.

Non-current loans and borrowings are specified as follows:		
	<b>2011</b>	<b>2010</b>
Secured bank loans .....	22,386	22,834
Unsecured loans .....	1,750	1,770
	<u>24,136</u>	<u>24,604</u>
Current maturities .....	( 4,137 )	( 3,248 )
Total non-current loans and borrowings .....	<u>19,999</u>	<u>21,356</u>
Current loans and borrowings are specified as follows:		
Current maturities of non-current liabilities .....	4,137	3,248
Total current loans and borrowings .....	<u>4,137</u>	<u>3,248</u>
Total loans and borrowings .....	<u>24,136</u>	<u>24,604</u>

Amounts are in ISK millions

## Notes, continued:

## 31 Terms and debt repayment schedule

	Currency	Nominal interest rates year end 2011	Year of maturity	Total remaining balance	
				2011	2010
Secured bank loan .....	USD	4.2%	2013–2018	16,992	15,638
Secured bank loan .....	EUR	5.8%	2017	2,293	3,699
Secured bank loan .....	ISK	6.5%	2013–2017	2,979	3,227
Secured bank loan, indexed .....	ISK	6.3%	2012–2028	122	270
Unsecured bond issue, indexed .....	ISK	5.7%	2012–2023	1,750	1,770
Total interest-bearing liabilities .....				<u>24,136</u>	<u>24,604</u>

Repayments of loans and borrowings are specified as follows:

Repayments in 2011 .....	–	3,248
Repayments in 2012 .....	4,137	3,099
Repayments in 2013 .....	5,175	7,820
Repayments in 2014 .....	5,547	4,242
Repayments in 2015 .....	1,939	1,033
Repayments in 2016 .....	1,949	1,061
Subsequent repayments .....	5,389	4,101
Total loans and borrowings .....	<u>24,136</u>	<u>24,604</u>

## 32 Long-term payables

Long-term payables corresponds to accrued cost of overhauling engines of leased aircraft and security deposits from lease contracts. Long term obligation at year end 2011 amounts to ISK 3.332 million (2010: ISK 4,745 million) and short term obligation, which is included in other payables amounts to 2.910 million (2010: ISK 1,249 million).

## 33 Share-based payments

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

	Weighted exercise price 2011	Number of options 2011	Weighted exercise price 2010	Number of options 2010
Outstanding at 1 January .....	–	–	27.5	14,126
Forfeited during the year .....	–	–	27.5	( 14,126 )
Outstanding at 31 December .....	–	<u>0</u>	27.5	<u>0</u>
Exercisable at 31 December .....		<u>0</u>		<u>0</u>

There were no outstanding options at year end 2011. All outstanding options at year end 2009 were forfeited in January 2010.

## 34 Trade and other payables

Trade and other payables are specified as follows:	<b>2011</b>	<b>2010</b>
Trade payables .....	4,228	3,298
Derivatives used for hedging .....	50	53
Other payables .....	12,273	10,697
Total trade and other payables .....	<u>16,551</u>	<u>14,048</u>

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 36.

## Notes, continued:

### 35 Deferred income

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

Deferred income are specified as follows:	<b>2011</b>	<b>2010</b>
Sold unused tickets .....	9,046	6,133
Frequent flyer points .....	1,622	1,567
Other prepayments .....	1,717	1,107
Total deferred income .....	<u>12,385</u>	<u>8,807</u>

### 36 Financial risk management

#### Overview

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

- I credit risk
- I liquidity risk
- I 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 Committee, 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.

#### 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 as follows:

	Note	Carrying amount	
		2011	2010
Long-term receivables and deposits .....	22	2,772	2,768
Trade and other receivables .....	25	14,518	14,180
Marketable securities .....	26	3,345	1,306
Cash and cash equivalents .....	27	9,735	11,688
		<u>30,370</u>	<u>29,942</u>

## Notes, continued:

### 36 continued:

#### Trade and other receivables

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

Credit risk is linked to trade receivables, investment 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. 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. However at year end 2011 the Group is still guaranteeing from divested companies (see note 40), the PDP payments of one 787 Boeing Dreamliner order but the economical proceeds from these orders have been sold to the creditors in relation to the financial restructuring in the year 2010.

