

80 YEARS OF AVIATION 1937-2017



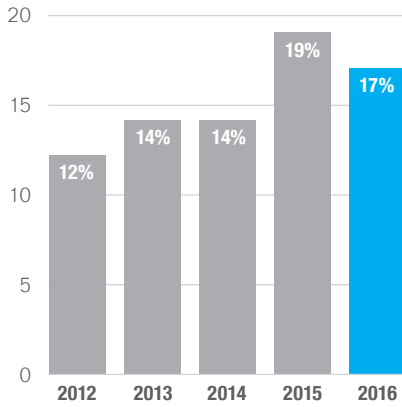
Key Figures

USD thousands

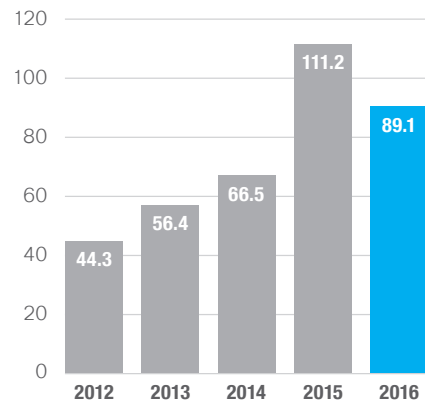
	2012	2013	2014	2015*	2016
Operating results					
Total income	898,866	1,022,957	1,113,297	1,139,699	1,285,574
EBITDAR	165,772	189,870	193,410	261,710	254,960
EBITDA	109,646	143,710	154,338	226,666	219,845
EBIT	50,787	73,011	79,009	142,840	118,437
EBT continuing operations	57,448	71,048	79,908	140,223	120,111
Profit for the period	44,275	56,418	66,499	111,223	89,068
Balance sheet					
Total assets	762,895	832,875	849,220	971,979	1,292,493
Total equity	295,932	346,082	365,055	456,531	568,213
Interest bearing debt	150,906	122,017	61,934	65,530	242,382
Net interest bearing debt	18,112	-77,476	-153,707	-148,589	-7,743
Cash flow					
Net cash from operating activities	166,743	230,874	215,315	245,136	209,024
Net cash used in investing activities	-76,476	-113,223	-130,156	-219,942	-291,759
Net cash from/used in financing activities	-51,453	-45,232	-88,684	-14,320	113,643
Cash and cash equivalents end of period	117,060	191,538	184,762	194,586	226,889
Key ratios					
Earnings per share in US Cent per share	0.89	1.13	1.34	2.24	1.79
Intrinsic value	7.29	8.52	8.99	11.24	13.99
Equity ratio	39%	42%	43%	47%	44%
Current ratio	0.94	0.94	0.83	0.80	0.92
Capex USD thousand	95,874	114,240	109,293	210,400	243,397
Transport revenues as % of total revenues	67%	69%	73%	74%	74%
EBITDAR ratio	18.4%	18.6%	17.4%	22.3%	19.8%
EBITDA ratio	12.2%	14.0%	13.9%	19.2%	17.1%

*Restated

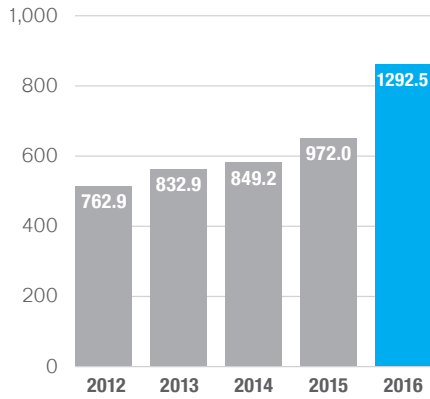
EBITDA % | 2012–2016



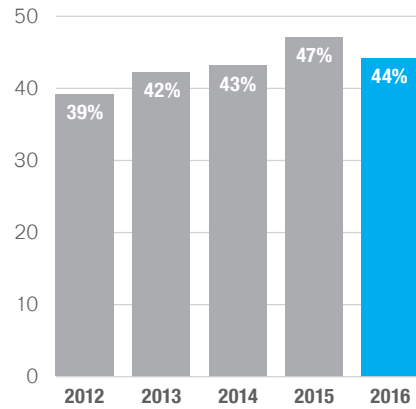
Net profit/loss in USD million | 2012–2016



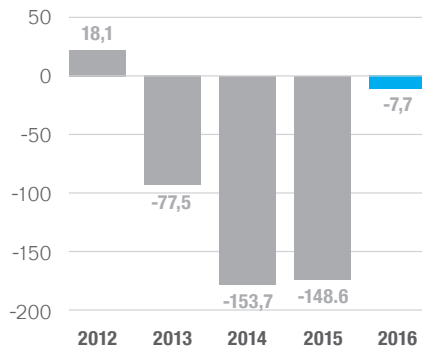
Total assets in USD million | 2012–2016



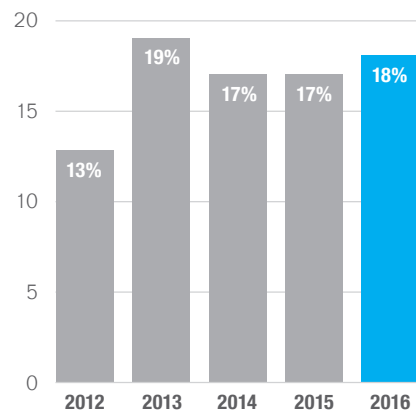
Equity ratio | 2012–2016



Net interest bearing debt in USD million | 2012–2016



Cash as % of income | 2012–2016



Eighty years of aviation

The illustrations in Icelandair Group's annual report for 2016 all stem from Icelandair's history. Celebrating 80 years of aviation this year, the airline has dug into its collection of old photographs and brought forth glimpses from their eight decades as pioneers above the clouds. ■

Design: Íslenska
Photos: Icelandair
Digital book: Oddi



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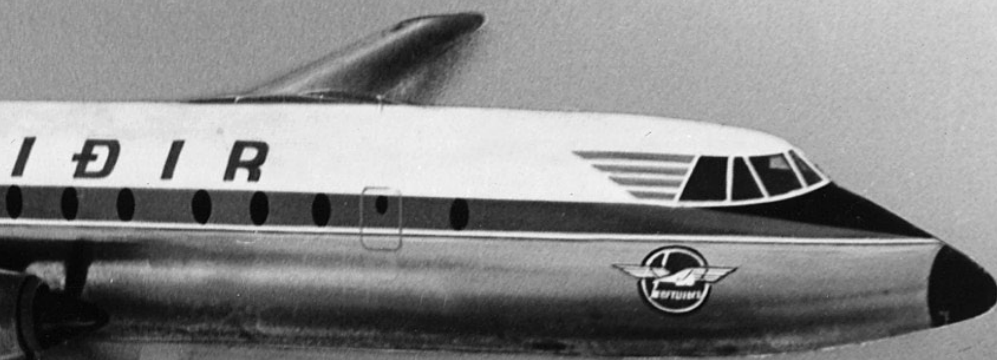


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LOFTLE

01

Loftleidir Icelandic began regular flights between Iceland and North America on 25 August 1948. The first flight was to New York, attracting substantial attention in the local papers, not least for the fact that the Icelanders had brought fur coats in the middle of a heat wave!



Our Vision

To unlock Iceland's potential as a **year-round destination**, to strengthen Iceland's position as a **connecting hub** and to maintain our focus on **flexibility** and **experience**





80 YEARS OF AVIATION 1937–2017

Interview with the Chairman of the Board of Directors and the President & CEO

Continued growth – more uncertainty ahead of us

Icelandair Group generated USD 1,286 million in revenue in 2016. International passenger numbers grew by 20% between years to almost 3.7 million. In 2017, the year of the Company's 80th anniversary, passenger numbers are projected to pass the four million mark. Nevertheless, there is more uncertainty in the operating environment going forward. Conditions in the international airline industry can change rapidly and, as we have seen before, infrastructure, flexibility, employee experience and financial strength can be put to the test. **Sigurður Helgason**, Chairman of the Board of the Company, and **Björgólfur Jóhannsson**, President and CEO, discuss the year's results and the prospects ahead.

"We have a very good year behind us. We continue to follow the same clear strategy that we have followed in recent years, focusing on profitable and sustainable growth and on developing the Company as an integrated operating company in the airline and tourism industries. This strategy has proven very successful and the Company has grown rapidly. It is my opinion that our diverse business activities complement one another in an exciting and challenging competitive market," says Sigurður Helgason, Icelandair Group's Chairman of the Board. "Operations over the year were successful, even though conditions were in many ways difficult. Our revenues have never been higher, and the Company is posting the second highest EBITDA number in its history. We had to cope with a number of challenging factors in our operations: a surge in the value of the Icelandic króna and significant domestic cost increases. Even so, our performance was good, which illustrates the flexibility that is built into the Company's business model. I believe that there are still a number of untapped opportunities to continue our profitable organic growth. The Company's strategy is to remain focused on these core activities and to maintain sustainable growth in line with the Company's capacity at any time. There are many opportunities and our Company possesses the knowledge, experience and strength to seize them."

Strong results in 2016

Björgólfur agrees regarding the success of the Group's operations: "Last year, 2016, ranks as the second best year in the Company's history. The Company's EBITDA amounted to USD 220 million, second only to the record USD 227 million posted the year before. The year as a whole saw continued organic growth, with total income at 1,286 million USD, up by 146 million USD, or 13%. Cash flow was very strong, with net cash provided



Continued growth – more uncertainty ahead of us, continued:

by operating activities at USD 211 million. These strong financial results have reinforced the Company's balance sheet, and equity now stands at USD 568 million, total assets at USD 1,292 million and our year-end equity ratio at 44%. Cash and short term investments amounted to USD 250 million at the end of the year. The Company's strategy of emphasising financial strength has always rested on the reasoning that the operating environment of air carriers is subject to major fluctuations. The Company is extremely well placed to cope with the volatility of its operating environment."

Growing Route Network

Björgólfur: "Icelandair's Route Network continues to grow, and last year we flew to 43 destinations in the International Route Network, 16 in North America and 27 in Europe. Passenger numbers have grown extensively; in 2015 we passed the three million mark for the first time, and last year we carried 3.7 million passengers. We are projecting passenger numbers to pass the four million mark in 2017, which places the rapid pace of our growth into perspective. Icelandair Group's hotel operations have expanded greatly in recent years, and our hotels are setting occupancy records virtually every month. We recently launched a 112-room hotel in central Reykjavik under the Canopy brand in partnership with the Hilton Hotel chain. Two new hotels, also in central Reykjavik, are scheduled to open in the next two years under the Curio brand, also in partnership with Hilton. The number of passengers by Air Iceland also increased in the year and foreign tourists now represent a steadily growing proportion of total passenger numbers. With the addition of direct flights between Keflavik and Akureyri the number of passengers using domestic flights may be expected to grow further. In the course of the year Air Iceland introduced Bombardier Q400 aircraft in its fleet, which are very well



“Icelandair's Route Network continues to grow, and last year we flew to 43 destinations in the International Route Network, 16 in North America and 27 in Europe.

suited for the company's operations. Iceland Travel has shown rapid growth in line with the increase in the number of tourists visiting Iceland; the business activities of the Company are diverse and going strong. Icelandair Cargo's freight operations were successful last year, both in imports and exports. Loftleidir-Icelandic is doing well; fleet utilisation is excellent year after year and the company possesses extensive knowledge, an extremely valuable resource in the complex market in which the company operates. Icelandair's expanded scope of business would not be possible without the strong support of IGS in Keflavik, which services Icelandair's aircraft. At IGS the principal challenge, as in so many businesses in Iceland at this time, is to recruit people to keep up with the growth. ISS operations are also showing success, with the number of customers growing in recent months. All in all, we look back on 2016 as a very good year in our operations."

How has the competitive environment been trending recently and what is Icelandair Group's principal strength in dealing with the competition?

Sigurður: "It is clear that competition is fierce in our markets, whether we look at tourism to Iceland or flights across the Atlantic. This is nothing new in itself, and there is also nothing novel about fluctuations characterising international airlines operations. Icelandair Group is extremely well positioned to take on the competition and the volatile environment. The Company is endowed with a wealth of experience and knowledge that will serve us well in these conditions. Our growth over the past five years has been in all our markets, but I can foresee that the 'VIA' market will continue to be the principal force driving our growth – although significant opportunities also remain in the market to and from Iceland. However, the principal task in our operations remains

Continued growth – more uncertainty ahead of us, continued:

unchanged: to develop and enlarge the Route Network between North America and Europe with Iceland as a connecting hub, and to build up Iceland as a year-round destination. Our strategy benefits from the advantage that Icelandair Group's business extends through virtually the entire value chain of the travel industry. This entails a number of opportunities. We have certainly been successful, and if we look back of the past few years, the Company's operating performance is best described in three words: profitable organic growth. This continues to be our goal and we are optimistic that we can continue on this path. In recent years the Company's Route Network has grown, with new destinations added and frequency increased to current destinations. Icelandair has taken advantage of a number of opportunities in a very shrewd manner in recent years, but even with all that growth our market share in the North Atlantic market remains a mere 2%. This reflects the sheer size of the market. Since 2009, the composition of our passenger mix has therefore changed somewhat radically, with passengers travelling through Iceland, between Europe and North America, now accounting for over 50% of all our passengers, as compared to 29% in 2009. However, 30% of the 50% make a stopover in Iceland for up to seven days before they travel onwards."

Björgólfur points out the strength of the Company's business model: "One of the strengths of Icelandair's business model is that it places us in a strategic position to respond to fluctuations and adapt our business operations to conditions as they change from time to time. At the beginning of this year we presented some changes that Icelandair intends to make in its fare and product structure with the objective of increasing the diversity of its product offerings. This adaptation, which has been in preparation since the fall, is intended

to meet increased competition and changed circumstances in the Company's markets as well as changed patterns of consumer behaviour. The purpose of the changes is to enable the Company to reach out to new customers, enhance the Company's visibility to certain target groups in search engines and broaden the Company's revenue base. Among other things, new airfares will be introduced, where a customer can elect to forego certain services which are presently included and pay for certain other services of choice, such as baggage allowances. At the same time, new value-added services will be introduced in the economy class and lower fares in business class for passengers who can book more ahead of time than the typical business traveller. Implementation will begin in the second quarter. The Company has recently changed its rules regarding baggage charges, with passengers now paying for the second bag on all routes. The changes are projected to increase ancillary income. Also, customers can now make payments on fares using frequent flyer points, regardless of the amount of the points. So, our services are under constant development in line with customer needs and wishes."

Now, at the beginning of this year, conditions have become more challenging in the markets. How is this affecting the Company, and how does it plan to respond?

Björgólfur: "That is right. At the beginning of this year it is clear that circumstances are more challenging than in the last few years. There is more pressure on yields than we have seen in recent years. We are looking to the future and we will respond to these changed circumstances with the Company's long-term interests in mind. We have taken a variety of actions on the revenue and expenditure side to deal with the new conditions and set ourselves the target of improving our

performance by USD 30 million per year once these actions are fully implemented at the start of 2018.

The Icelandic tourism industry has been expanding rapidly. What are Icelandair Group's main tasks ahead in that area?

Sigurður: "The Company's growth over the last years is partly a result of the increased number of tourists visiting Iceland. Icelandair Group has focused principally on increasing the number of visitors to Iceland during the wintertime. The availability of flights during the winter has been increased proportionally more than in-season flights, and in our marketing efforts we have focused on presenting Iceland as a year-round destination. Last year was quite successful in this regard and the increase in the number of tourists was proportionally much greater during the winter than the summer. But even though we have made advances in this regard in recent years, there are still extensive opportunities when it comes to year-round tourism in Iceland. By evening out seasonal fluctuations we strengthen our tourist operations in Iceland. Icelandair Hotels have been expanding rapidly and there are exciting times ahead in the hospitality industry. Hotel room occupancy over the winter is rising rapidly, which is an extremely welcome boost for our hotel operations. Developing high-quality hotels in high-end areas presents great opportunities for the Company. Direct scheduled air service between Akureyri and Keflavik will also reinforce tourism in rural areas."

Icelandair will be taking delivery of its first Boeing 737 MAX aircraft next year. What changes will that bring?

Sigurður: "There are certainly exciting times ahead with the scheduled delivery of the first Boeing 737 MAX aircraft. The MAX aircraft are a new, improved and longer-range version of the Boeing 737 aircraft currently in service. These aircraft

Continued growth – more uncertainty ahead of us, continued:

are extremely cost effective, with new and more efficient engines, which will reduce fuel cost per seat. The fuel expenses of the new aircraft will be approximately 20% less per seat than in the case of the Company's Boeing 757 aircraft. Different-sized aircraft will give us opportunities to continue our development of the Route Network and improve its flexibility. The MAX aircraft can reach 70% of the destinations already offered by the Company and more efficient aircraft will give us opportunities to advance into new destinations and at the same time to meet varying seasonal demand by deploying large aircraft in high season and smaller aircraft in low season. The Boeing 737 MAX is very popular with 3,600 aircraft already on order from many of the major air carriers in the world. Our plans for the development of our fleet assume that by 2021 we will have over 40 aircraft in service, a mix of Boeing 737 MAX, Boeing 757 and Boeing 767."

Sigurður, you have decided to step down after having been Chairman since 2009. What stands out to you from this time?

"In 2009, we faced a major undertaking, which was in fact twofold: on one hand, we needed to ensure the short-term interests of the company in the wake of the financial crisis, reorganise its balance sheets from scratch and simply ensure that the company survived the blows brought on by the crash. On the other hand, we needed to carry ourselves past the short-term difficulties and look further into the future and try to see opportunities in the situation. It wasn't easy in these first years following the crash to look forward with growth as a guiding light. But the company has a remarkable team who put all their knowledge, experience and energy into the task. And now, following the second best operational year in the history of the company, all the employees of Icelandair Group can be proud of their contributions over the last few years.



There are certainly exciting times ahead with the scheduled delivery of the first Boeing 737 MAX aircraft.

Our Route Network has expanded, and we've put an emphasis on sustainable and profitable organic growth. Then the matter of our fleet has also been important in recent years, and the investments we've made in aircraft will be a huge asset to our company well into the future."

Broad Shareholder base

Sigurður: "The number of the Company's shareholders has grown steadily, to 2,560 at the end of 2016. It is important for any company to have the backing of strong shareholders – but it is no less important for the shareholder group to be large and diverse. The Company's share price dropped by 35% in 2016, and shareholders were paid a dividend amounting to 0.54 U.S. cents per share. The Board of Directors has decided to buy back the Company's own shares up to the amount of ISK 1.7 billion in accordance with a resolution approved at the annual general meeting in 2016. The Board of Directors proposes a payment of 565 million ISK in dividends to shareholders in 2017. I would like to thank our fellow shareholders for their continued support of the Company." ■





In 1966, Loftleidir Icelandic built a stylish hotel in Reykjavik, allowing them to offer their passengers a new choice: Stopover in Iceland. An extra 24 hours in Iceland including hotel, meals and sightseeing were available for for only 12 dollars and 50 cents.