The Group will remain a guarantor in terms of the lease of two Airbus 320 aircraft until April 2012 and two Boeing 767 until the end of the year 2012. These aircraft are operated under SmartLynx's air operator's certificate.

#### Impairment losses

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

	Gross 2011	Impairment 2011	Gross 2010	Impairment 2010
Not past due .....	5,553	( 45 )	4,089	( 45 )
Past due 0–30 days .....	1,215	( 22 )	1,199	( 293 )
Past due 31–120 days .....	1,444	( 360 )	837	( 394 )
Past due 121–365 days .....	1,131	( 334 )	184	( 107 )
More than one year .....	316	( 282 )	290	( 235 )
Total .....	<u>9,659</u>	<u>( 1,043 )</u>	<u>6,599</u>	<u>( 1,074 )</u>

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

	2011	2010
Balance at 1 January .....	1,074	448
Impairment loss recognized (reversed) .....	( 31 )	626
Balance at 31 December .....	<u>1,043</u>	<u>1,074</u>

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

The allowance account in respect of trade receivables is used to record impairment losses 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.

## Notes, continued:

## 36 continued:

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

31 December 2011	Carrying amount	Contractual cash flows	Within 12 months	1–2 years	2–5 years	More than 5 years
<b>Financial liabilities</b>						
Unsecured bank loans .....	1,750	( 2,470 )	( 210 )	( 205 )	( 616 )	( 1,439 )
Secured bank loans .....	22,386	( 26,357 )	( 5,145 )	( 6,002 )	( 10,541 )	( 4,669 )
Payables & prepayments .....	19,883	( 19,883 )	( 16,551 )	( 1,804 )	( 1,528 )	0
	<u>44,019</u>	<u>( 48,710 )</u>	<u>( 21,906 )</u>	<u>( 8,011 )</u>	<u>( 12,685 )</u>	<u>( 6,108 )</u>
<b>Off balance sheet liabilities</b>						
Operating lease payments .....	0	( 28,826 )	( 6,955 )	( 4,266 )	( 6,511 )	( 11,094 )
<b>Exposure to liquidity risk</b> .....	<u>44,019</u>	<u>( 77,536 )</u>	<u>( 28,861 )</u>	<u>( 12,277 )</u>	<u>( 19,196 )</u>	<u>( 17,202 )</u>
<b>31 December 2010</b>						
<b>Financial liabilities</b>						
Unsecured bond issue .....	1,770	( 2,600 )	( 247 )	( 205 )	( 586 )	( 1,562 )
Secured bank loans .....	22,834	( 27,549 )	( 4,275 )	( 4,053 )	( 14,691 )	( 4,530 )
Payables & prepayments .....	18,793	( 18,793 )	( 14,048 )	( 2,109 )	( 2,109 )	( 626 )
	<u>43,397</u>	<u>( 48,942 )</u>	<u>( 18,570 )</u>	<u>( 6,268 )</u>	<u>( 17,386 )</u>	<u>( 6,718 )</u>
<b>Off balance sheet liabilities</b>						
Operating lease payments .....	0	( 30,005 )	( 7,657 )	( 6,556 )	( 7,343 )	( 8,449 )
<b>Exposure to liquidity risk</b> .....	<u>43,397</u>	<u>( 78,947 )</u>	<u>( 26,227 )</u>	<u>( 12,824 )</u>	<u>( 24,729 )</u>	<u>( 15,167 )</u>

Unused loan commitments at year end 2011 amounted to ISK 500 million (2010: ISK 500 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 income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

The Group uses 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 6 to 9 month horizon and uses a portfolio of instruments, but most importantly forwards.

## Notes, continued:

## 36 continued:

*Exposure to currency risk*

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

	USD	EUR	DKK	SEK	NOK
<b>2011</b>					
Net balance sheet exposure .....	591	( 2,428)	314	( 61)	112
Forecast revenue .....	42,007	26,510	4,398	4,988	5,309
Forecast purchases .....	( 54,658 )	( 16,295 )	( 1,401 )	409	( 621)
Forward FX contracts .....	1,708	( 1,544 )	0	0	0
Net currency exposure .....	<u>( 10,352 )</u>	<u>6,243</u>	<u>3,311</u>	<u>5,336</u>	<u>4,800</u>
<b>2010</b>					
Net balance sheet exposure .....	( 283 )	( 3,607 )	392	488	767
Forecast revenue .....	29,276	13,060	3,011	3,536	3,182
Forecast purchases .....	( 39,635 )	( 8,775 )	( 1,270 )	( 341 )	( 423 )
Forward FX contracts .....	520	( 520 )	0	0	0
Net currency exposure .....	<u>( 10,122 )</u>	<u>158</u>	<u>2,133</u>	<u>3,683</u>	<u>3,526</u>

The following significant exchange rates applied during the year:

	Average rate		Reporting date spot rate	
	2011	2010	2011	2010
USD .....	116.31	122.53	122.60	115.34
EUR .....	161.90	162.62	159.17	154.36
DKK .....	21.80	21.84	21.42	20.71
NOK .....	20.87	20.24	20.52	19.77
SEK .....	18.03	17.07	17.89	17.20

*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 as for 2010.

	Equity	Profit or loss
<b>2011</b>		
USD .....	828	1,193
EUR .....	( 499 )	( 525 )
DKK .....	( 265 )	( 265 )
NOK .....	( 427 )	( 427 )
SEK .....	( 384 )	( 384 )
<b>2010</b>		
USD .....	830	1,071
EUR .....	( 13 )	( 37 )
DKK .....	( 175 )	( 175 )
NOK .....	( 289 )	( 289 )
SEK .....	( 302 )	( 302 )

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.

## Notes, continued:

### 36 continued:

#### Interest rate risk

The largest share of outstanding long term loans, carrying 1–6 months floating interest rates are directly related to aircraft financing and denominated in USD as a consequence. The risk management policy benchmark for variable rate exposure is the level of net interest bearing debt. Swap contracts are mainly used to exchange floating rates for fixed up to 5 years ahead, which at year end 2011 amounts to USD 10 million.

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

	Carrying amount	
	2011	2010
<b>Fixed rate instruments</b>		
Financial assets .....	1,778	1,424
Financial liabilities .....	( 7,099 )	( 4,381 )
	<u>( 5,321 )</u>	<u>( 2,957 )</u>
 <i>Variable rate instruments</i>		
Financial assets .....	0	0
Financial liabilities .....	( 17,037 )	( 20,223 )
	<u>( 17,037 )</u>	<u>( 20,223 )</u>

#### 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 immaterial effects on the fair value.

#### 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.

	Equity	
	100 bp increase	100 bp decrease
<b>31 December 2011</b>		
Variable rate instruments .....	( 52 )	52
Cash flow sensitivity (net) .....	<u>( 52 )</u>	<u>52</u>
 <b>31 December 2010</b>		
Variable rate instruments .....	11	( 5 )
Cash flow sensitivity (net) .....	<u>11</u>	<u>( 5 )</u>

#### Other market price risk

##### Fuel price risk

The Group maintains a policy of hedging fuel price exposure by a ratio reflecting forward sales of tickets and up to 60% of the fuel exposure by using swaps and options going 6 to 9 months forward on rolling basis.

##### 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 equity:

	Effect on equity		Effect on profit before tax	
	2011	2010	2011	2010
Increase in fuel prices by 10% .....	202	30	0	0
Decrease in fuel prices by 10% .....	( 202 )	( 30 )	0	0

## Notes, continued:

### 36 continued:

#### Capital management

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business.

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.