We are Icelandair Group

Icelandair Group operates in the international airline and tourism sectors, with Iceland as the focal point of its international Route Network. We believe that our current portfolio of companies in the aviation and tourist services sectors is both stable and mutually reinforcing, covering a wide range of the industries' value chain. We strive to retain a high level of flexibility to adapt to unforeseen changes in the market environment to better serve our customers and continuously meet our stakeholders' expectations.

Icelandair Group's business concept is built on Icelandair's Route Network and on marketing Iceland as a year-round destination. In addition to the international passenger flights operated by Icelandair, the Group has extensive interests in most other parts of Icelandic tourism and aviation, including hotel chains, travel agencies, regional airline and cargo, support services and ground handling and technical services, in addition to its leasing and charter operations. In 2016 the Group employed an average of 3,900 full-time employees, generated total revenues of USD 1,286 million and carried approximately 4 million passengers on its international and regional routes.



The main focus of the Route Network is to operate flights based on the hub-and-spoke concept, taking advantage of the country's geographical location by efficiently connecting flights between Europe and North America via the hub in Iceland.

We are Icelandair Group, continued:

The Route Network is our cornerstone

In 2016 Icelandair flew to 43 destinations in the international Route Network, 16 in North America and Canada and 27 in Europe. The Route Network is based on a 24-hour rotation schedule with morning and afternoon connections through the hub in Iceland and offering an increasing number of connections outside the two main connection banks. At year-end 2016 the fleet consisted of 30 aircraft.



Our strategy

Icelandair Group's strategy is regularly and continually tested in order to enable the Company to fully understand the competitive market in which it operates and to take advantage of any hidden opportunities that may exist and any new opportunities that may arise. To this end we strive to develop tools that will enable us to create more value than our competitors for the benefit of all of our stakeholders.

The Group's long-term strategy remains firmly centred on five key points:

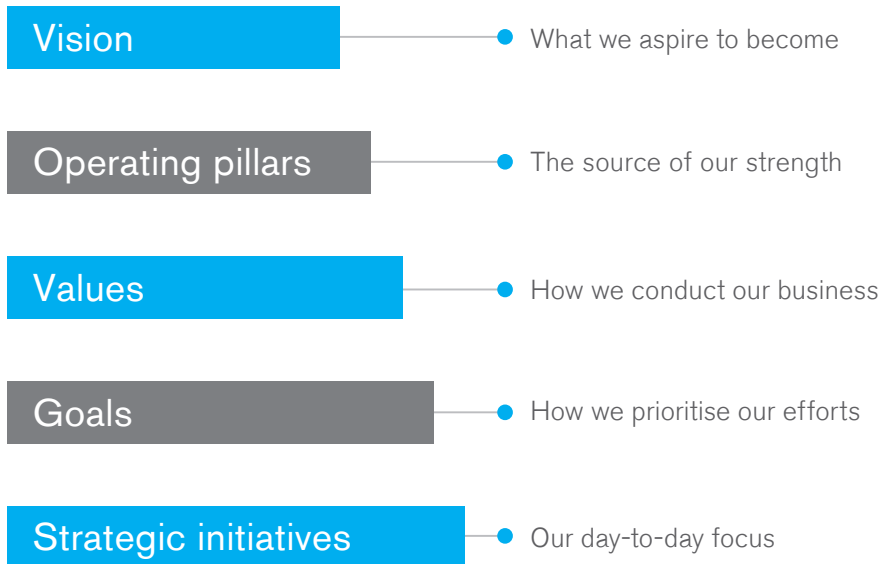
1. Focusing on Route Network and tourism services
2. Reducing seasonality in the Group's operations
3. Focusing on organic growth and business development
4. Achieving greater synergies between Group companies
5. Improving efficiency with special emphasis on continuous cost control

We are Icelandair Group, continued:

Our building blocks of sustainable shareholder value

Icelandair Group's strategy can be graphically illustrated in the shape of building blocks, rising in order to show our approach to the Company's strategic development from the ground up. At the base is the day-to-day focus of our employees on current operations and at the top is our vision for Icelandair Group.

Our building blocks of sustainable shareholder value



The top three building blocks represent our long-term aspirations and corporate conduct. They are the core of our competitive advantage and determine how we structure our operations to leverage our strengths. In essence, they determine our strategic direction and serve as the lens through which we evaluate new projects and strategic initiatives.

The bottom two building blocks represent our short-term focus on profitable operation. They are revised annually and updated to capitalise on emerging short-term and long-term trends. The strategic initiatives are the engine that drives the long-term strategic direction of the Group and the goals provide us with important checkpoints along the way to monitor our progress.

We are Icelandair Group, continued:

Vision statement

Our vision statement encapsulates our aspirations. It is a powerful tool to rally all our stakeholders in a common future direction. It reflects our ambitions and quantifies our goals of unwavering commitment to connect Iceland.



Vision

The vision belongs to Icelandair Group as a whole, and all our employees contribute to its realisation. Through our goals and strategic initiatives we translate our aspirations into actions that can be measured and managed throughout the business cycle. The essence of our vision encompasses the focal points of our business concept of leveraging our strengths; to us, these points are much more than mere words on paper.

■ Year-round tourist destination

Icelandair Group has been at the forefront of devising a long-term strategy for Iceland as world-class destination, and through our investments in Icelandic tourism we have played a leading role in a sustained campaign of development and promotion that benefits not only our own operations but the entire Icelandic travel industry.

■ Strengthen Iceland as a connecting hub

Steadily expanding Icelandair's Route Network, which has grown by 19 destinations since the year 2010, is the Group's key to enhancing Iceland's position as an international connecting hub.

■ Focus on flexibility and experience

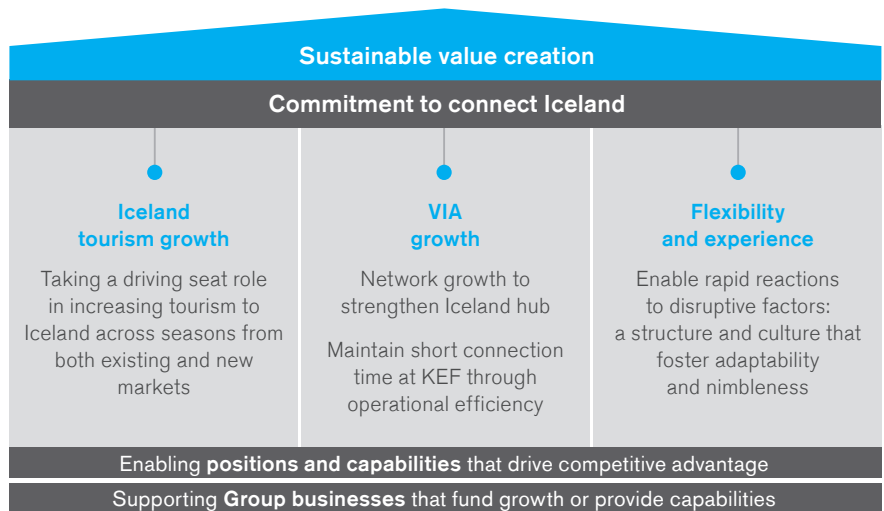
Our unique talent pool remains our primary source of strength, as our employees have proven time and again.

We are Icelandair Group, continued:

Operating pillars

Operating pillars of Icelandair Group

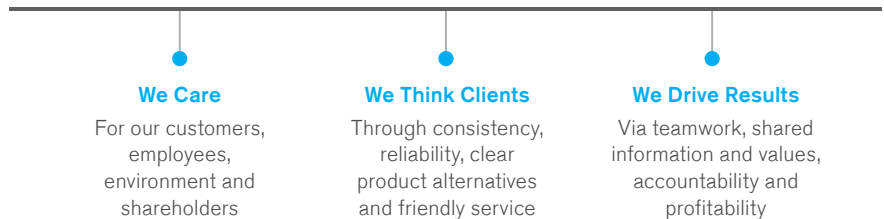
We depict our vision as a structure resting on three pillars: the growth of Icelandic tourism, the growth of connecting VIA traffic, and a combination of flexibility and experience. Sustainable value creation for our shareholders and other stakeholders lies at the heart of our organisation. The best way for us to succeed in this effort is to maintain our traditional dedication and commitment to connecting Iceland by drawing on the strength of our operating pillars.



Icelandair Group has several supporting subsidiaries that provide capabilities which enable the Group to expand its profitable operations.

Values

Our core values are grounded in the philosophy that guides our internal conduct as well as our external relations with our customers, partners, shareholders and other stakeholders.



What we do, what we say, and how we behave determines how our customers see us. Our behaviour is the practical manifestation of our brand and reflects our values.

We are Icelandair Group, continued:

Goals and strategic initiatives

What Icelandair Group needs to do in order to survive in its competitive landscape is dictated by financial objectives which are universal and apply in all business operations. These objectives however, do not in themselves suggest business strategies, nor do they provide strategic direction. Through continuous strategic development, Icelandair Group seeks to continue to sustainably grow its profitable operations. We evaluate our effort by comparison with clear-cut short-term and longer-term financial and operational goals that we translate into our EBITDA projection, which is published quarterly. ■



Goals

Strategic initiatives

The low fares Loftleidir offered in the sixties made flights across the Atlantic available to a larger group of people. Many of their passengers were young – and long-haired as well.

The airline even got nicknamed “the Hippie Airline”.





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Corporate Governance

AUDIT COMMITTEE:

Katrín Olga Jóhannesdóttir,
Chairman

Ásthildur Otharsdóttir

Magnús Magnússon

COMPENSATION COMMITTEE:

Sigurður Helgason,
Chairman

Úlfar Steindórsson

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 accessible on the Company's website and the Guidelines and Rules for Issuers can be accessed on the NASDAQ OMX Iceland website.

The Company complies in all main respects with the rules cited above. However, the Company does not have a Nomination Committee, as the Board of Directors has not seen any need for such a committee. No government organisation has found the Company to be in breach of any rule or regulation regarding corporate governance.

In 2013 the Iceland Chamber of Commerce, the Confederation for Icelandic Employers and NASDAQ OMX Iceland hf. recognised the Company as "Exemplary in corporate governance". The aim of the award is to enhance the credibility and transparency of Icelandic companies' corporate governance with respect to shareholders and other stakeholders.

Internal Audit and Risk Management

The Group's Audit Committee oversees the manner in which 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 is entrusted

with overseeing the Group's consolidated accounts. The committee is also responsible for evaluation of the independence and eligibility of both the Company's auditor and auditing firm and for submitting recommendations to the Board of Directors regarding the selection of the Company's auditor. The Audit Committee held ten meetings in 2016.

Values, 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, which was subsequently amended on 5 January 2011 and on 18 November 2016. The Code of Ethics is accessible to all Company employees through the Company's intranet, MyWork, as well as on the Group's website.

Compensation Committee

The purpose of the Compensation Committee is to prevent the Company's management from being placed in control of their own remuneration and to ensure that management 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 management's performance and related bonuses, including stock options. The Committee conducts evaluations of management remuneration and monitors management's acquisition of stock in the Company. The Compensation Committee meets on average four times a year. ■

The Board of Directors

■ SIGURÐUR HELGASON | CHAIRMAN

Sigurður Helgason was President & CEO of Flugleidir/Icelandair 1985–2005. He was Director Cash Management 1974–1980, Senior Vice-President Finance 1980–1983, General Manager The Americas 1983–1985 at Flugleidir/Icelandair. He was a member of the IATA Board of Governors 2004/2005. He was a Member of the Board of Directors at Finnair 2007–2012. He was Chairman of the Board of The Icelandic International Development Agency 2005–2008. He has been Chairman of the Icelandair Special Children Travel Fund since 2005. He has served on various boards of Icelandic business enterprises since 1974. He graduated with an MBA degree from the University of North Carolina, Chapel Hill, USA, in 1973 and completed a Cand. Oecon. degree at the University of Iceland in 1971. He joined the Board on 6 August 2009.



■ ÚLFAR STEINDÓRSSON | DEPUTY CHAIRMAN

Úlfar Steindórsson was born in 1956 and is CEO and Chairman of Toyota in Iceland ehf. and JÚ ehf. He was CEO of Primex ehf. in Siglufjörður from 2002–2004, and CEO of the New Business Venture Fund from 1999–2002. Úlfar is Chairman of the Board of Bifreiðainnflutningur ehf., Bílaútleigan ehf., Okkar bílaleiga ehf. and TK bílar ehf. He is a Board member of Mótormax, Áltak ehf., Toyota á Íslandi ehf., Króksslóð ehf., UK fjárfestingar ehf., Johan Rönning hf., S Guðjónsson ehf., Skorri ehf., My Car ehf. and Úlfar holds a Cand. Oecon degree from the University of Iceland and an MBA from Virginia Commonwealth University. He joined the Board on 15 September 2010.

■ ÁSTHILDUR M. OTHARSDÓTTIR | BOARD MEMBER

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

■ KATRÍN OLGA JÓHANNESDÓTTIR | BOARD MEMBER

Katrín Olga Jóhannesdóttir was born in 1962 and is the former Chief Strategy Officer of Skipti hf. and the current Chairman of the Board of Já hf., where she is a shareholder. Before that she was VP for sales and marketing and VP for residential markets at Síminn hf. Prior to that she held a position as the Managing Director of Navision Iceland and was a management consultant at VSO. Katrín Olga currently serves on the boards of directors of Ölgerðin hf. and Njála ehf., having previously served on the boards of the Central Bank of Iceland, Sirius IT and SkjáMiðlar. She was elected Chairman of the Iceland Chamber of Commerce in February 2016. She holds a Cand. Oecon degree from the University of Iceland and an M.Sc. in Business Economics from Odense University. She joined the Board on 6 August 2009.

■ MAGNÚS MAGNÚSSON | BOARD MEMBER

Magnús Magnússon was born in 1965 and has been employed as a division manager at LBI hf. since early 2009, having previously worked for Búnaðarbankinn and the financing company Lýsing hf. following a period of self-employment from 2003 to year-end 2008. Magnús currently serves on the boards of directors of Lýsi hf. and the manufacturing and contracting company Loftorka in Borgarnes, as well as several subsidiaries of LBI hf. Magnús holds a degree in Business Economics from the University of Iceland and a Masters Degree in international business from Norges Handelshøyskole. Magnús has been a reserve member of Icelandair Group's Board of Directors from 2009–2014 and a full member of the Board since 1 August 2014.

The Board of Directors, continued:

The Company's Board of Directors exercises the supreme authority in the Company's affairs between shareholders' meetings, and 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 on 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 adequate supervision of the Company's accounts and secure safeguarding of its assets and shall adopt working procedures in compliance with the Companies Act. Only the Board of Directors may assign powers of procurement 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 authorisation of the Board of Directors, unless it is impossible to await the decision of the Board without seriously disadvantaging the operation of the Company. In such instances the President and CEO is required to consult with the Chairman of the Board, if possible, after which the Board of Directors must immediately be notified of the measures. The President and CEO shall ensure that the accounts and finances of the Company conform to the law and accepted practices and that all assets belonging to the Company are securely safeguarded. The President and CEO is required to provide the members of the Board of Directors and Company

auditors with any information pertaining to the operation of the Company which they may request, as required by law.

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

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

On 12 September 2007 the Board of Directors approved Rules on Working

Procedures for the Board of Directors, which were last amended on 10 August 2012. The Rules on Working Procedures are accessible to the Board of Directors and management through the Board's intranet. In accordance with article 14 of the Rules on Working Procedures the Board of Directors must annually evaluate its own work, number of members, composition and practices, and must also evaluate the performance of the President and 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 includes evaluation of the strengths and weaknesses of the Board's work and practices and takes into consideration work components where the Board believes there is room for improvement.

The Board of Directors elects the members of two sub-committees: the Compensation Committee and the Audit Committee. The sub-committees are subject to the Rules on Working Procedures. The Board of Directors met 19 times over the year with full participation at almost all meetings. All the members of the Board of Directors are independent of the Company with the exception of Ásthildur Margrét Otharsdóttir. All Board members were independent of the Company's major shareholders in 2016. ■

Executive Committee

■ BJÖRGÓLFUR JÓHANSSON |

PRESIDENT AND CEO, ICELANDAIR GROUP

Before joining Icelandair Group in 2008, Björgólfur was CEO of Icelandic Group, an international seafood company, from March 2006. From 1999-2006 he was CEO of Síldarvinnslan, a fisheries and fish processing enterprise. Björgólfur served as Director of Innovation and Development at the fisheries company Samherji from 1996-1999. From 1992-1996 he was CFO of UA, a fisheries and fish processing company in Akureyri. Björgólfur worked as an accountant from 1980-1992. He was elected Chairman of the Confederation of Icelandic Employers in March 2013 and served as Chairman of the Board of the Federation of Icelandic Fishing Vessel Owner from 2003-2008. He graduated with a degree in Business Administration from the University of Iceland in 1983 and qualified as a chartered accountant in 1985.



■ BOGI NILS BOGASON | CFO, ICELANDAIR GROUP

Bogi Nils began his career with Icelandair Group in October 2008. He was CFO of the investment firm Askar Capital from January 2007 until he joined Icelandair Group, and CFO of the international seafood company Icelandic Group, from 2004-2006. Bogi Nils was an auditor and partner at KPMG in Iceland in 1993-2004. He holds a Cand. Oecon. degree in Business from the University of Iceland and qualified as a chartered accountant in 1998.

■ BIRKIR HÓLM GUÐNASON | CEO, ICELANDAIR

Birkir Hólm Guðnason was appointed CEO of Icelandair in May 2008, after serving with the company from 2000. Earlier posts at Icelandair include Sales Manager in Iceland 2000-2002, Sales & Marketing Manager in North America 2002-2005, General Manager for Central Europe, situated in Frankfurt, 2005-2006, and General Manager for Scandinavia, situated in Copenhagen, from 2006. Birkir studied in Aalborg, Denmark, 1995-2000 and holds a B.Sc. degree in Business Economics and an MBA degree in International Business Economics from Aalborg University. Birkir is the chairman of the board of the American Icelandic Chamber of Commerce. He is a board member of the Chamber of Commerce and Íslandsstofa (Promote Iceland).

■ MAGNEA ÞÓREY HJÁLMAUSDÓTTIR | MANAGING DIRECTOR, ICELANDAIR HOTELS

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

Shareholder Information

Icelandair Group's shares are listed on NASDAQ OMX under the symbol ICEAIR. The shares lost value in 2016. The total shareholder return was negative by 33%, with the Group's share price decreasing by 35%. Shareholders were paid a dividend amounting to 0.54 US Cent per share.

Share capital

Icelandair Group's share capital as at 31 December 2016 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 carries one vote. Shareholders are entitled to dividends as declared from time to time. The Company held own shares in the nominal amount of ISK 25 million at year-end 2016 (2015: ISK 25 million). The Group's shares are listed under the code ICEAIR on the NASDAQ OMX Iceland.

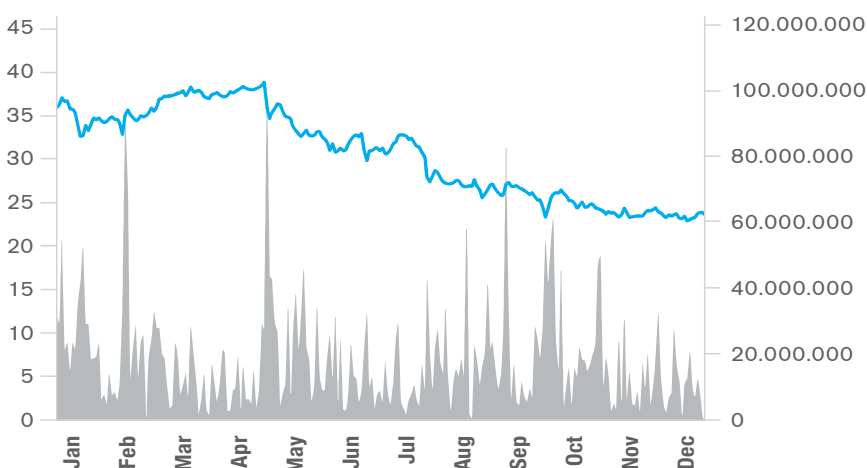
The Board of Directors of Icelandair Group has decided to execute a share repurchase program in order to reduce the share capital of the Company. This decision was made following authorisation given by the Annual General Meeting on the 10th of March 2016, which gave the Board of Directors permission to execute a share repurchase program where up to 10% the Company's shares would be purchased within a period of 18 months. The share repurchase will at most amount to 114 million shares or 2.28% of the total share capital.

Share performance

Icelandair Group's shares got off to a good start in 2016 and the share price rose until it reached its peak at ISK 38.90 on 28 April 2016. External factors in the operating environment of air carriers exerted pressure on results in the sector and the Company's price started to decline, reaching a low of ISK 22.95 on 15 December 2016. Over the year Icelandair Group's share price decreased by 34.7%. Taking dividend payment into account, shareholders' return was negative by 32.8% in 2016.

Icelandair Group share price and trading volume in 2016:

Icelandair Group share price and trading volume | 2016 per month



Shareholder Information, continued:

All amounts in ISK	2012	2013	2014	2015	2016
Market capitalisation, million	41,100	91,000	107,000	177,000	115,500
Share price at year-end	8.22	18.20	21.40	35.40	23.10
Highest closing price	8.24	18.20	21.40	35.40	38.90
Lowest closing price	4.83	8.22	16.45	20.95	22.95
No. of issued shares, million	5,000	5,000	5,000	5,000	5,000
No. of outstanding shares, million	4,975	4,975	4,975	4,975	4,975
Average no. of outstanding shares, million	4,975	4,975	4,975	4,975	4,975

Share liquidity

Icelandair Group has entered into an agreement with Landsbankinn hf., Íslandsbanki hf. and Arion banki hf. regarding market-making for the issued shares of Icelandair Group. The agreement is of unspecified duration and may be terminated with one month's notice. The purpose of the agreement is to improve liquidity and to enhance transparent price formation for the Company's shares on NASDAQ OMX Iceland.

Shares in Icelandair Group were traded 6,407 times in 2016 for a total market value of ISK 140.1 billion (ISK 87.5 billion in 2015). Icelandair Group's market capitalisation at the end of 2016 was ISK 115.5 billion.

Key ratios

Icelandair Group reported net profit of USD 89.1 million in 2016, corresponding to 1.79 US Cents per share. The Company's total equity at year-end was USD 568.2 million. The P/E ratio at the same time was 11.4 and the P/B ratio was 1.6.

	2012	2013	2014	2015	2016
Earnings per share in US Cents	0.9	1.1	1.3	2.2	1.8
Intrinsic value of share capital	7.3	8.5	9.0	11.2	14.0
P/E ratio	7.2	14.0	12.6	12.1	11.4
P/B ratio	1.1	2.1	2.4	3.1	1.6
Number of shareholders	1,458	1,833	2,099	2,387	2,560

Shareholders

At the end of 2016 the number of shareholders was 2,560, as compared to 2,387 at the beginning of the year. 0.5% of the total shareholder base held 64.2% of the shares in the Company.

Number of shares	Shareholders	%	Shares	%
1-100,000	1,883	72.8%	46,445,476	0.9%
100,001-1,000,000	541	21.1%	176,476,971	3.5%
1,000,001-10,000,000	109	4.3%	314,423,736	6.3%
10,000,001-100,000,000	35	1.4%	1,254,159,328	25.1%
100,000,001 +	12	0.5%	3,208,494,489	64.2%
Total	2,560	100.0%	5,000,000,000	100.0%

Financial Calendar

Q1 2017 | 27.04 2017

Q2 2017 | 27.07 2017

Q3 2017 | 26.10 2017

Q4 2017 | Week 06 2018

AGM | Week 11 2018

Shareholder Information, continued:

20 Largest shareholders 31 December 2016:

Name	No. Shares	Shares in %
Lífeyrissjóður verslunarmanna	734,361,239	14.69
Stefnir – ÍS 15	482,225,929	9.64
Gildi – Lífeyrissjóður	369,261,301	7.39
Lífeyrissj.starfsm.rík. A-deild	341,600,000	6.83
Stefnir – ÍS 5	239,237,069	4.78
Landsbréf - Úrvalsbréf	188,236,747	3.76
Birta Lífeyrissjóður	184,552,761	3.69
Stapi Lífeyrissjóður	171,153,864	3.42
Sameinaði Lífeyrissjóðurinn	145,101,887	2.90
Brú Lífeyrissjóður	126,217,806	2.52
Lífeyrissj.starfsm.rík. B-deild	124,440,000	2.49
Söfnunarsjóður Lífeyrisréttinda	102,105,886	2.04
Landsbréf Öndvegisbréf	92,922,744	1.86
Virðing safnreikningur	82,149,466	1.64
Almenni Lífeyrissjóðurinn	81,378,324	1.63
Festa - Lífeyrissjóður	71,783,531	1.44
A.C.S safnreikningur I	69,861,000	1.40
Íslandsbanki hf.	59,447,881	1.19
IS Hlutabréfasjóðurinn	57,392,156	1.15
Frjálsi Lífeyrissjóðurinn	51,606,435	1.03
Other	1,224,963,974	23.59
Total	5,000,000,000	100.00

Dividend and dividend policy

Icelandair Group's goal is to pay 20-40% of each year's net profit in dividends. Final annual dividend payments will be based on the financial position of the Company, operating capital requirements and market conditions. This year Icelandair Group's Board of Directors proposes that dividend payments in the amount of ISK 565 million will be made in ISK to the shareholders, which corresponds ISK 0.11 per share. The amount represents 5.8% of the net income for the year. Based on Icelandair Group's share price as at 31 December 2016, ISK 23.1, the dividends correspond to 0.5% of market capitalisation.

Investor relations

Icelandair Group's objective is to ensure that timely and correct information about the Company is made available to all stakeholders simultaneously, regularly and consistently. All press releases, financial disclosures and Company announcements are published through GlobeNewswire, a NASDAQ OMX company. Icelandair Group strives continuously to improve the quality, transparency and consistency of its information disclosures.

The Investors' website at 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. ■

80 YEARS OF AVIATION 1937-2017



ROLLS-ROYCE
400 JET PROP



HOFTLEIBIR

MAX. LD. 5000 LBS.





Pilots of Flugfélag Íslands relax between flights. It was in the prosperous years Iceland enjoyed after WW2 that regular flights to and from the island began, ending the relative isolation of the nation once and for all.

Performance in 2016

Icelandair Group's 2016 results are the second best in the Company's 80-year history, and on the whole operations were successful over the year in challenging conditions. Net profit amounted to USD 89.1 million, as compared to USD 111.2 million in 2015, which was a record year. Total operating income was USD 1.3 billion, up by 13% between years.

Transport figures

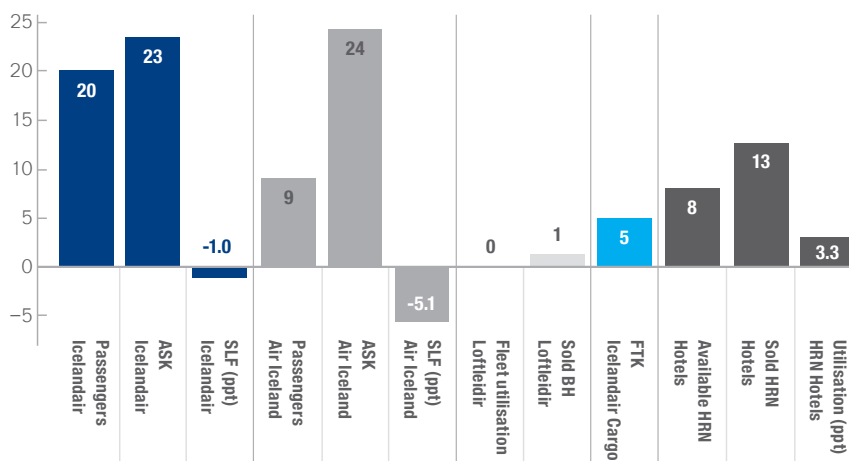
Passengers on international flights were 3.7 million in 2016, up by 20% from the preceding year. The Company has never before transported so many passengers in a single year. The passenger load factor over the year was good, at 82.2%, down by 1.0 percentage point between years. The passenger load factor has only once been higher in the Company's history, in 2015, when the factor was 83.2%. The increase in passenger numbers between years was proportionality greatest in the tourist market to Iceland, at 23%. This market accounts for 38% of the year's total passenger numbers. Passengers on the transatlantic market via Iceland also increased significantly, by 22%; this market is the Company's largest market, accounting for 50% of total passenger numbers in 2016. The increase in passenger numbers in the domestic market from Iceland was 3% between years.

Passengers on domestic and regional flights (flights in Iceland, to Greenland and Scotland) were approximately 323 thousand, as compared to 296 thousand in 2015, which corresponds to an increase of 9%. Capacity increased by 24% between years, with flights to Aberdeen accounting for about half of the increase. The passenger load factor was 69.3%, as compared to 74.4% last year. Sold block hours on charter flights increased by 1% between years, and transported cargo by 5% from the preceding year. The number of sold hotel nights increased significantly, by 13%. The number of available hotel nights increased by 8% over the same period. Hotel room occupancy in the Company's hotels in 2016 was a record-high 81.5%.

		2016	2015	Change
International flights				
Number of passengers	Thousand	3,675	3,074	20%
Load factor	%	82.2	83.2	-1.0 ppt
Available Seat KM (ASK)	Million	13,653	11,083	23%
Domestic and regional flights				
Number of Passengers	Thousand	323	296	9%
Load Factor	%	69.3	74.4	-5.1 ppt
Available Seat KM (ASK)	Million	180	145	24%
Charter flights				
Fleet utilisation	%	100.0	100.0	0.0 ppt
Sold block hours	Number	23,523	23,263	1%
Cargo				
Freight Tonne KM (FTK)	Thousand	105,379	100,497	5%
Hotels				
Available hotel room nights	Number	352,214	325,941	8%
Sold hotel room nights	Number	287,160	254,842	13%
Utilisation of hotel rooms	%	81.5	78.2	3.3 ppt

Performance in 2016, continued:

Traffic figures | YOY change in %



Earnings

Results in 2016 the second best in the Company's 80-year history

Net profit amounted to USD 89.1 million, down from USD 111.2 million in 2015, which was a record year. EBITDA amounted to USD 219.8 million, down by 3% between years. These good results were achieved in the face of negative pressure from external factors. The passenger load factor was favourable in the Company's international flight operations; however, average fares fell between years in all markets in line with the general trend among air carriers. The strengthening of the Icelandic króna against the USD also had a negative impact on EBITDA.

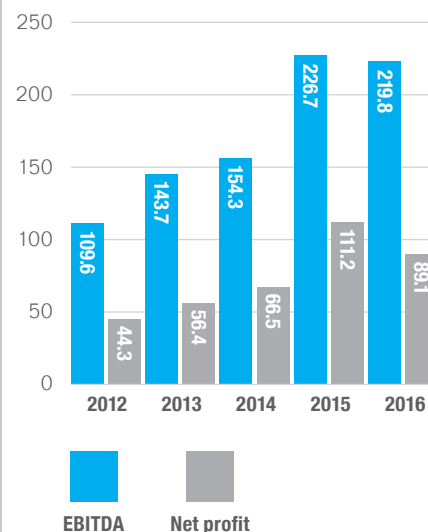
USD thousand	2016	2015	Change
EBITDAR	254,960	261,710	-3%
EBITDA	219,845	226,666	-3%
EBIT	118,437	142,840	-17%
EBT	120,111	140,223	-14%
Net Profit	89,068	111,223	-20%
EBITDAR %	19.8%	23.0%	-3.1 ppt
EBITDA %	17.1%	19.9%	-2.8 ppt

Operating income

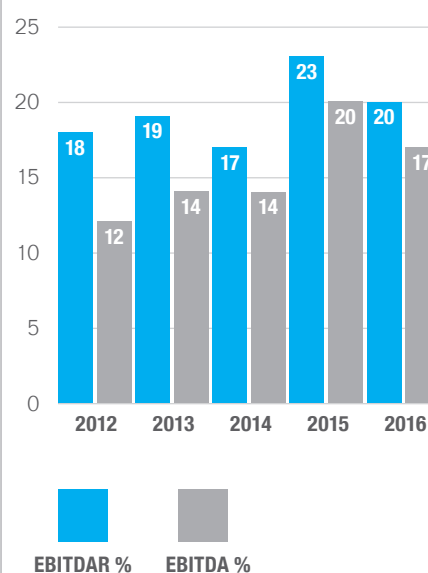
Operating income amounted to USD 1,285.6 million in 2016, up by 13% from 2015.

USD thousand	2016	2015	Change	% Change	% of rev. '16
Transport revenue:	947,823	848,868	98,955	12%	74%
Passengers	895,614	806,555	89,059	11%	70%
Cargo and mail	52,209	42,313	9,896	23%	4%
Aircraft and aircrew lease	84,574	83,356	1,218	1%	7%
Other operating revenue	253,177	207,475	45,702	22%	20%
Total	1,285,574	1,139,699	145.875	13%	100%

EBITDA and net profit in USD million | 2012–2016

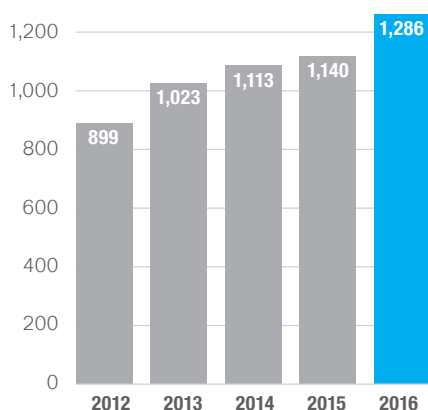


EBITDAR % and EBITDA % | 2012–2016

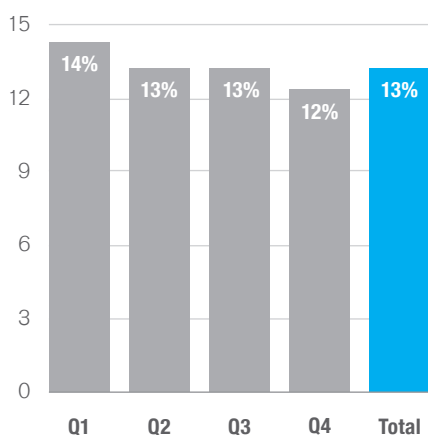


Performance in 2016, continued:

Total income in USD million | 2012–2016



Change in total income per quarter | 2016 vs 2015



Passenger revenue up by 11%

Transport revenue totalled USD 947.8 million, up by 12% from 2015. Transport revenue accounts for 74% of Icelandair Group's total income. Of this figure, passenger revenues amounted to USD 895.6 million, up by 11% from 2015. The largest increase was in the tourist market to Iceland and in the North Atlantic market.

Increased number of tourists visiting Iceland stimulates other revenue

Other revenue totalled USD 253.2 million in 2016, up by USD 45.7 million from the preceding year. Nearly 1.8 million tourists visited Iceland in 2016, which corresponds to more than five times the country's population and represents a 39% increase from the preceding year. The heightened interest in Iceland is reflected in increased revenue for Icelandair Group, especially in sales in the Company's hotels and in airports (USD 27.2 million) and in increased revenues from tourism services (USD 18.4 million).

Expenses

Operating expenses amounted to USD 1,065.7 million in 2016, as compared to USD 913.0 million in 2015, an increase of 17% between years.

USD thousand	2016	2015	Change	% Change	% of exp. '16
Salaries and other personnel expenses	354,253	278,015	76,238	27%	33%
Aircraft fuel	213,418	223,828	-10,410	-5%	20%
Aircraft lease	20,687	22,896	-2,209	-10%	2%
Aircraft maintenance expenses	77,361	68,808	8,553	12%	7%
Aircraft handling, landing and communication	108,784	85,662	23,122	27%	10%
Other operating expenses	291,226	233,824	57,402	25%	27%
Total	1,065,729	913,033	152,696	17%	100%

Performance in 2016, continued:

Salaries and personnel expenses increased substantially between years

Salaries and other personnel expenses amounted to USD 354.3 million, increasing by USD 76.2 million, or 27%, from 2015. The reasons for the increase are the expanded scope of the Company's business, contractual wage increases and the strengthening of the ISK against the USD over the comparison period, as most of the Company's wage costs are in ISK. The average number of full-time employees was 3,900 in 2016, as compared to 3,384 in 2015.

Fuel cost fell between years despite expanded business

Fuel cost totalled USD 213.4 million in 2016, down by USD 10.4 million from 2015. Fuel cost as a percentage of total expenses was 20%. The world market price of fuel fell by 20%, down to an average of USD 425/ton in 2016, as compared to USD 529/ton in 2015. Icelandair Group's reporting price, taking fuel hedging into account, fell more between years, by 27%, to an average of USD 501/ton in 2016, as compared to USD 685/ton in 2015.

Other operating expenses totalled 291.2 million

Other operating expenses increased by USD 57.4 million between years, or 25%. The main reason is the Company's expanded scope of business. Under other operating expenses, advertising, booking fees and commission cost totalled USD 83.3 million, as compared to USD 72.8 million in the preceding year, and tourism expenses increased in line with increased revenues from tourism. Total tourism expenses amounted to USD 70.5 million, up by USD 18.1 million from 2015.

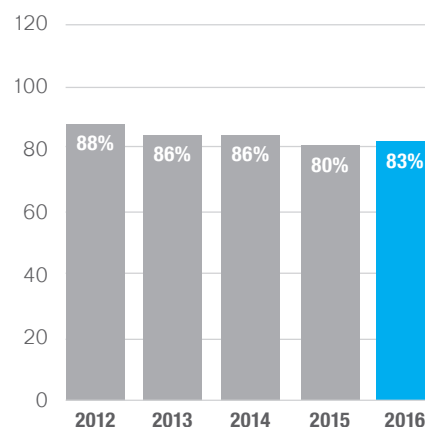
Depreciation and amortisation amounted to USD 101.4 million

Total depreciation of operating assets amounted to USD 99.2 million in 2016, as compared to USD 80.1 million in 2015. Amortisation of intangible assets totalled USD 2.2 million, down by USD 1.5 million from 2015. No impairments were made in 2016.