### 37 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:

	2011		2010	
	Carrying amount	Fair value	Carrying amount	Fair value
Loans and receivables .....	17,290	17,290	16,948	16,948
Marketable securities .....	3,345	3,345	1,306	1,306
Cash and cash equivalents .....	9,735	9,735	11,688	11,688
Unsecured bond issue .....	( 1,750 )	( 1,750 )	( 1,770 )	( 1,770 )
Secured bond loans .....	( 22,386 )	( 22,386 )	( 22,834 )	( 22,834 )
Payables and prepayments .....	( 19,883 )	( 19,883 )	( 18,793 )	( 18,793 )
Total .....	<u>( 13,649 )</u>	<u>( 13,649 )</u>	<u>( 13,455 )</u>	<u>( 13,455 )</u>

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

### 38 Off-balance sheet items

#### Leases as lessee

As a lessee the Group has in place operating leases for 15 aircraft at the end of December 2011. The leases are for ten Boeing 757 aircraft and five Boeing 767 aircraft. The Group also has in place operating leases for storage facilities, accommodations, equipment and fixtures for its operations, the longest until the year 2032. During the year ISK 7.338 million was recognised as an expense in profit or loss in respect of operating leases (2010: ISK 8.676 million). At the end of December 2011 the leases are payable as follows:

	Real estate	Aircraft	Other	Total 2011	Total 2010
In the year 2010 .....	–	–	–	–	7,657
In the year 2011 .....	1,326	5,324	305	6,955	6,556
In the year 2012 .....	1,228	2,914	124	4,266	3,764
In the year 2013 .....	1,210	1,405	87	2,702	1,908
In the year 2014 .....	1,166	1,152	71	2,389	1,670
In the year 2015 .....	1,121	232	67	1,420	1,263
Subsequent .....	11,028	–	66	11,094	7,187
Total .....	<u>17,079</u>	<u>11,027</u>	<u>720</u>	<u>28,826</u>	<u>30,005</u>

### 39 Leases as lessor

As a lessor the Company leases aircraft on wet, dry and other various leases, both on short and long term leases. Lease income for the year 2011 amounted to ISK 16,749 million (2010; ISK 19,972 million). Contracted leases at year end were as follows:

	2011	2010
In the year 2011 .....	–	12,908
In the year 2012 .....	10,282	10,911
In the year 2013 .....	5,519	5,683
In the year 2014 .....	2,168	3,064
In the year 2015 .....	2,029	2,689
In the year 2016 .....	1,022	961
Total .....	<u>21,020</u>	<u>36,216</u>

Amounts are in ISK millions

## Notes, continued:

### 40 Capital commitments

IG Invest, a former subsidiary of the Company, has signed an agreement with Boeing regarding the purchase of one Boeing 787 Dreamliner aircraft to be delivered in the year 2014. Despite the disposal of IG Invest, Icelandair Group is still guarantor for these capital commitments.

As a part of the financial restructuring of the Company's balance sheet in 2010 the Company divested assets to its creditors for ISK 7.6 billion. Icelandair Group guarantees that the final sale price will be at least ISK 4.0 billion, however the maximum guarantee is ISK 0.5 billion. If the creditors will receive ISK 7.6 billion plus REIBOR+3% interest for the assets at sale, Icelandair Group will receive 50% of the upside net of REIBOR +3%.

### 41 Contingencies

During the first half of 2007 the Icelandic Competition Authorities imposed a fine on the subsidiary Icelandair due to an alleged breach of the Icelandic Competition law. The penalty amounts to ISK 130 million following a ruling by the Competition Appeals Committee. Icelandair took this case to the District Court of Reykjavik which ruled in February 2010 to dismiss the penalty. The court ruling was appealed to the Supreme Court of Iceland which ruled in January 2011 that due to formalities the District Court should reopen the case. The District Court confirmed its ruling in 2011 and a final decision by the Supreme Court is expected in February 2012. The Group considers that the final ruling will be in favour of the Group.