Interest expenses down by 31% in 2016

Net finance income totalled USD 0.7 million in 2016, as compared to net finance costs of USD 3.1 million in 2015. The biggest contributing factor was a decrease in finance costs, which amounted to USD 5.7 million in 2016, as compared to USD 8.2 million in 2015. Interest income totalled USD 3.3 million, up from USD 2.9 million in the preceding year. The currency exchange gain resulting from the position of financial assets and liabilities at the end of the year totalled USD 3.1 million, as compared to USD 2.2 million in 2015. ■

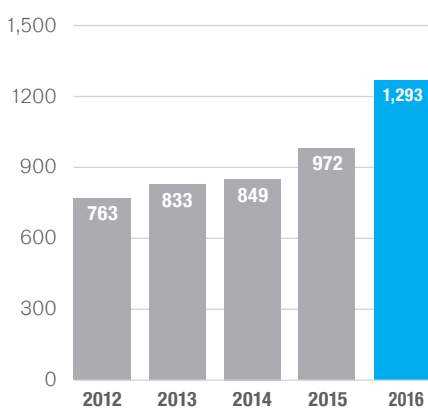
Operating expenses as % of total income | 2012–2016



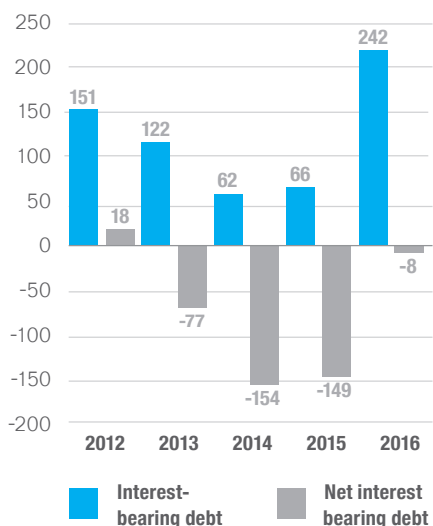
Financial Position

Icelandair Group's financial position is strong, with the year-end equity ratio at 44%. Assets increased by 33%, to a total of USD 1,292.5 million at year-end. Cash and short term investments in excess of interest-bearing liabilities amounted to USD 7.7 million at year end.

Total assets in USD million | 2012–2016



Interest-bearing and net interest bearing debt in USD million | 2012–2016



ASSETS

Non-current assets increased by 237.4 million

The Group's total assets increased by USD 320.5 million in 2016, to USD 1,292.5 as at 31 December 2016. Non-current assets increased by USD 237.4 million, to USD 875.0 million, and current assets increased by USD 83.1 million, to USD 417.5 million.

Within non-current assets, operating assets increased by USD 183.5 million. The increase is largely a result of investments in aircraft and aircraft components. To support the growth of the Company, five aircraft were added to the balance sheet: two Boeing 757 200 and three Boeing 767 300. Intangible assets and goodwill totalled USD 174.7 million, mainly comprising goodwill in the amount of USD 139.0 million. Other non-current assets amounted to USD 97.7 million at year-end, increasing by USD 51.8 million from the preceding year. Of this figure, investments in associates totalled 23.5 million and prepayments on aircraft purchases amounted to USD 68.4 million.

Within current assets, trade and other receivables increased by USD 38.2 million and totalled USD 139.3 million at year-end 2016. Cash and short term investments increased by USD 36.0 million, amounting to USD 250.1 million at year-end 2016.

EQUITY AND LIABILITIES

Equity increased by 24%

Equity increased by 24% and amounted to USD 568.2 million as at 31 December 2016. The largest part of the increase is due to comprehensive income of USD 138.7 million. Dividend payments amounted to USD 27.0 million, which is equivalent to 0.54 US cent per share. The equity ratio was 44%, as compared to 47% in 2015. Share capital at year-end amounted to ISK 5,000 million in nominal value. The Company held own shares in the nominal amount of ISK 25 million at year-end 2016, unchanged from 2015.

USD thousand	2016	2015	2014	2013	2012
Result*	138,650	109,419	37,967	61,910	38,854
Profit for the year	89,068	111,223	66,499	56,418	44,275
Equity	568,213	456,531	365,055	346,082	295,932
Equity ratio	44%	47%	43%	42%	39%

* Comprehensive income

Interest-bearing liabilities up due to bond issue

Non-current liabilities amounted to USD 268.2 million at year-end 2016. Of that figure, loans and borrowings amounted to USD 196.7 million, up from USD 55.4 million. In October 2016 Icelandair Group issued an unsecured bond in the amount of USD 150 million. The bond was placed at a coupon of 3 month LIBOR + 3.50% with no LIBOR floor. The proceeds from the bond issue will be used to finance pre-delivery payments on new aircraft and for Icelandair Group general corporate purposes. Current liabilities totalled USD 456.1 million. Under current liabilities, trade and other payables amounted to USD 210.5 million, down from USD 219.7 million. Deferred income increased by USD 13.8 million, to USD 199.9 million. Current loans and borrowings increased between years and amounted to USD 45.7 million at year-end, as compared to USD 10.1 million.

Financial Position, continued:

Interest-bearing liabilities amounted to USD 242.4 million, as compared to USD 65.5 million at the beginning of the year. Payments on long-term debts amounted to USD 10.1 million over the year.

Calculation of net interest-bearing debt:

USD thousand	31.12.2016	31.12.2015	Change
Loans and borrowings non-current	196,722	55,387	141,335
Loans and borrowings current	45,660	10,143	35,517
Short term investments	23,236	19,533	3,703
Cash and cash equivalents	226,889	194,586	32,303
Net interest bearing debt	-7,743	-148,589	140,846

CASH FLOW AND INVESTMENTS

USD thousand	2016	2015	Change
Working capital from operations	210,801	211,260	-459
Net cash from operating activities	209,024	245,136	-36,112
Net cash used in investing activities	-291,759	-219,942	-71,817
Net cash from/used in financing activities	113,643	-14,320	127,963
Increase in cash and cash equivalents	30,908	10,874	20,034
Cash and cash equivalents at 31 December	226,889	194,586	32,303

Cash provided by operating activities 209.0 million USD

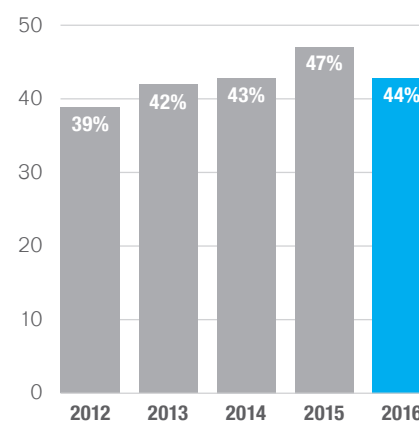
Cash flow from operating activities decreased by USD 36.1 million and came to USD 209.0 million. Net cash used in investing activities amounted to USD 291.8 million; of that figure investment in aircraft and aircraft components was USD 107.1 million.

Net cash from financing activities amounted to USD 113.6 million in 2016. Dividend payments amounted to USD 27.0 million, and repayments of long-term borrowings amounted to USD 10.1 million. Proceeds from non-current borrowings were USD 150.7 million. Cash and cash equivalents at year-end amounted to USD 226.9 million, as compared to USD 194.6 million in 2015.

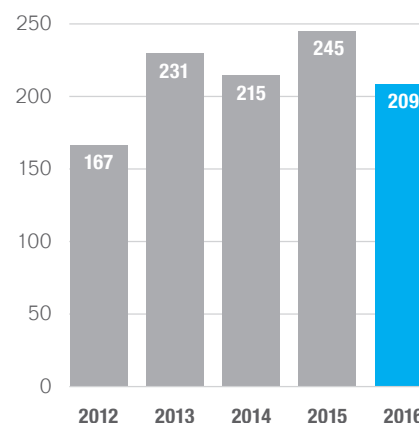
Total investments in 2016 USD 243.4 million

Investments in operating assets amounted to USD 231.1 million. Of this figure, investment in aircraft and aircraft components totalled USD 107.1 million, while investment in engine overhauls on own aircraft totalled USD 70.6 million over the year. Investments in long-term expenses amounted to USD 10.7 million, largely stemming from overhauls of leased engines. Investment in intangible assets amounted to USD 1.6 million.

Equity ratio | 2012–2016







Cash flow from operating activities in USD million | 2012–2016



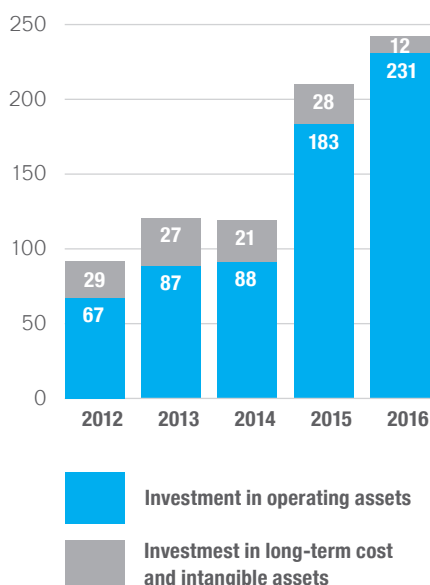
Financial Position, continued:

Fleet

At the end of 2016 Icelandair Group's fleet comprised 48 aircraft, of which 40 were owned by the Company and 8 were leased. Of the Company's own aircraft, 35 are free of liens in the balance sheet. The Company's Fokker-50 aircraft are in the process of being sold. The table below provides an overview of the Company's fleet:

Aircraft type	ICELANDAIR 	ICELANDAIR CARGO 	LOFTLEIDIR ICELANDIC 	AIR ICELAND FLUGFELAG ISLANDS 
Boeing 757-200	25	2	2	
Boeing 757-300	1			
Boeing 767-300	4		2	
Boeing 737-700			1	
Boeing 737-800			2	
Bombardier Q-200				2
Bombardier Q-400				3
Fokker 50				4
Total	30	2	7	9

Total investment in USD million | 2012–2016



The Company has an order for sixteen 737 MAX8 and 737 MAX9 aircraft, with an option to buy an additional eight aircraft. The commitment resulting from the confirmed orders, according to Boeing's list prices at the date of the contract, amounted to USD 1.6 billion. The Company received acceptable discounts which, due to confidentiality agreements, cannot be disclosed.

Delivery of the first aircraft is scheduled for early 2018. The order was for nine 737 MAX8 aircraft, with a seating capacity of 154 passengers, and seven 737 MAX9 aircraft, with a seating capacity of 175 passengers in Icelandair's configuration. For comparison, Icelandair's Boeing 757-200 aircraft used in the Company's international Route Network seats 183 passengers.

Financial Position, continued:

	Group fleet 31.12.16	Group fleet 31.12.15	Of which own	Of which leased	Ch. as of 31.12.15
	29	26	26	3	3
	1	1	1		0
	6	4	4	2	2
	1	1		1	0
	2	2		2	0
	2	2	2		0
	3	3	3		0
	4	4	4		0
	48	43	40	8	5

The Boeing 737 MAX aircraft are a new and improved version of the current Boeing 737. They will be fitted with new and more efficient engines, which will reduce fuel consumption by 20% per seat in comparison with the Boeing 757-200 aircraft currently used on the Company's international routes.

Boeing 757 aircraft will continue in use, as they have proven extremely well suited for the routes extending from Iceland to Europe and North America. The new aircraft will enlarge the fleet and improve both flexibility and the potential for further growth. Their range will permit them to fly to destinations in North America and Europe, opening new possibilities for increased flight frequency and an increased number of destinations, particularly in the wintertime, which will even out the seasonal fluctuations in the Company's operations. ■

2017 Outlook

The year 2017 will be more challenging for Icelandair Group than the last few years. Average airfares have been falling more sharply lately than generally anticipated in the international airline sector, and, in addition, fuel prices have been rising and currency trends have been unfavourable. Nevertheless, the Company, with its strong balance sheet, is well prepared to take on these short-term challenges and the long-term prospects are favourable.

More challenging market conditions

Average fares have been falling in our international flight operation in 2016 in line with the trends seen by other air carriers. This trend is projected to continue in 2017. It can be traced principally to increased competition, but it can also be argued that uncertainty resulting from changes in international politics has affected demand. In addition, fuel prices have been rising and currency trends have been unfavourable, especially the strengthening of the Icelandic króna against the USD.

EBITDA guidance for 2017 at USD 140-150 million

The EBITDA guidance for 2017 projects a decrease in EBITDA between years to the range of USD 140-150 million. The EBITDA guidance for the year assumes an average exchange rate of the EUR against the USD of 1.07 and an average exchange rate index of the ISK at 164 in 2017. The price of fuel (net of hedging) is forecast at USD 540 per tonne on average in 2017.

Goal to improve financial results by USD 30 million annually

Actions have already been taken in the Group's operations which are expected to improve efficiency and increase revenue. The Company's target is that these actions, which relate to both revenue and expenditure, should improve financial results by USD 30 million annually when fully implemented at the beginning of 2018. Icelandair will for example make adjustments to the structure of its airfares and increase the diversity of its product offerings to meet increased competition and changed patterns of consumer behaviour. Since last fall cost containment measures have also been significantly strengthened in the Company.

Capacity in the international Route Network increased by 12%

The flight schedule for 2017 assumes a 12% increase in available seat kilometres and a 5% increase in the number of flights. The difference is explained on the one hand by the increased weight of longer routes to North America and on the other hand by the increase in the number of larger aircraft. The number of passengers in 2017 is projected at 4.0 million, up from 3.7 million in 2016. Flights will be offered to 46 destinations, 18 in North America and 28 in Europe. A total of 30 aircraft will be in use on passenger flights next summer, 4 Boeing 767-300 wide-body aircraft and 26 Boeing 757 narrow-body aircraft.

Extensive opportunities in tourist services in Iceland

Last year was yet another strong year for Icelandic tourism. Nearly 1.8 million tourists visited Iceland, which corresponds to more than five times the country's population and represents a 39% increase from 2015. Tourist numbers are projected to increase by about 24% in 2017, so there are clearly numerous opportunities for expansion in Icelandair Group's tourist services as the Company focuses on implementing and fine-tuning the latest technology and methods in online optimisation and marketing.



The Company's target is that actions relating to both revenue

and expenditure should improve financial results by USD 30 million annually when fully implemented at the beginning of 2018.

2017 Outlook, continued:

New hotel opened in the autumn of 2017

Icelandair Group's hotel operations have been developing at a robust pace in recent years. The occupancy rate in 2016 was excellent, at a record 81.5%. A new hotel, Canopy by Hilton, was opened in Central Reykjavik around mid-year and was very well received. The outlook for 2017 remains good. Negotiations have been concluded with the Hilton chain on the operation of two high-end hotels in the heart of Reykjavik under the Curio Collection brand. The first will have 50 rooms, with launching scheduled for autumn 2017. The second will have about 160 rooms and is scheduled to open in 2018. Work is also in progress on the construction of a hotel at Lake Mývatn in North Iceland.

More tourists in Iceland are taking advantage of domestic flights

The increase in the number of tourists visiting Iceland has resulted in a growing number of foreign travellers on domestic flights, and this trend is expected to continue. In 2016 foreign tourists accounted for 18% of the total number of Air Iceland's passengers. In 2017 Air Iceland will fly to two destinations in partnership with Icelandair: Aberdeen in Scotland and Belfast in Northern Ireland. As of February 2017 the company will also introduce direct domestic flights between Keflavik and Akureyri with links to international flights to and from Keflavik.

Strong financial position and favourable long-term prospects

The Company's balance sheet remains strong, with the equity ratio at 44%. The Company's strategy of maintaining financial strength has always rested on the reasoning that the operating environment of air carriers is highly subject to fluctuations. Icelandair Group is therefore well placed to address the volatility that characterises its operating environment. ■



The flight schedule for 2016 assumes a 12% increase in the number of available seat kilometres. The number of passengers carried is projected at 4.0 million, as compared to 3.7 million passengers in 2016. Flights will be offered to 46 destinations.

Risk Management

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

Various macroeconomic, sector-specific, financial and enterprise-related risks can impact Icelandair 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 that need to be considered when managing risk, especially risk 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 determine the methods to be used to reduce costs and disadvantages arising from any instability and uncertainty in the Company's operating environment. The policy is reviewed on a regular basis and modified when improvements are needed.

Foreign currency risk

The Group seeks to reduce its foreign exchange exposure arising from its business dealings in diverse 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. Historically, the biggest currency mismatch has been a USD deficit, where the annual USD cash inflow falls short of the USD outflow, mainly due to investment, maintenance, fuel costs, and funding-related payments, which are to a large extent denominated in USD.

This mismatch has been shrinking, however, in both relative and absolute terms due to USD revenue growth and lower fuel and funding costs. The gap is expected to shrink still further in 2017 due to stronger USD inflows resulting from increased US sales via marketing, combined with the USD appreciation. In recent years an ISK deficit has emerged and expanded from being trivial to becoming a significant and growing ISK shortfall since 2009. This trend stems from the revenue growth in foreign markets, whilst the consequential added operations

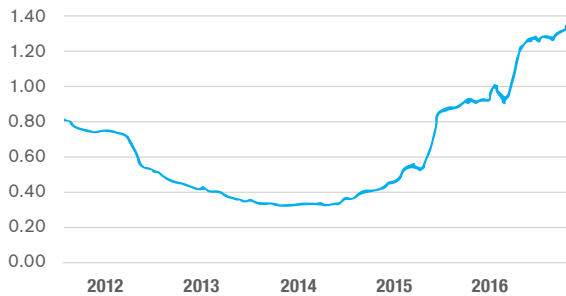
are domestic and need to be covered by ISK. This shortage is financed by a surplus of European currencies, most importantly the EUR and Scandinavian currencies, and the CAD. The Group follows a policy of hedging 50-80% of the net currency exposure 9-12 months forward. In addition to the impact on cash flow, risk exposure of this nature affects the Balance Sheet. The Risk Management Committee monitors on a monthly basis the net Balance Sheet currency mismatch and mitigates the exposure through short-term management of assets and loans to the extent feasible and within the scope of the cash flow objectives.