### 42 Related parties

#### Identity of related parties

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

#### Transactions with management and key personnel

Salaries and benefits of management paid for their work for Group companies during the year 2011, share option agreements and shares in the Company are specified as follows:

	Salaries and benefits	Shares held at year-end 2011	Share held by related parties
<b>Board of Directors:</b>			
Sigurður Helgason, Chairman of the Board .....	3.8 *	4.5	
Finnbogi Jónsson .....	1.9 **		
Herdís Dröfn Fjeldsted .....	2.1 **		
Katrín Olga Jóhannsdóttir .....	2.3	0.4	
Úlfar Steindórsson .....	2.1		
Anna Guðný Aradóttir, alternative board member .....	0.2		
Auður Björk Guðmundsdóttir, alternative board member .....	0.2		
Magnús Magnússon, alternative board member .....	0.3 *		
Vilborg Lofts, former alternative board member .....	0.1		
<b>Key employees:</b>			
Björgólfur Jóhannsson CEO of Icelandair Group hf. ....	41.7	1.0	
Bogi Nils Bogason, CFO of Icelandair Group hf. ....	33.3	1.0	
Birkir Hólm Guðnason, CEO of Icelandair .....	34.1		
Guðni Hreinsson, MD of Loftleidir – Icelandic ehf. ....	22.2		
Six MD of group companies .....	123.4	6.1	

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

#### Transaction with associates

During the year 2011 the Group purchased services from associates for ISK 28 million (2010: ISK 0 million). The Group's revenues were ISK 8 million from associates (2010: ISK 6 million). The Group has not granted any loans to its associates. Transactions with associates are priced on an arm's length basis.

#### Transaction with shareholders

Shareholders with significant influence at year end 2011 is Framtakssjóður Íslands slhf. Transactions with Framtakssjóður Íslands slhf. and its four identified associated companies consist of purchase and sale of services in the ordinary course of business on an arm's length basis. Total purchases in 2011 from these entities amounted to ISK 286 million (2010: N/A). Total sales amounted to ISK 57 million (2010: N/A).

\* Two board members have dismissed their rights to salaries so instead the board agreed to pay the same amount to Icelandair's Special Children's Travel Fund.

\*\* The salaries of two board members are paid to Framtakssjóður Íslands slhf

## Notes, continued:

### 43 Group entities

The Company holds ten subsidiaries at year end 2011. SmartLynx, Latvia was sold at year end 2011 and is included in discontinued operations. Bluebird Cargo ehf., IG Invest ehf. and Icelase ehf. were sold at year end 2010 and are therefore only included in 2010 comparative amounts with turnover of ISK 4.7 billion and EBITDA of ISK 1.1 billion. Addition during the year is A320 ehf., a company owning one Airbus 320 aircraft leased to SmartLynx. The company started operation in June 2011. The subsidiaries included in the consolidated financial statements are specified as follows:

	Ownership interest 2011
Route network:	
Air Iceland ehf. ....	100%
Icelandair .....	100%
Icelandair Cargo ehf. ....	100%
IGS ehf. ....	100%
Icelandair Shared Services ehf. ....	100%
Loftleiðir – Icelandic ehf. ....	100%
Tourism services:	
Iceland Travel ehf. ....	100%
Icelandair Hotels ehf. ....	100%
Other operation:	
A320 ehf. ....	100%
IceCap Ltd., Guernsey .....	100%
Discontinued operation:	
SmartLynx, Latvia, sold at year end 2011 .....	100%

The subsidiaries further own 17 subsidiaries that are also included in the consolidated financial statements.

At year end the shares in the subsidiaries in Route Network and Tourism services are pledged as mortgage against the Group's borrowings.