Fuel price risk

The Group's risk policy requires a hedge ratio between 40% and 60% 9-12 months forward and up to 20% of the estimated exposure 13-18 months forward. Account is taken of the ratio of forward ticket sales as a minimum cover if it exceeds the 40% lower band. The policy entails a mixture of swaps and options, which are allocated in accordance with the degree of risk exposure. The policy and hedge strategy take account of several supporting factors which are eligible to counter the fuel risk exposure. These factors are acknowledged as hedge proxies and evaluated to some extent as substitutions for hedge contracts. First, contractual risk transfer is used where possible and the benefits of a correlation between jet fuel and the USD are monitored and calculated on a regular basis. Second, ticket pricing is a very important and effective tool in the medium term to offset fluctuations in fuel prices. Third, production management is a longer-term option, which can become relevant when coping with fuel price trends over longer periods. Hedge strategies are subject to IFRS hedge accounting standards, but, importantly, the embedded instrument quality requirements are aligned with policy guidelines of sufficient effective-

Risk Management, continued:

Six month USD LIBOR | 2012–2016



Jet fuel price USD per tonne | 2012–2016



EUR/USD exchange rate | 2012–2016



Carbon price EUR per tonne | 2012–2016



ness, reporting clarity and transparency of scenario analysis. Thus, basis risk is avoided and hedge effectiveness sustained by choice of instruments.

Interest rate risk

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 using fixed-rate loan contracts or swap contracts, where the floating rate is exchanged for fixed interest rates. When evaluating the interest risk exposure and the optimal level of protection, account is taken of the Group’s level of interest-bearing cash and marketable securities and various other offsetting economic factors. Due to future investments, steps have been taken to prepare for future funding and to contemplate hedge measures to meet the resulting increase in interest rate exposure.

Carbon price risk

Since the beginning of 2012 all airlines offering European destinations have been required to comply with the EU Emissions Trading Scheme (ETS), which commits them to raise their carbon permits in proportion to their emissions of carbon. Icelandair Group is already hedged against roughly 45% of its 2017 exposure through the EU allocations of emissions quotas. In November 2012 the EU decided to offer airlines flying to and from European destinations an exemption from the Scheme with respect to international flights. Icelandair accepted this offer and its commitment was therefore reduced to covering internal European flights (i.e. “stop the clock”). Again, in April 2014, the EU extended this exemption to 2016 and has therefore relieved airlines temporarily from the uncertainty of carbon exposures within this time frame. Emission permits are mainly purchased using spot and forward con-

Risk Management, continued:

tracts, and carbon exposure is subject to the same scrutiny and risk management as jet fuel. However, while the consequences of ETS compliance are economically trivial in comparison with the magnitude of fuel cost volatility, the emission allowances will not be embedded into the fuel hedge strategies yet, but instead procured on a rolling 3-6 month basis in proportion to fuel consumption.

Liquidity risk

Liquidity risk reflects the Group's ability to fulfil its payment obligations associated with financial and operational liabilities. Liquidity risk management is based on a policy of minimum cash target levels deemed adequate under both normal and stressed conditions. Embedded in the policy are guidelines concerning the quality of the cash equivalents and financial assets. Through risk analysis, and based on past experience, the Group has used an estimation of three-month operating costs as a benchmark for the preferred minimum cash positions, where 30% can be in the form of unused lines of credit. Cash flow requirements and their impact on cash levels are monitored by using rolling currency flow forecasts, which are updated on regular basis.

Credit risk

Credit risk is dependent on the likelihood of a counterparty's default and the loss of their financial obligations. The greatest part of the exposure is concentrated in the form of cash and cash equivalents. Secondly, there is considerable exposure through trade and other receivables from services rendered. The relative spread of claims across counterparties is a relevant factor contributing to credit risk exposure in addition to the composition of asset classes. The risk is countered by the choice of counterparties and dealt with in the accounts with allowances for impairment. The Group maintains an awareness of potential losses relating to credit risk

exposure and chooses its counterparties based on business experience.

Industry-related risk factors

At group and subsidiary levels, management monitors and assesses the airline industry's risk exposure, which has historically posed uncertainty, even in normal operating conditions. A part of the Company's 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 systematically focuses attention on potential threats from a prospective viewpoint, as the environment is extremely cyclical. The Group operates and thrives in well-established and defined markets which, as such, can be regarded as valuable intangible assets that require attention. Icelandair's credibility and reputation are crucial for its market status and growth, but the markets are also sensitive to external factors, such as the macro-economic elements governing aggregate demand. An economic downturn will usually reduce the general purchasing power of potential customers and thereby 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. Abnormal weather conditions and volcanic eruptions in recent years have caused costly and unanticipated threats of disruptions. Terrorist incidents and pandemics are also examples of events that need to be considered at all times. Factors that can be analysed and monitored with respect to reasonable risk of occurrence and impact call for close monitoring and readily available contingency plans. The ash cloud experience of Eyjafjallajökull Glacier in 2010 and Grímsvötn in 2011 put the contingency planning and operational flexibility of Icelandair Group to the test, and the test was passed. This experience benefits the Group now in light of the recent Holuhraun eruption and geo-

logical unrest in Bárðarbunga Glacier, which calls for constant monitoring and scenario analysis. The Company owes its adaptive potential and flexibility of operations chiefly to its capable human resources, contingency policies and economies of scale. The quality of the Company's responsive processes enables us to cope with other adverse circumstances and industry factors, such as seasonality, competition, insurance and new taxes.

Operational risk

The Group distinguishes between industry-related risks and those which expose the subsidiaries at individual company level. Embedded in the Group's operations is a natural spread of business risk, not only in terms of market diversification, but also between the subsidiary business models themselves. This dispersion of interests has returned rewards during periods of economic turbulence. Methods of coping with threats of disruptions and disturbances are also decentralised when it comes to operational hazards. Again, the long and successful history of Icelandair Group and its companies is a valuable asset, which serves both as the foundation and 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 in catering, ground services or flight control. Human resources need to be managed, labour disputes resolved and work stoppages prevented. Wage negotiations are regular, and sometimes extensive, as a result of the number of different unions covering a large majority of the Company's work force. These negotiations were favourably resolved after extensive efforts on both sides.

Risk Management, continued:

Management constantly evaluates the risks involved and the potential consequences of individual events. Scenarios are projected, charted and contemplated and action plans launched based on possible outcomes, where collaboration is maintained between the Group and its individual companies.

Enterprise risk management

Risk management needs access to a secure and steady flow of information about all enterprise-related risks at the Group level and thus requires centralised mapping and detailed registration of risk factors and their estimated inherent financial value and potential consequences. The Group's Risk Management Committee has focused on enterprise-related risk assessment in collaboration with Internal Audit and concentrated on aligning risk records across all subsidiaries to achieve consistency and compliance. The key objective of enterprise risk management is to enhance motivation in risk analysis and improve risk awareness, standardise the quantification of risk and establish the Company culture that is needed to promote everyday risk awareness and risk-reduction measures. Cash-flow stress testing is now performed with enterprise risk inputs by simulating events and scenarios induced by the factors defined in the risk registry. Although based on sensitive and qualitative assumptions, this practice has the merit of shedding light on the possible operational and financial consequences of external and internal disturbances. Annually, results are submitted to the Audit Committee for evaluation and support. ■

05

Icelanders welcome the first jet plane. Named Gullfaxi, the Boeing 727-100 arrived on 24 June 1967. Its interior was specially designed for Flugfélag Íslands, among other things featuring illustrations of life in Iceland on the inside walls.

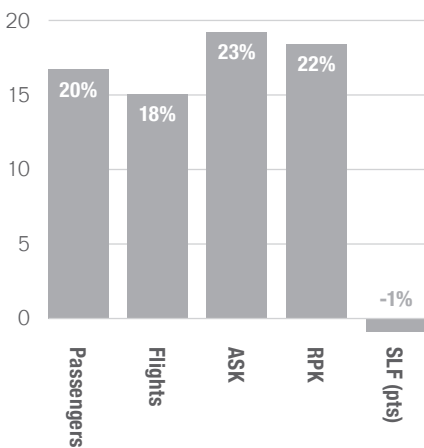




International Route Network

The business concept behind Icelandair Group's largest subsidiary, Icelandair, is based on Iceland's advantageous geographic position on the flight routes between northern Europe and North America, making it an ideal central point for an extensive international hub-and-spoke airline network spanning the distance between both continents. In a typical element of Icelandair's Route Network, an aircraft will take off from Keflavik Airport in the morning and fly to Europe. It will then return later in the day and continue westward to North America to return to Iceland in the morning after.

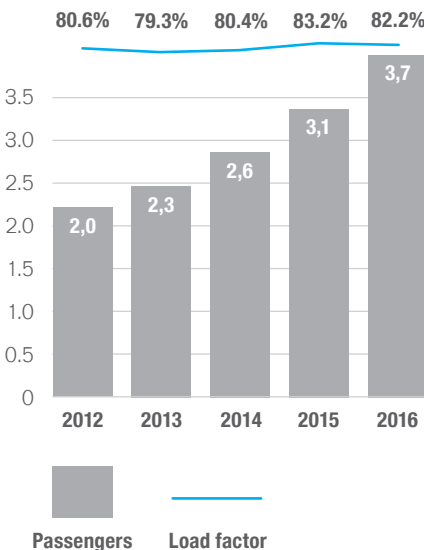
Traffic Data Icelandair | YOY Change in %



Variety of destinations

Icelandair's Route Network serves three different passenger markets: the Icelandic domestic market, i.e. the FROM market, the tourist market with Iceland as a destination, i.e. the TO-market, and the international market between Europe and North America, i.e. the VIA market. Serving these three markets with the same aircraft enables the Company to offer a higher flight frequency and a greater variety of destinations than the markets TO and FROM Iceland alone would allow. Of the three markets, the VIA market is the largest and has been the main driving force of the growth of the Route Network in recent years. Since 2010 the proportion of VIA passengers has grown from 38% to 50% of the total passenger numbers in 2016.

Number of passengers (millions) and load factor | 2012-2016



Growing Route Network

Icelandair's flight schedule for 2017 will be the largest in the Company's history, growing by 12% from the 2016 schedule. Three new destinations are being added to the Route Network: Philadelphia and Tampa Bay, in the US, and Belfast in Northern-Ireland. In addition, the frequency of flights to various cities in North America and Europe will be increased. The number of weekly departures from Keflavik will increase from 331 to 356 over next summer's high season. The new destinations will provide excellent opportunities to strengthen the Route Network still further.

The number of passengers in 2017 is projected at around 4.0 million, as compared to 3.7 million in 2016. A total of 26 Boeing 757 aircraft and four Boeing 767 aircraft will be used to serve the Company's passenger routes next summer, two more than in 2016.

Increased connectivity

In 2017 the Route Network will comprise 28 European cities and 18 North American cities. The 46 destinations offer Icelandair customers 496 connection options, which corresponds to a connectivity multiple of 10.8 times the number of destinations. In 1990 the Route Network comprised 12 destinations with the option of 39 connections for our customers, representing a connectivity multiple of 3.3 relative to each destination. This comparison illustrates the exponential increase in the Network's connectivity.

Increased number of destinations and flight frequency

When a new flight schedule is announced for the coming year the new destinations will usually get the most attention, but in fact the greatest change from 2016 to 2017 will lie in the greater frequency of flights to and from the current destinations. As an example of the extended reach of the Route Network, year-round flights will now be offered to 12 cities in North America, up from five cities four years ago, and daily flights will be offered all year to 11 European cities this winter, up from four cities four years ago.

24-hour hub-and-spoke concept at Keflavik Airport

The heart of the Route Network is the 24-hour hub at Keflavik Airport. In the morning Icelandair aircraft take off for all the destinations in the East. They reach Europe around mid-day and start the return flight early in the afternoon. Because of the time difference between Iceland and most of Europe, the fleet is typically back in Keflavik at around

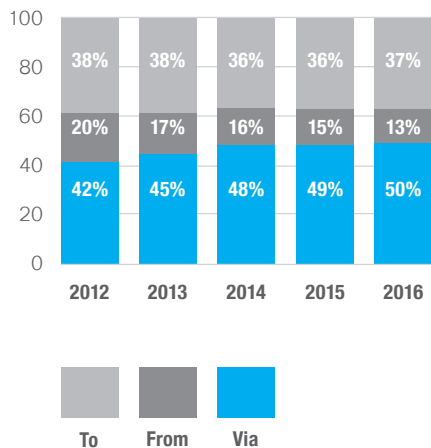
The Route Network



Iceland's uniquely central location between Europe and North America is the key to our hub-and-spoke network. In 2017 the Route Network will comprise 28 European cities and 18 North American cities. The number of passengers in 2017 is projected at over 4.0 million, with 26 Boeing 757 aircraft and four Boeing 767 aircraft serving the Route Network.

International Route Network, continued:

Passenger mix in % | 2012–2016



midday, Icelandic time. The North America operation begins toward late afternoon and the fleet arrives in the U.S. and Canada in the early evening and returns to Keflavik early in the morning of the next day, just in time to depart again for Europe. In recent years a second connecting bank has been set up, with North-American departures from Keflavik just before noon. The expansion through a second bank gives the option of two separate departure times per day to certain destinations, providing extra support for the main connection bank in the morning. The second connecting bank is operated for over five months in 2017, from May until October.

Connecting Europe and North-America

Almost two thirds of the seat capacity in the Route Network is on flights to Europe, with the remaining capacity deployed on North American routes. The United States is Icelandair's largest single destination country, while its European network focuses mainly on Scandinavia and Northern Europe, with the United Kingdom as the Company's second largest destination country. Daily year-round frequency for the winter

2017 to 2018 is planned on 17 out of 46 routes. The Company offers 11 routes with a frequency of double daily flights or more during the peak season.

Fleet of Boeing 757s and 767s

Iceland is situated on the busiest transatlantic flight paths connecting North-America and Europe. Flights from Iceland to Europe are between three and four hours long, and flights to North America take between five hours (Halifax, Boston) and about eight hours (Denver, Orlando). In 2016 the fleet comprised a total of 26 Boeing 757 aircraft, the majority configured with 183 seats, and two 767s, with 262 seats, bringing the total number of aircraft in the Network to 28. The Company's aircraft have three classes: a business class, economy comfort and economy class. The fleet is equipped with personal in-flight entertainment systems and Icelandair offers on-board WiFi connections on its routes across the North Atlantic.

New aircraft type in 2018

The Company has ordered sixteen 737 Boeing MAX8 and 737 Boeing MAX9 aircraft, with an option to buy an additional eight aircraft. Delivery of the first aircraft is scheduled for early 2018. The order involves nine 737 MAX8 aircraft, with a seating capacity of 154 passengers, and seven 737 MAX9 aircraft, with a seating capacity of 175 passengers. A mixed fleet of Boeing 767s, Boeing 757s and Boeing 737 MAX aircraft fits well into Icelandair's Route Network, as Europe and North America are within the reach of all aircraft. The new aircraft will be an excellent addition to the fleet and increase both flexibility and capacity for growth through added frequency and new destinations.

Presence in key markets

International marketing and sales activi-

ties are organised through Icelandair's offices in its key markets: North America, Scandinavia, Central Europe and Iceland, the last being the location of the Company's headquarters. In addition, the Company has sales agents in large markets outside the core network, such as Asia. Extensive efforts are being made to promote Iceland as a tourist destination and to brand Icelandair as a stimulating and uniquely Icelandic travel experience.

80 years of operations

The strategy of Icelandair is to use the efficiency and flexibility of its operation to be the leading airline for travel to and from Iceland as well as a distinctive and exciting alternative for air travel across the North Atlantic. The mission is to operate a first-rate airline and to maintain a reliable quality service through the experience and knowledge gained from 80 years of operation. ■

80 YEARS OF AVIATION 1937-2017



Cargo Operation

Icelandair Group's cargo operation focuses on air freight services to and from Iceland by leveraging the Group's strong international Route Network, which comprises Icelandair's passenger routes combined with scheduled air cargo flights to and from North America and Europe.

Servicing 51 destinations

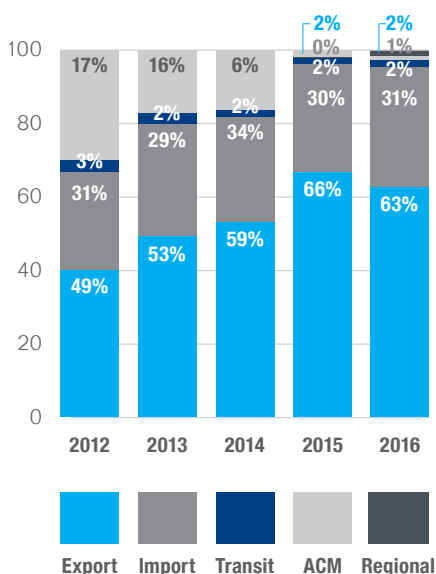
The market area served by Icelandair Group's cargo operation is based on the Group's Route Network, both international and domestic. Icelandair Cargo operates two B757-200 cargo aircraft, in addition to utilising the passenger network of Icelandair and Air Iceland. In 2016 Icelandair Cargo offered direct services to 51 international destinations in Europe and North America and three domestic destinations. Extensive collaboration with overland haulage companies in Europe and North America enables services to and from all the principal cities in these market regions. In 2016 two wide body B767-300 passenger aircraft joined Icelandair's passenger fleet. This capacity has extended air freight possibilities to key markets and has proven to be very effective. Two additional B767 aircraft will join the fleet in 2017, increasing capacity further and giving more possibilities for future development. Icelandair Cargo also co-operates with a number of other air carriers to offer continued flights to more distant markets, including Asia.

The Group's cargo operation has offices in New York and Liège in Belgium, servicing business in North America and Central Europe. In addition, cargo operation has agencies in all of Iceland's principal market areas in Europe, America and Asia.

Good prospects

Icelandair Group's cargo network places the Icelandic fish industry in a unique position to distribute its fresh fish products to key markets, which in turn will continue to strengthen the market position of the Group's cargo operation for exports. Fresh fish will remain the fundamental product for export going forward, as it has been in recent years. We anticipate that exports of fish will continue to be strong in 2017. White fish will maintain steady growth, while increased salmon harvesting will create a greater need for transport to Icelandair Cargo markets. The outlook for imports is good for 2017, and we are anticipating strong growth, as imports are projected to increase in line with improving economic conditions in Iceland. A significant increase in imports to Iceland was observed in 2016, and this trend is expected to continue in 2017. Four B767-300 aircraft will also provide new opportunities for transit freight, which has limited possibilities when the fleet consists exclusively of narrow body aircraft. ■

Revenue split in % | 2012–2016



Fresh fish remains the most important export product

The Group's cargo operation has been growing in recent years. Carried freight measured in freight ton kilometres (FTK) amounted to 105 million FTKs in 2016, up by 5% from the preceding year. Fresh fish has been the most important product for the export part of the operation, and, in particular, the volume to North America has been rapidly increasing. After years of stagnation following the economic downturn in 2008, imports to Iceland increased substantially in 2016.

Aircraft Leasing

Icelandair Group offers capacity solutions to international passenger airlines and tour operators under the Loftleidir-Icelandic brand. Launched as a marketing vehicle for the Group's international Aircraft, Crew, Maintenance and Insurance (ACMI) and charter market services, Loftleidir-Icelandic has narrowed its focus to leverage its expertise as a capacity solution provider, concentrating mainly on Aircraft and Maintenance (AM) projects and consulting services. The company operated two B757 200s, two B767 300s, two B737 800s and one B737 700 aircraft in 2016.