### 44 Statement of cash flows

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

	2011	2010
Expensed long term cost .....	3,903	4,618
Exchange rate difference and indexation of liabilities and assets .....	( 34 )	193
Gain on disposals in relation to financial restructuring .....	0	( 4,246 )
Gain from assets held for sale .....	( 755 )	( 906 )
(Gain) loss on the sale of operating assets .....	( 316 )	162
Share of profit of associates .....	11	391
Income tax .....	( 584 )	1,458
Other items .....	186	339
Total other operating items in the statement of cash flows .....	<u>2,411</u>	<u>2,009</u>

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

Inventories, increase .....	( 269 )	( 187 )
Trade and other receivables, (increase) decrease .....	( 684 )	1,998
Trade and other payables, decrease .....	( 780 )	( 656 )
Deferred income, increase .....	3,578	1,629
Net change in operating assets and liabilities in the statement of cash flows .....	<u>1,845</u>	<u>2,784</u>

### 46 Additional cash flow information:

Interest paid .....	1,490	1,703
Interest received .....	692	219

### 47 Ratios

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

Current ratio .....	0.91	1.11
Equity ratio .....	0.36	0.34
Intrinsic value of share capital .....	6.49	5.71

Amounts are in ISK millions

## Corporate Governance Statement

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### The framework

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

The Company complies in all main respect to the rules mentioned above. The Company however does not have a Nomination Committee as the Board of Directors has not seen the need for it. That decision will however be reconsidered in 2012. No government organization has found the Company to be in breach with any rule or regulation.

### Internal audit and risk management

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

### Audit Committee:

Katrín Olga Jóhannesdóttir, Chairman  
Herdís Dröfn Fjeldsted  
Úlfar Steindórsson

### Values and code of ethics and corporate responsibility

The company's values are:

WE CARE for our customers, employees, environment and shareholders.

WE THINK CLIENTS through consistency, reliability, clear product alternatives and friendly service.

WE DRIVE RESULTS via teamwork, shared information and values, accountability and profitability.

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

### Compensation Committee

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

Compensation Committee  
Sigurður Helgason, Chairman  
Finnbogi Jónsson

## Corporate Governance Statement, continued:

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**Corporate Governance Statement**, continued:

### The Board of Directors and Executive Committee

#### Board of Directors

##### *Sigurður Helgason, Chairman*

Sigurður Helgason was born in 1946 and has been a Member of the Board of Directors at Finnair since 2007. He was President & CEO of Flugleidir/FL-Group/Icelandair 1985–2005. He was Director Cash Management 1974–1980, Senior Vice-President Finance 1980–1983, General Manager The Americas 1983–1985 for Flugleidir/Icelandair. He was Chairman of the Board of The Icelandic International Development Fund 2005–2008. He is the Chairman of the Icelandair Special Children Travel Fund since 2005. He was a member of the IATA board of Governors 2004/2005. He graduated with a MBA degree from The University of North Carolina, Chapel Hill, USA in 1973 and a Cand. Oecon. degree from the University of Iceland in 1971. He joined the Board on 6 August 2009.

##### *Finnbogi Jónsson, Deputy Chairman*

Finnbogi Jónsson was born in 1950 and is the former CEO of the Icelandic Enterprise Fund. He was the CEO of the The New Business Venture Fund from 2006. Finnbogi was the CEO of SR-Mjöl from 2003–2006. Finnbogi has for the past 25 years held various managerial positions within the Icelandic fishing industry. Finnbogi has also held various board positions, mainly within the fishing industry and related businesses. Finnbogi is the Chairman of the Board of Eignarhaldsfélagið Vestia ehf. and Gogo Holding slhf. He holds a degree in engineering and business from the University of Lund in Sweden. He joined the Board on 15 September 2010.

##### *Herdís Dröfn Fjeldsted*

Herdís Dröfn Fjeldsted was born in 1971 and is the Investment Manager at Framtakssjodur Islands, holds a BSc degree in business administration and a MSc degree in corporate finance from Reykjavik University 2010. She is also a certified securities broker. Herdis joined Framtakssjodur Islands after about six years in the private equity industry. Most recently, Herdis was a member of the investment team at Thule Investments. Her job there consisted of investment analysis, negotiations and active participation in individual companies owned by the fund. Herdis is Chairman of the Board of Wave Operations and Board Director of Icelandair Group. She joined the Board on 14 December 2010.

##### *Katrín Olga Jóhannesdóttir*

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

##### *Úlfar Steindórsson*

Úlfar Steindórsson was born in 1956 and is the CEO of Toyota in Iceland and Jú ehf. He was the CEO of Primex ehf. in Siglufjordur from 2002–2004, and the CEO of the New Business Venture Fund from 1999–2002. Úlfar is the Chairman of the Board of Bifreiðainnflutningur ehf., Bílaútleigan ehf., Okkar bílaleiga ehf., and TK bílar ehf. Úlfar is a board member of Blue Lagoon International Ltd, Bláa Lónið hf., Blue Lagoon international ehf., Eldvörp ehf., Hótel Bláa Lónið ehf., Hreyfing Eignarhaldsfélag ehf., Johan Rönning hf., Kraftvélar ehf., Motormax ehf., S.Guðjónsson ehf., Skorri ehf., and UK fjárfestingar ehf. Úlfar holds a Cand.Oecon from the University of Iceland and a MBA from Virginia Commonwealth University. He joined the Board on 15 September 2010.

## **Corporate Governance Statement, continued:**

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### **Corporate Governance Statement, continued:**

#### **Executive committee**

##### *Björgólfur Jóhannsson, President and CEO*

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

##### *Bogi Nils Bogason, CFO*

##### *Magnea Þórey Hjálmarsdóttir, Managing Director of Icelandair Hotels*

##### *Birkir Hólm Guðnason, CEO of Icelandair*

#### **Board of Directors**

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

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

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

The Company's Board of Directors consists of five members and three 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 Deputy 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 President and CEO. Meetings of the Board are valid if attended by a majority of its members. However, important decisions shall not be taken unless all members of the Board have had an opportunity to discuss the matter, if possible. The outcome of issues is decided by force of vote, and in the event of an equality of votes, the issue is regarded as rejected. The

## Corporate Governance Statement, continued:

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### Corporate Governance Statement, continued:

President and CEO attends meetings of the Board of Directors, even if he or she is not a member of the Board, and has the right to participate in discussions and submit proposals unless otherwise decided by the Board in individual cases. A book of minutes is kept of proceedings at meetings and must be signed by participants in the meeting. A Board member who disagrees with a decision made by the Board of Directors is entitled to have his or her dissenting opinion entered in the book of minutes. The same applies to the President and CEO. The Chairman is responsible for the Board's relations with the shareholders and he shall inform the Board on the views of the shareholders.

On 12 September 2007 the Board of Directors approved Rules on Working Procedures for the Board of Directors that was amended on 15 November 2010. The Rules on Working Procedures are accessible to the Board of Directors and the management through the Board's intranet, Coredata. In accordance with article 14 of the Rules on Working Procedures the Board of Directors must annually evaluate its work, size, composition and practices, and must also evaluate the performance of the CEO and others responsible for the day-to-day management of the Company and its development. The annual performance assessment is intended to improve working methods and increase the efficiency of the Board. The assessment entails e.g. evaluation of the strengths and weaknesses of the Board's work and practices and takes into consideration the work components which the Board believes may be improved.

The Board of Directors elects the members of the two sub-committees; the Compensation Committee and the Audit Committee. The sub-committees adhere to the Rules on Working Procedures. The Board of Directors convenes on average twelve times a year. The Board of Directors however convened eleven times in the year and all Board Members attended almost all meetings. All the Members of the Board of Directors are independent from the Company. Sigurdur Helgason, Katrin Olga Johannesdottir and Ulfar Steindorsson were independent from the Company's major shareholders in 2011.