Strong market in 2016

In 2016 the ACMI market continued strong in an environment of limited availability. As before, the strongest demand was in the narrow body market, especially for A320s and B737 NGs. The wide body market continued its slow decline, with operators' most common aircraft types being challenging to place, especially with the increased inflow of the B777 type into the dry lease market.

Despite the increased availability of the B777 on the dry lease market the aircraft has yet to make a serious entry onto the ACMI market, as it is still not economical enough and offers excessive capacity.

In 2016 Loftleidir-Icelandic secured two new contracts, adding two new customers to its portfolio. Captain's Choice in Australia is a new addition to the VIP operation, contracting for four globe-spanning VIP trips in 2018. In addition, Loftleidir signed an AM contract for one B757 to fly in Russia for three years.

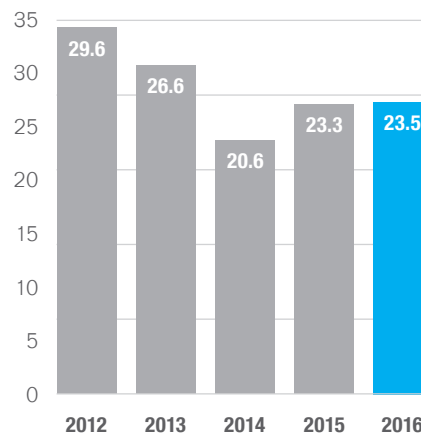
Loftleidir also extended and expanded its contracts with current customers, converting an AM contract to a dry lease contract with La Compagnie in France, while extending the contract for two additional years. The company also purchased one B767, on lease with Air Niugini, which was due to expire in the spring of 2016, and extended its AM contract with Air Niugini until 2021.

Market outlook for 2017

The market outlook for the aircraft leasing market in 2017 anticipates ongoing demand for aircraft. Demand for the narrow body aircraft, the Airbus 318-321 family and the B737NGs, continues to be stronger than the market for wide bodies. However, demand for the B737NG may decline somewhat with the first B737 MAX deliveries rapidly approaching. As before, the ageing B757 dry lease market is very small and isolated, with limited action due to the small size of the market.

On the wide body market there is a continued surplus of B777s as well as the A330 & A340 type. This is clearly reflected in the wet lease market, as demand for wide bodies continues slow. As before, Icelandair Group's capacity solutions will be focusing on the AM product in its sales and marketing efforts, especially the B737NG type, while maintaining its marketing efforts in the VIP, ACMI & Full Charter markets. ■

Number of sold block hours (thousands) | 2012–2016



Hotels and Hospitality

Icelandair Group's hotel and hospitality operations provide hospitality services through a cohesive mix of international and local brands. The Icelandair Hotel brand fuses traditional hotel hospitality with innovative services to keep up with the trends and requirements of the modern traveller's lifestyle.

Authentic Icelandic experience

The vision of the Group's hotel operations is to create an authentic Icelandic experience for visiting tourists. The focus is on leveraging Iceland's unique qualities as a tourist destination to add value to Iceland as a destination and support the Group's other operations.

Although guests using Icelandair Group's hotels come from all over the world, the principal targeted markets are those that comprise the Group's international Route Network. The ongoing increase in the number of flights on existing routes and new gateways provide numerous opportunities for further growth for the Group's hotels. Marketing efforts involving Icelandair Hotels in 2017 will focus both on existing and prospective new gateways. Also, direct flights between Keflavik and Akureyri, commencing in February 2017, are a welcome addition, providing Icelandair Hotels with new means of marketing the Company's existing and upcoming facilities in northern Iceland over the wintertime.

Icelandair Hotels offers 8 high-quality hotels. Edda Hotels operates 11 summer hotels, offering a diverse choice of lodgings at key locations around the country. The Hilton Reykjavik Nordica is a high quality hotel that sets the standard for competitors. The company's latest addition, Canopy by Hilton in Reykjavik City Centre, opened on 1 July 2016 as the first hotel in what will be an extensive international chain of lifestyle hotels worldwide. The hotel has received outstanding reviews and enjoyed excellent occupancy from day one.

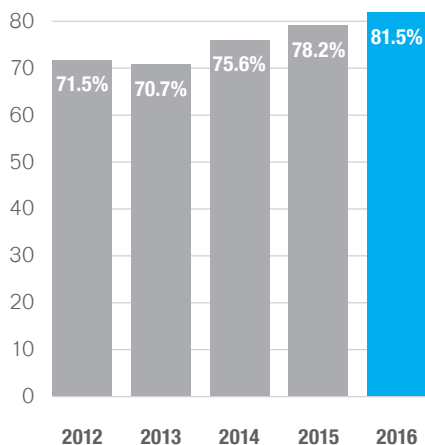
2016: a year of continuing growth and new opportunities

The year 2016 was yet another year of outstanding results in terms of occupancy and increases in average room rates in Reykjavik all year around. The countryside hotels operated at maximum capacity during the busy summer months, and the facilities on Iceland's south coast experienced strong growth during the winter months as

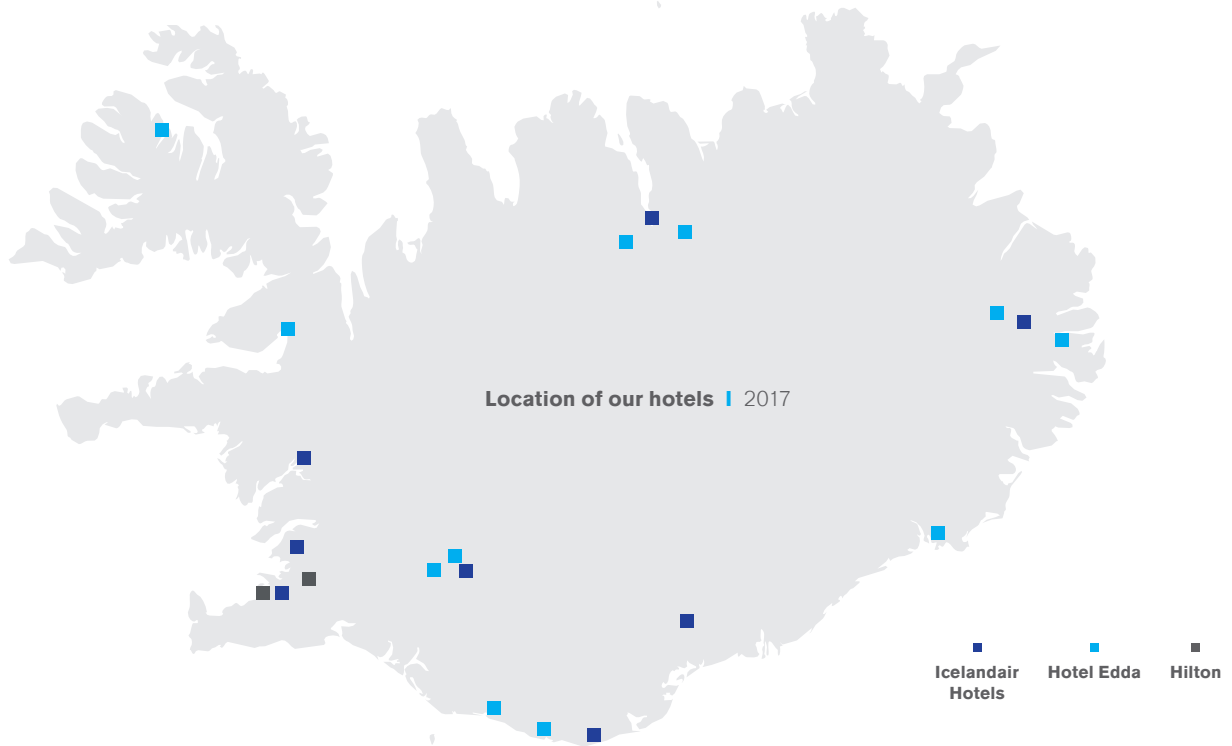
well. Air Iceland's scheduled flights between Akureyri and Keflavik during the winter months bring prospects of improved occupancy in northern Iceland during winter, and will set the tone for new possibilities of marketing Iceland with a clearer division between urban and rural travel experiences in the future. This will not only improve occupancy in countryside hotels, but also open new avenues for high-end hotels to focus on Reykjavik and its culture, rather than serving as base stations for nature lovers. Accordingly, Icelandair Hotels' focus in 2017 will be on conceptualising, planning, and designing the company's two current development projects in Reykjavik, located in Hafnarstræti, near the Harbour, and Austurvöllur, by the House of Parliament. A franchise agreement has been reached for both hotels with Hilton International, making both hotels members of Curio Collection by Hilton, a collection of unique, luxury hotels around the world. The two new Curio hotels will add further variety to the existing brand portfolio of Icelandair Hotels Group, now with yet another luxury twist to the higher-end class for which Canopy Reykjavik has already set the stage. Reykjavik Consulate hotel, a 50-room facility located in Hafnarstræti, will open in the autumn of 2017, while Iceland Parliament Hotel by Austurvöllur will open its doors in 2018.

Ongoing development and further improvements of the company's infrastructure and technical solutions marked the year's operations, together with successful improvements in the online appearance and booking interface of all hotel brands, resulting in further growth of direct online sales through Icelandair Hotels' proprietary websites. Implementation of a revenue management system at all hotels was completed in 2016, providing an essential tool for further maximisation of ADR in a time of constantly increasing demand. An update of our booking system also played a central role in 2016, as well as the

Occupancy in % | 2012–2016



Hotels and Hospitality, continued:



continuing development of the company's own in-house education and training centre. In 2017, continuation of the enhancement of training and education of current employees, with a focus on high-end hotel and F&B services, will be vital to maintaining the high standards that the Group has set itself. Another essential project will be to tackle the increasing shortage of qualified staff as the number and variety of hotels and restaurants in Iceland continue to grow. Continued attention will be focused on developing Icelandair Hotels as a vibrant workplace with attractive and varied job opportunities and an outstanding learning platform for F&B trainees in order to meet the education needs of the growing local talent pool.

Ongoing increase in bookings and revenues foreseen in 2017

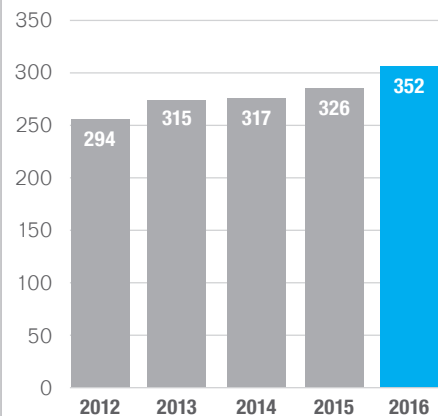
In addition to taking advantage of the abundant opportunities for further growth for Icelandair Group's hotels arising out of both the existing and forthcoming gate-

ways of the international Route Network, other main projects will include ongoing development of the new facilities referred to earlier and a continued focus on identifying and securing key locations for future expansions in rural Iceland. Along with the work on renovating our facilities, efforts will continue to improve booking procedures, increase online visibility and enhance the Group's brand strength and infrastructure.

While the expanded flight schedule of our international Route Network will open new markets, resulting in further improvement of hotel room occupancy and ADR, political instability, anticipated increases in taxes on accommodation, combined with the strengthening of the ISK, may well affect the Icelandic hotel scene. The focus of Icelandair Hotels remains clear however, and that is to maintain the company's position as a leading hospitality provider in Iceland, and to outperform our competition with outstanding services, hotel and F&B facilities all around the country. Focus on continuing development of new hotel

properties, outstanding training platform for current and future employers, and the implementation of benchmark technical solutions will mark the operation of 2017. In this manner, Icelandair Hotels intend not only to continue leading the way towards improved hospitality industry in Iceland, but also towards continuing positive financial end results. ■

Available hotel room nights (thousand) | 2012–2016



Regional Operations

Icelandair Group's regional carrier, Air Iceland, offers domestic flights to four destinations in Iceland and five destinations in Greenland. Following a fleet renewal in 2016, the company entered a new era with flights from Keflavik to Aberdeen in Scotland, linking with Icelandair's network to North America. Air Iceland's focus is on offering efficient and reliable air transport to improve the quality of life of people living in the more sparsely populated areas of Iceland. Dependable regional flight services also make it possible for business undertakings and public agencies around the country to operate in a more efficient manner. Cooperation with other airlines enables interregional connections, both domestically in Iceland and to Greenland, Scotland and the Faroe Islands.

Strong roots in Iceland

Icelandair Group's regional operations have strong roots that extend back to the dawn of aviation in Iceland. The aim of the Group's regional services is to operate an extensive and flexible domestic flight schedule in Iceland and regional operations to neighbouring countries. In the course of our decades of domestic and regional air services, Icelanders have relied on our efforts to enable close links between friends and families, swift communications between businesses and just-in-time deliveries of goods and supplies. Tourists in Iceland have also appreciated the opportunities afforded by Air Iceland for quick transport to remote areas.

Fleet changes

The Group's regional fleet currently comprises three Bombardier Q400 and two Bombardier Q200 aircraft.

Fokker 50 aircraft have been the mainstay of the regional operation for some 25 years, but in 2015 the decision was made to replace them with three Bombardier Q400 aircraft. In light of the good experience of Bombardier aircraft since their first inclusion in our fleet in 2006 it was a logical step to look at the larger version in the Q400 to replace the Fokker 50. By retaining the two Q200s with their 37 seats and adding in three Q400s with their 72-76 seats, the flexibility to meet different market demand has been preserved, but at the same time the operation is being streamlined by focusing on a single aircraft manufacturer and thereby on the same type of training for the cockpit crews. Implementation of the three Q400s was the main operational challenge in 2016, with the first aircraft entering into service in March 2016 and the two additional aircraft following in April and May. Their introduction had an immediate impact, with 8% more domestic passengers flown on 19% fewer flights than in the

preceding year. The Q400, with its high-speed performance, also opens opportunities for new destinations, such as Aberdeen, and these opportunities will be explored further in 2017, with Belfast in Northern Ireland planned as a new destination as of June 2017.

Growth of tourism in Iceland stimulates demand

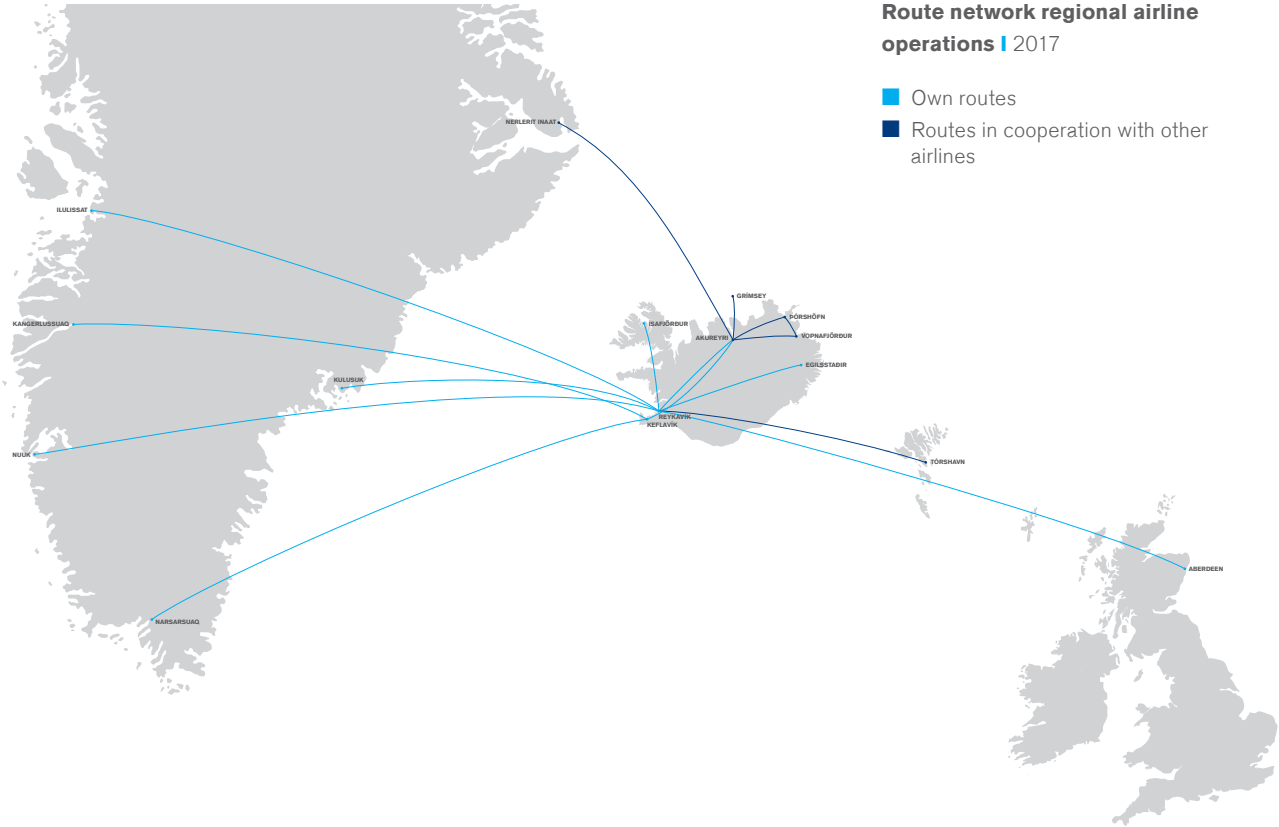
Icelandair Group's regional operations have benefitted significantly from the growth in tourist arrivals in Iceland over the last five years. Product development has increasingly been focused on foreign tourists, with marketing efforts concentrated on offering a wide variety of day tours and multi-day tours combining domestic and regional flights. The relative proportion of foreign tourists utilising the domestic network stands at around 18% of total passenger numbers, growing from 15% in previous year and becoming Air Iceland's fastest growing market segment.

On Greenland flights sustainable growth has been achieved over the last five years. Following the fleet changes with the placement of one Q400 in Keflavik, two routes – the established Narsarsuaq route and the new route to Kangerlussuaq – were operated in 2016 out of Keflavik, giving passengers an improved connection to other international flights. New product development, with offers of varied and attractive packages, lies at the heart of the marketing efforts in the Greenland market.

Outlook is improving

The domestic operation has historically shown a strong correlation with the underlying performance of the local economy. Most economic forecasts assume continued growth in Icelandic GDP, with increased purchasing power and investment capacity, which should be reflected in growing demand for domestic flight services. However, future prospects will also depend on government policy

Regional Operations, continued:

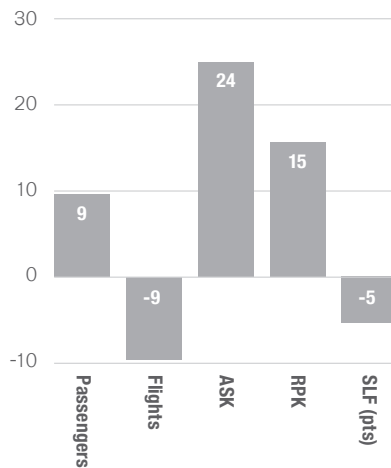


regarding public levies on air travel.