## Quarterly statements (unaudited)

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

Year 2011	Q1	Q2	Q3	Q4	Total
Operating income	16,017	25,029	35,868	20,020	96,934
Operating expenses without depreciation	( 16,215 )	( 22,942 )	( 27,215 )	( 20,149 )	( 86,521 )
Operating (loss) profit before depreciation (EBITDA)	( 198 )	2,087	8,653	( 129 )	10,413
Depreciation	( 1,237 )	( 1,464 )	( 1,569 )	( 1,408 )	( 5,678 )
Operating (loss) profit (EBIT)	( 1,435 )	623	7,084	( 1,537 )	4,735
Net finance (expense) income	( 424 )	( 180 )	( 454 )	( 166 )	( 1,224 )
Share of profit (loss) of associates	1	9	4	( 25 )	( 11 )
Profit (loss) before income tax	( 1,858 )	452	6,634	( 1,728 )	3,500
Income tax	737	( 43 )	( 1,270 )	1,160	584
(Loss) profit from continuing operations	( 1,121 )	409	5,364	( 568 )	4,084
Profit from discontinued operation	0	0	0	368	368
<b>(Loss) profit</b>	<b>( 1,121 )</b>	<b>409</b>	<b>5,364</b>	<b>( 200 )</b>	<b>4,452</b>
Other comprehensive income (loss)	221	( 326 )	373	( 786 )	( 518 )
<b>Total comprehensive income (loss)</b>	<b>( 900 )</b>	<b>83</b>	<b>5,737</b>	<b>( 986 )</b>	<b>3,934</b>
Working capital (used in) from operations	( 607 )	3,090	9,345	713	12,541
Net cash from (used in) operating activities	8,582	5,259	( 648 )	1,193	14,386
Net cash used in investing activities	( 6,440 )	( 1,596 )	( 2,073 )	( 2,908 )	( 13,017 )
Net cash from (used in) financing activities	1,113	( 3,430 )	( 2,368 )	1,301	( 3,384 )
<b>Year 2010</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Total</b>
Operating income	16,283	21,885	31,082	18,765	88,015
Operating expenses without depreciation	( 16,105 )	( 19,736 )	( 21,947 )	( 17,649 )	( 75,437 )
Operating profit (loss) bef. depr. (EBITDA)	178	2,149	9,135	1,116	12,578
Depreciation	( 1,341 )	( 1,306 )	( 1,590 )	( 2,087 )	( 6,324 )
Operating (loss) profit (EBIT)	( 1,163 )	843	7,545	( 971 )	6,254
Gain on disposals in relation to financial restructuring	0	0	0	4,245	4,245
Net finance (expense) income	( 736 )	( 1,051 )	( 1,171 )	( 574 )	( 3,532 )
Share of profit (loss) of associates	63	1	10	( 465 )	( 391 )
Profit (loss) before income tax	( 1,836 )	( 207 )	6,384	2,235	6,576
Income tax	351	46	( 1,187 )	( 668 )	( 1,458 )
(Loss) profit from continuing operations	( 1,485 )	( 161 )	5,197	1,567	5,118
Loss from discontinued operation	( 400 )	0	0	( 162 )	( 562 )
<b>(Loss) profit</b>	<b>( 1,885 )</b>	<b>( 161 )</b>	<b>5,197</b>	<b>1,405</b>	<b>4,556</b>
Other comprehensive income (loss)	337	232	( 1,356 )	( 1,625 )	( 2,412 )
<b>Total comprehensive income (loss)</b>	<b>( 1,548 )</b>	<b>71</b>	<b>3,841</b>	<b>( 220 )</b>	<b>2,144</b>
Working capital from operations	80	1,628	9,573	1,608	12,889
Net cash from operating activities	3,967	5,419	2,556	3,731	15,673
Net cash used in investing activities	( 690 )	( 1,614 )	( 459 )	( 2,749 )	( 5,512 )
Net cash (used in) from financing activities	( 1,161 )	( 382 )	( 1,887 )	3,381	( 49 )





**4.5**

ISK billion net profit  
for 2011

**0.89**

ISK earnings  
per share in 2011

**10%**

increase in income  
from 2010

**11%**

EBITDA ratio  
in 2011

**89.5**

ISK billion assets  
end of 2011

**36%**

equity ratio  
end of 2011

**35**

aircraft in our fleet  
end of 2011

**1.75**

million passengers  
Icelandair in 2011

**79.9%**

load factor in our  
network in 2011

**31**

routes in our  
network 2011