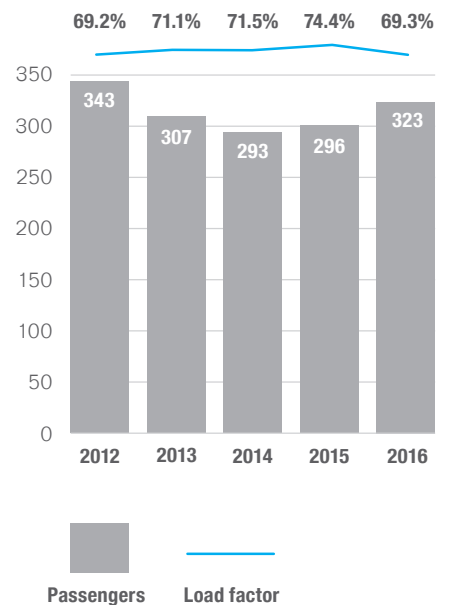
While mining and oil exploration in Greenland are currently at a low, the demand for Greenland as a tourist destination is growing, and the number of passengers on routes to and from Greenland is expected to increase in 2017 from 2016, as it has increased over the last half decade. Air Iceland's focus on the tourist market to Greenland will be further extended as the demand for travel to Greenland continues to grow in both existing and new markets.

With the introduction of the Bombardier Q400 aircraft new opportunities have opened up. Icelandair's Route Network, with Keflavik as a hub, has been growing rapidly for the last five years, which has opened up new demand for smaller feeder traffic to maximise the benefit of the hub system. ■

Traffic data Air Iceland | YOY %



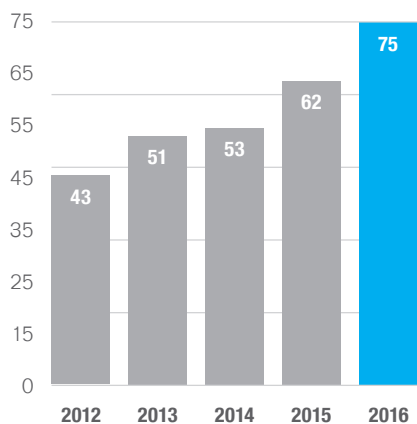
Number of passengers (thousands) and load factor | 2012-2016



Tourist Services in Iceland

Iceland Travel employs a diverse team of two hundred travel experts who focus their efforts on creating unique experiences for travellers visiting Iceland. The company is a one-stop shop for travel services in Iceland. The core business consists in servicing leisure travellers through travel agencies around the world and through direct online sales to consumers. Other segments include services relating to incentives, conferences and cruise ships. Iceland Travel is currently working on further growth in servicing luxury travel under the Nine Worlds brand.

Number of tourists with flights to Iceland through IT (thousands) | 2012–2016



A year of transformation

Last year was another strong year for Icelandic tourism. Iceland Travel saw a 47% growth in its winter sales, continuing the positive trend of substantial growth in the off season months that it has seen in recent years. Iceland Travel is continuing its efforts to create more of its own products, servicing high-end market segments and leveraging the expertise of the employees to strengthen the tailor-made services. This has proven successful, as evidenced by the company's 32% growth in higher payment segments.

Iceland Travel faced several challenges in 2016, which were handily dealt with by its very capable staff. Of these challenges, the higher exchange rate of the Icelandic króna and the shortage of accommodation for the customers were the most significant.

Realising a new digital vision

Iceland Travel has introduced a new vision, where the company intends to position itself as the leading digital tour operator in Iceland, whose travel experts use the best available digital solutions to create the perfect vacation experience for customers. To realise this vision, Iceland Travel is focusing on an improved IT infrastructure, advanced digital solutions and streamlined distribution channels.

In response to the continued growth in tourism, to support the new digital vision, and to reinforce the onboarding processes, the company launched the Iceland Travel School in 2016, where both external and internal experts share their knowledge and insights into the travel industry. To transform the internal processes in order to improve customer service and eliminate waste, Iceland Travel is using lean management techniques and introducing greatly improved procedures to respond to and learn from customer feedback.

Exciting opportunities ahead

An important milestone will be reached in the development of self-service offering

in the first quarter of 2017, when Iceland Travel will launch its new online booking process for the B2C (business to consumer) market. The new booking process will be continuously improved going forward, using the latest technology and methodology in online optimisation. The first version of the Iceland Travel self-drive app will be launched in the first quarter of 2017. This application will run on Android devices and feature an advanced road guide for customers who have booked a self-drive tour with Iceland Travel.

To expand Iceland Travel's online marketing reach a partner program was launched in late 2016, where online influencers can offer day tours to their followers and customers. The aim in early 2017 is to add Iceland Travel's own product line to the reseller program. ■

80 YEARS OF AVIATION 1937-2017

Farþegaafgreiðsla
Passenger's Service

Farangur
Baggage



06

Trendily dressed Flugfélag Íslands flight attendants pose in front of the jet Gullfaxi, the company's flagship, in the early 1970s.





Icelandair Group and Society

Icelandair Group is a part of the Icelandic society. Every day we contribute to our society by creating value. Every day we strive to meet the needs of our customers. Icelandair Group is proud of its role in the Icelandic community and continues to seek new opportunities to expand its ties to society at large. That is how Icelandair Group energises the power of the Icelandic tourism industry for the benefit of Iceland as a nation.

Focus elements of our stakeholder model

We focus on creating sustainable value for our stakeholders by integrating into our business model a wide range of efforts to ensure our social responsibility.

- **Employees and Governance:** Exemplary corporate governance and commitment to our employees with extensive programmes for human resource development.
- **Environment:** Minimise our impact on the environment by setting measurable targets, raising awareness and benchmarking our performance to do better than before.
- **Society:** Cooperate with society and ensure that the impact of our operations is beneficial through direct contributions and positive engagement with society at large.

We believe in stakeholder engagement. We believe in matching ourselves against other international airlines and tourism companies, identifying where the Group stands in comparison with its competitors and finding where improvements can be made. Finally, we believe in regularly reviewing our sustainability initiatives and maintaining an open dialogue with our employees. At Icelandair Group, we believe that the implementation of a sustainability policy is most likely to be successful if the policy is directly linked to the Company's business strategy. That is how we best contribute to our society.

Sustainability policy

Our sustainability initiatives are under constant review. It is important to bear in mind that our adherence to a sustainability strategy does not simply mean tweaking current initiatives that are already being successfully implemented; it means putting all our current activities and

various initiatives into a coherent and comprehensive context that can be easily communicated and understood by stakeholders, and it means adding new priorities and setting new measurable targets. It means educating our employees, engaging them and empowering them to develop new initiatives. We are committed to continuous improvements. We see a coherent and well-implemented sustainability policy for Icelandair Group as a means of deepening our understanding of the Company and the environment in which we operate, through:

- A clearer view of the Company's risks and opportunities when it comes to environmental and social factors.
- Clearer communication with internal and external stakeholders.
- Better coordination among the different subsidiaries of Icelandair Group when it comes to environmental and social risk.

Sustainability policy

Icelandair Group's environmental impact is not limited to flight operations. It also involves ground facilities, offices and maintenance areas. Our goal is to maximise the use of green energy and minimise waste in all operations by embracing sustainable solutions. In 2016 Air Iceland, Icelandair Cargo, Loftleidir Icelandic, Icelandair Shared Services, and Icelandair Group Management, all achieved environmental management system certification in accordance with ISO 14001. Icelandair Hotels and Icelandair Ground Services had already achieved certification. And on the 80th anniversary year of our operations we celebrate completion of the implementation of environmental management in all Icelandair Group.

We report our sustainability initiatives on the Company's website, www.icelandairgroup.is. ■

Employees

Icelandair Group's steady growth in recent years owes much to the skills and knowledge of the Company's employees. Their flexibility and dedication have been instrumental in dealing with a constantly evolving business environment. Without their resilience and energy the Company would not have enjoyed the success that it has had. As our business operations have expanded we have added a large number of new employees. Through the team spirit fostered by our corporate culture we have been able to accommodate them successfully, and we will continue to rely on them as we continue to grow.

Employees

Icelandair Group has grown at an extremely robust pace in recent years, adding many destinations, carrying many more passengers, adding a number of hotel rooms, and generally growing across all segments. As our business has expanded, so has our staff, which has grown by more than 90% since 2010.

The strain caused by our rapid growth and the various natural disasters that have disrupted our services have tested the mettle of our employees. They have responded with initiative and energy, resilience and flexibility, demonstrating their commitment to the Company.

We always try to integrate new employees quickly into the Company's corporate culture. This fosters the team spirit needed to link employees throughout the Company's different corporate units. We make every effort to bring all our employees from all companies forming the Group, in Iceland and abroad, into our family.

Recruitment

Icelandair Group uses a recruitment process that is designed to select the people who are best suited for each specific type of job, not only based on professional qualifications, but also based on how we think they will fit into our results-driven corporate culture.

Having once acquired top talent, we try to provide the training and development needed to promote our employees to their full potential. By recruiting internally from our own ranks we are able to ensure strong engagement and commitment from our employees.

Icelandair Group has always been able to recruit new and well-qualified personnel in Iceland. As one of Iceland's largest private employers, and with its long and well-known history, the Company has always been seen as a desirable place to work. There is a large local pool of talented and dedicated individuals who are eager to join the Company, and as we grow we are able to offer an ever wider range of jobs for highly trained professionals at competitive salaries in an international working environment.

In the summer, during the high tourist season in Iceland, the Company needs to add more than a thousand extra employees. Many are students, who return to work for us year after year; quite a few join us later as full-time employees. By that time they have already acquired knowledge of the Company and our corporate culture. To meet the most recent surge in growth we have also recruited many employees from abroad, mainly for IGS and Icelandair Hotels.

Icelandair Group employees, full time equivalents (FTEs) | by company 2012–2016

	2012	2013	2014	2015	2016
Icelandair	1,236	1,387	1,529	1,678	1,924
IGS	425	469	544	571	695
Icelandair Cargo	47	49	49	51	58
Loftleidir	11	11	11	11	10
Air Iceland	224	230	221	215	224
Icelandair Hotels	384	468	495	568	646
Iceland Travel	64	94	115	135	176
Feria (Vita)	21	19	18	21	23
Fjárvakur - Icelandair Shared Services	107	109	115	120	128
Parent company	13	13	12	14	16
Total	2,532	2,850	3,109	3,384	3,900

Employees, continued:

Professional development

At Icelandair Group we take the professional development of our employees very seriously. We want to employ people who find satisfaction in adding to their knowledge, developing their skills and then putting these skills and knowledge to meaningful use in their work. We believe that training and experience make a vital contribution to our employees' capacity, in addition to innate talent and formal qualifications. We provide our employees with a variety of training opportunities and courses that suit their needs, because we want to make the best use of their talents.

We try to provide as much training and as many opportunities as possible within the Company. Our recently launched training centre in Hafnarfjörður, which features a sophisticated flight simulator, has already proved its worth. It brings important training in-house, making it more flexible, more efficient and more cost-effective. We also take particular care to train our staff to maintain rigorous safety and security standards.

Communication

At Icelandair Group we try to keep employees well informed of Company affairs. We share information through newsletters and employee meetings, as well as the Company MyWork intranet. With our operations so diverse and dispersed over so many countries, we believe it is essential to maintain engagement and foster team spirit among our employees by keeping them aware of what is going on throughout the Company.

In July we introduced Workplace by Facebook in Icelandair Group for use by the employees of the Company and its subsidiaries. Workplace is based on the user interface that just about everyone is familiar with from Facebook, with some convenient additional features designed for corporate use. There were two main reasons for our decision: first, to enhance communications, improve the flow of

information and strengthen the dissemination of knowledge within the Group, both within individual companies and divisions and between Icelandair Group companies. Second, Workplace is a performance enhancement tool designed to improve performance and work processes in joint projects within companies and between them. By taking advantage of the most widely used social medium in the world we feel we have found an excellent venue to improve our communications and circulate information.

In addition, we regularly hold meetings with employees where they can discuss their ideas and concerns directly with top management, including the CEO. These exchanges serve to build trust between employees and management, which in turn is the basis for achieving optimum results. All of this leads to greater job satisfaction and serves to keep our employees committed and maintain a team spirit within the Company.

Human resources strategy

Icelandair Group seeks to attract talented and qualified recruits who can help the Company meet the challenges of the future. We look for people that fit into the existing corporate culture, with the qualities that have served us so well in the past. We provide them with opportunities for further development and training so that we always have the best person for every job. We try to maintain an attractive, yet challenging and demanding workplace, where our employees can flourish and rise to their highest potential.

Our HR strategy emphasises equality and non-discrimination and embraces diversity. We make sure that our employees are given equal opportunities to further their careers, and we make every effort to improve their well-being and make them feel that they are part of a team. We also train our employees in observing safety and security standards and we have in

Icelandair Group employees, full time equivalents (FTEs) | by company:

	Jan. 2016	Jul. 2016
Icelandair	1,581	2,220
IGS	527	880
Icelandair Cargo	53	65
Loftleidir	10	10
Air Iceland	212	256
Icelandair Hotels	514	892
Iceland Travel	146	193
Feria (Vita)	23	23
Fjárvakur – Icelandair		
Shared Services	124	131
Icelandair Group	15	15
Total	3,205	4,685

Employees, continued:

place detailed action plans designed to achieve our goals.

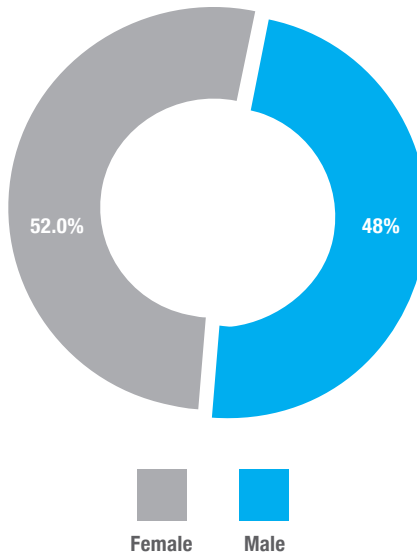
We regularly carry out work audit surveys among Icelandair Group employees, where we try to measure various indicators of how well our HR strategy is working. We repeatedly score high in job satisfaction and employee engagement, and in the latest survey, conducted this autumn, these factors showed higher scores than ever before.

Corporate culture

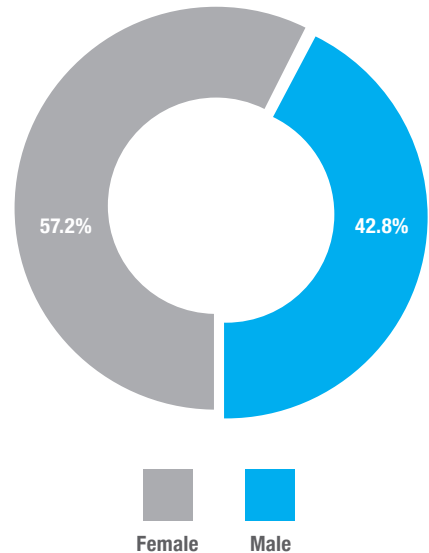
Icelandair Group's corporate culture is characterised by a strong team spirit, originally fostered in our base in Iceland. Throughout our long history we have served as the main gateway for travellers to Iceland as well as the first choice for Icelanders travelling to the rest of the world. This is a fundamental service, which we still provide and which needs to be carried out as seamlessly as possible.

Although the Company is a prominent player in Iceland, it is still small compared to its international competitors. In order to succeed we must therefore rely heavily on the quality of our employees. Flexibility, efficiency, responsiveness, drive and initiative count as our strengths. We are very much aware that every employee is important and every customer valuable. This knowledge underpins our corporate culture and informs our experience as we continue to grow. ■

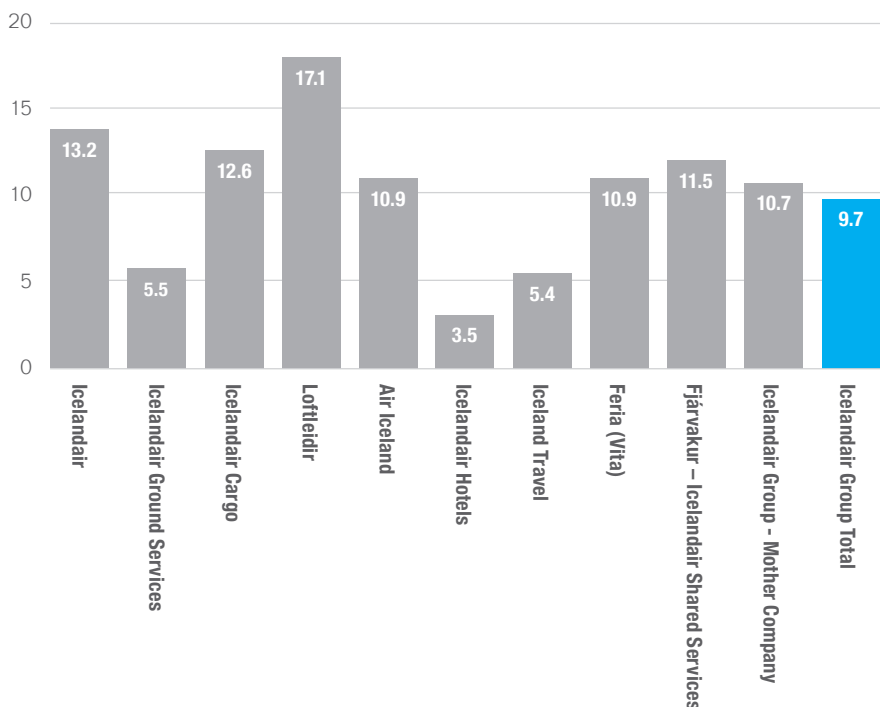
Male/female ratio
Icelandair Group | January 2016



Male/female ratio
Icelandair Group | July 2016



Average job tenure in years | by company 2016



Environment

Environmental responsibility and dedication to minimising the environmental impact of our operations are guiding principles at Icelandair Group. We recognise that air travel has an impact on the environment and we commit ourselves by addressing our responsibilities to reduce emissions, conserve natural resources and optimise the use of sustainable energy and recyclable materials.

Icelandair Group is an environmentally conscious company; we aim to set the standard for safe, responsible aviation and we have a comprehensive programme of initiatives and targets designed to minimise our impact on the environment.

Environmental policy

Icelandair Group's environmental policy describes our approaches to protecting and preserving the environment. All Company employees are responsible for ensuring compliance with Company policy. Management at all Company subsidiaries and entities are adopting guidelines and procedures to comply with the Company's environmental policy.

Icelandair Group Environmental Policy

Minimising the environmental impact of our operations is an integral element of Icelandair Group's business plan.

We are focused on keeping Icelandair Group green by means of sustainable practices and optimal use of the resources at our disposal.

Icelandair Group is committed to minimising its impact on the environment by continuous improvement of the Company's environmental policies, sustainable material use and disposal, conduct of business with environmentally friendly suppliers and adherence to environmental protection principles.

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

- Minimising our carbon footprint and raising awareness
- Reducing waste by increasing recycling
- Promoting responsible use of resources
- Increasing the use of environmentally friendly products and services

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

Icelandair Group is getting greener

Sustainable business growth requires us to address our environmental impact, both globally and locally. As part of this effort, we participate in stakeholder groups, such as the International Air Transport Association Environmental Assessment and Airlines for Europe (A4E).

Icelandair Group's environmental impact is not limited to flight operations. It also involves ground facilities, offices, hotels and maintenance areas. Our goal is to maximise the use of green energy and minimise waste in all operations by embracing sustainable solutions.

In order to achieve this goal, we have been implementing environmental management systems in all Icelandair Group companies. We have already achieved ISO-14001 certification for Icelandair Hotels and Icelandair Ground Services.

In 2016 Icelandair reached compliance with IATA Environmental Assessment (IEnvA) Stage 2 certification for its environmental management systems. IEnvA is an environmental management system developed by IATA for airlines, which Icelandair applies to adopt the best practices in its industry. Icelandair who completed the first of two stages in 2015 alongside some other prominent international carriers, being the fourth airline globally reaching Stage 2 of the IEnvA Program.

In 2016 Air Iceland, Icelandair Cargo, Loftleidir Icelandic, Icelandair Shared Services, and Icelandair Group Management, all achieved environmental management system certification in accordance with ISO 14001. And on the 80th anniversary year of our operations we celebrate completion of the implementation of environmental management in all Icelandair Group.

A company certified under ISO 14001 is required to formulate policies regarding environmental affairs and carry out exhaustive reviews of the environmental

Environment, continued:

impact of its operations, setting goals to reduce any significant environmental effects of its operations and addressing requirements in the standard for continual improvement.

Icelandair Group is committed to implementing programmes of continuing environmental education for its staff and informing its customers of the importance of environmental awareness. In this way, we seek to contribute to a successful future for our Company and for the rest of the world.

We put pride in our certifications and cooperate with accredited certification bureaus, such as ACS Aviation solutions via IATA, DNV-GL, BSI Group and Vottun hf.

Fuel consumption and fuel efficiency

Recognising the importance of conserving fuel and minimising CO₂ emissions, Icelandair Group monitors and evaluates all new ideas and solutions in this field, and all departments participate in this activity. The main goal of the Icelandair Fuel Management Committee is to reduce fuel burn and thereby reduce the emission of greenhouse gases, in particular CO₂, and air pollutants (NO_x).

During the past few years, numerous changes have been made to both the Company's operations and its aircraft. All our aircraft are now fitted with winglets that reduce fuel burn and CO₂ emissions. We constantly pursue new ways of improving fuel burn in our operations; ongoing projects such as winglet improvements and engine core wash equipment are examples of successful environmental initiatives.

As the first airline in Europe, Icelandair is operating with improved Scimitar Blended Winglets (SBW). This will further cut fuel consumption by around 1% on many flights. Existing winglets now reduce fuel burn up to 6%.

In 2016 fuel burn per 100-revenue passenger kilometre (RPK) was 3.7 litres, as compared to 3.79 L/100 RPK in 2015,

and 3.83 L/100 RPK in 2014.

In 2016 fuel burn per operational tonne kilometre (OTK) was 0.283 kg, as compared to 0.290 kg/OTK in 2015 and 0.296 kg/OTK in 2014.

Aircraft noise and engine emissions

All aircraft operated by Icelandair comply with the ICAO international requirements of Annex 16, Environmental Protection Vol I "Aircraft noise" and Vol II "Aircraft Engine Emissions".

Icelandair continuously strives to adopt targeted procedures to reduce the environmental impact of its aircraft, both to reduce noise and limit carbon emissions.

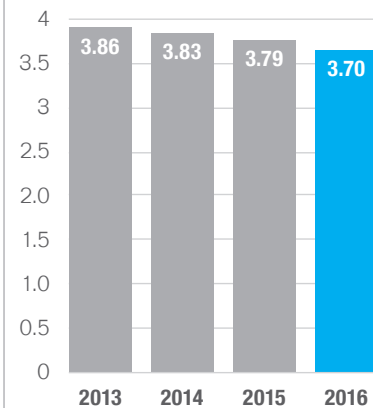
Examples of such procedures include Continuous Descent Approach (CDA), jet engine core wash, targeted centre of gravity loading and single-engine taxiing.

We are committed to ensuring that our operations and the aircraft we purchase will enable us to continue to reduce our environmental impact on communities in the vicinity of airports, particularly in relation to the issue of aircraft noise and engine emissions.

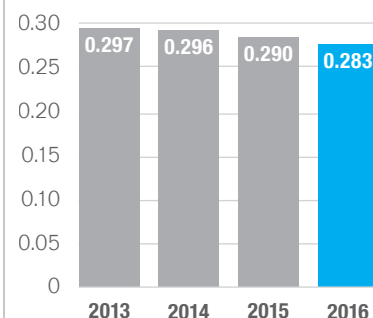
Minimising waste and managing utilities

Icelandair Group acknowledges its responsibility to reduce the amount of waste resulting from its operations, whether aluminium tins, paper or used parts in maintenance areas. The Company Waste Management Programme helps reduce, recycle and reuse materials across the organisation. Icelandair Group is constantly reviewing its processes and operations and identifying possible new ways to reduce unnecessary waste. The Company's aircraft, ground facilities, offices and maintenance areas are dedicated to reduce its environmental footprint with regard to energy, materials and related emissions and waste. The Company focuses on best practices by implementing initiatives to minimise the use of resources and identify cost savings

RPK - Fuel burn per 100 revenue passenger kilometre | 2013–2016



OTK - Fuel burn per operational tonne kilometre | 2013–2016



Environment, continued:

throughout the system.

The Waste Management Programme has been implemented throughout our entire organisation. Successful employee participation in waste reduction and sorting has increased recycling of the waste that is sent from our facilities.

Over 60% of all waste from our offices and hotels goes to recycling. As an example, by recycling all corrugated paper from our hotel facilities, we are reducing CO₂ emissions equivalent to over 850 trees every year.

We continue to promote, develop and encourage waste reduction on site in a systematic and cost-effective manner. We use suitable regulated waste management contractors that ensure safe management and handling of hazardous and non-hazardous waste sent off-site in accordance with best environmental practice. The Company's goals are to reduce waste and increase recycling of materials, conserve energy, reduce pollution and greenhouse gas emissions. Accordingly, our offices follow a "print only what you need" policy and they buy supplies manufactured from recycled material when available. Icelandair Group offices sort paper, plastic, metal, batteries and used printer cartridges in an effort to reduce waste and increase general recycling.

Environmentally friendly purchasing

Icelandair Group has a purchasing policy that focuses on sustainable and green procurement. We support cooperation with suppliers that have adopted environmental practices and sustainability in providing their goods and services.

Icelandair Group is working closely with major suppliers towards further optimisation and environmental improvements of existing purchasing procedures by implementing a central purchasing, inventory and receipt management solution, integrated with resource planning and electronic point of sales

system for Icelandair Group and its subsidiaries.

We are increasing our focus on sustainable and environmental friendly procurement. By introducing our purchasing policy and guidelines for sustainable procurement to our suppliers, we are involving them in our expectations and requirements.

Environmentally friendly commuting

Icelandair Group views public transportation, carpooling, biking and telecommuting as means of saving energy and reducing greenhouse gas emissions from employees' travels to and from work. We pursue an environmentally sound commuting policy and encourage our employees to consider options other than drive-alone commuting in our effort to reduce greenhouse gas emissions and adopt more environmentally friendly practices.

Where applicable, Icelandair Group employees are invited to participate in a commuting agreement, committing themselves to choose environmentally friendly ways of commuting to and from work.

Environmental awareness

Icelandair Group is committed to increasing the environmental awareness of all employees. We have implemented a training program throughout the organisation, emphasising individual participation and an understanding of the environmental impact that each employee can have.

We communicate locally with our employees within the organisation on environmental performance. We also communicate environmental awareness to our customers, suppliers and the general public. ■



80 YEARS OF AVIATION 1937-2017



Icelandair Group and the Community

The various companies within Icelandair Group support a wide variety of community activities all year round. The main focus is on support for Icelandic sports, Icelandic music, the Icelandic tourism industry and the Special Children Foundation.

Special Children Travel Fund

The main objective of the Special Children Travel Fund (Vildarbörn) 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 donations of our customers. In 2016, 55 children and their families, around 300 people in all, received travel grants from the fund to go on their "dream journey". Since the fund was established 11 years ago, 526 families have been supported in this way. Vigdis Finnbogadóttir, former President of Iceland, is the protector of the fund. For more details see www.vildarborn.is.

The National Olympic and Sports Association of Iceland

The National Olympic and Sports Association of Iceland (ISI) is the umbrella organisation of the entire sports movement in Iceland and the supreme authority in all amateur sports activities and associated volunteer work 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.

Iceland 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 and coaches 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 faithful sponsor. 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. In 2016 the men's A-team participated for the first time in a major tournament, Euro 2016 in France, making Iceland the smallest nation ever to qualify for a major football tournament and the first to do so with a population under one million. In 2016 the women's A-team qualified for the third time for participation in a major tournament, Euro 2017, which will take place in the Netherlands.

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, making its first appearance at a major tournament, the EuroBasket, in Berlin 2015 and qualifying for the second time in 2016 for participation in the 2017 EuroBasket Qualifiers.

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 for a long time focused on providing travelling leisure golfers with the services they need, and the successful cooperation with the Icelandic Golf Association is an extension of those services.

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.

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 IF for 26 years and is one of the association's five largest sponsors and partners.

Iceland Airwaves

Icelandair is the founder and main sponsor of Iceland Airwaves (or "Icelandair waves" as some of us like to spell it), a music festival held in October each year in Reykjavik. Iceland Airwaves is an annual music event that started in 1999 as a talent show for the benefit of foreign record company executives; since then, Airwaves has grown and blossomed and is now an integral part of the cultural life of Reykjavik. The fruits of the festival's labour have been ripening, and today

Icelandair Group and the Community – continued:

many Icelandic artists, such as Quarashi, Sigur Rós, Apparat Organ Quartet, Trabant, Of Monsters and Men and others, have made their way to the international music scene. In 2017, for the first time, an add-on to the festival will include two days of Iceland Airwaves in Akureyri. For more details see the festival website www.icelandairwaves.com.

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 début 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.

Reykjavik Airbridge

Icelandair supports Icelandic musical talent beyond Iceland Airwaves. Through cooperation with the city of Reykjavik, and musicians' organisations, Icelandair has set up a fund that helps Icelandic musicians 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 exclusively with Icelandic ingredients. The menu is featured 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.

Eyrarrósinn

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

ICE-SAR – Slysavarnarfélagið Landsbjörg

Icelandair Group has since December 2014 been one of the main sponsors of ICE-SAR, the Icelandic Search and Rescue operation. The Company's objective is to provide support to enable the organisation to engage in efficient accident prevention and rescue efforts and to enhance the safety of tourists travelling in Iceland. The aim of the organisation is to minimise the frequency of travel accidents and reinforce the image of Iceland as a safe tourist destination by providing useful travel information and maintaining an effective safety net. The partnership will reinforce the already outstanding work of ICE-SAR still further and represent an important factor in promoting safer tourism by various means, including the sponsorship and marketing of the SafeTravel.is website to tourists through Icelandair Group's distribution channels. The sponsorship agreement also provides for additional support to ICE-SAR, an efficient all-volunteer organisation, in its core field of search and rescue.

Gröndalshús

Icelandair Group has partnered with the City of Reykjavik, UNESCO City of Literature, in the renovation and running of Gröndalshús, a cultural jewel in Reykjavik's old town of Grjótaþorp. The house has a history of over 130 years. Benedikt Gröndal, poet and naturalist, bought the house in 1888 and lived there until his death. Gröndalshús will be dedicated to the memory of Benedikt

Gröndal and to the history of the 19th century in Reykjavik with an exhibition on the main storey of the house, prepared in collaboration with the Reykjavik City Archives. Gröndal's parlours will also be used for literary functions, and there will be facilities for meetings and receptions. The basement will feature a poet's residence for foreign writers visiting Reykjavik for their work and the attic will include working facilities for poets and literary scholars.

Reykjavik Arts Festival

Icelandair Hotels is a patron of the Reykjavik Arts Festival, a biannual multidisciplinary cultural festival with a special focus on new commissions and the creative intersection of the arts. It presents, to the widest possible audience, exhibitions and performances of contemporary and classical works in major cultural venues and unconventional spaces throughout the city. Since its inception in 1970, the Reykjavik Arts Festival has invited hundreds of artists from all parts of the globe to perform or exhibit at the festival. Through this activity, the festival has helped to create a vast network of connections between national and international artists, been a catalyst for the creation of new works and a major force in the development of cultural diversity in Iceland.

Forskot

Icelandair Group is one of the founding members of Forskot, an achievement fund established in 2013. The fund has the objective of supporting golfers, professionals and amateurs, who aspire to achieve the top ranks of their sport in the world. In 2016, Olafía Thorunn Kristinsdóttir, who is supported by the fund, earned her card on the LPGA in the United States, the most demanding tour in the world, becoming the first Icelandic woman to do so. ■





Between 1964 and 1971 Canadair CL-44, nicknamed Rolls Royce 400 after their speedy jet engines, were Loftleidir Icelandic's main aircraft. In Iceland they were often called "monsies", referring to their monstrous size. The monsies were for a while the largest aircraft transporting passengers over the North Atlantic.

Icelandair Group hf.

Consolidated Financial
Statements for the year
2016 – USD

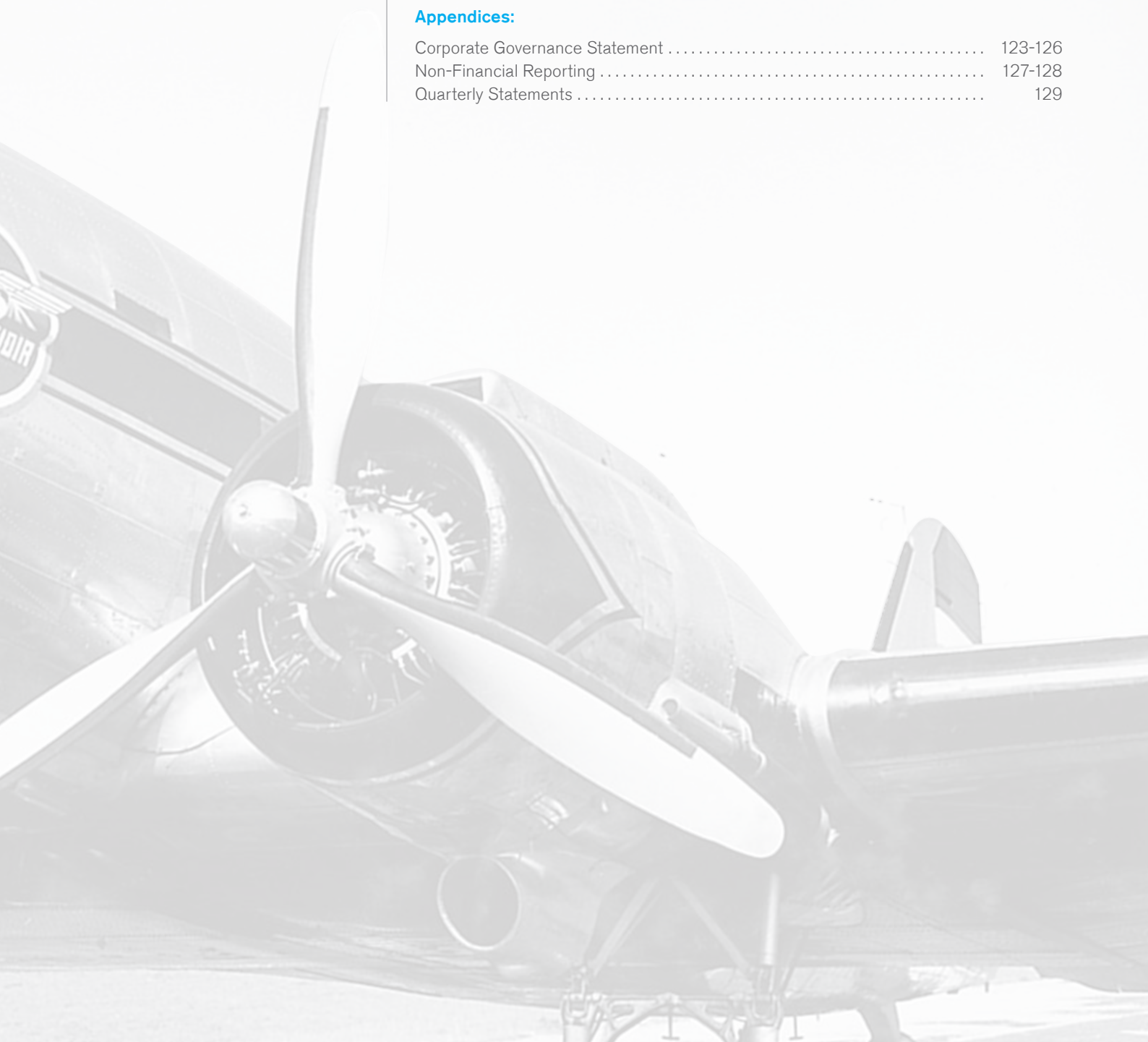


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Endorsement and Statement by the Board of Directors and the CEO

Operations in the year 2016

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

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

The Board of Directors proposes a dividend payment to shareholders in 2017

of ISK 565 million, equal to USD 5.0 million, which represents 6% of profit for the year 2016.

Share capital and Articles of Association

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

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

Corporate Governance

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

The framework for Corporate Govern-

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

Name	Shares in ISK thousand	Shares in %
Lífeyrissjóður verslunarmanna.....	734,361	14.69
Stefnir Sjóðir	721,463	14.43
Lífeyrissjóður starfsmanna ríkisins A deild og B deild	466,040	9.32
Gildi – Lífeyrissjóður	369,261	7.39
Landsbréf - Úrvalsbréf	188,237	3.76
Birta Lífeyrissjóður.....	184,553	3.69
Stapi Lífeyrissjóður	171,154	3.42
Sameinaði Lífeyrissjóðurinn	145,102	2.90
Brú - Lífeyrissjóður starfsmanna sveitarfélaga....	126,218	2.52
Söfnunarsjóður lífeyrisréttinda	102,106	2.04
	3,208,495	64.17
Other shareholders	1,766,045	35.32
Treasury shares	25,460	0.51
Total issued shares	5,000,000	100.00

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

Endorsement and Statement by the Board of Directors and the CEO, continued:

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

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

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

Non-Financial Reporting

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

Statement by the Board of Directors and the CEO

The consolidated financial statements for the year ended 31 December 2016 have

been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional Icelandic disclosure requirements for financial statements of listed companies.

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

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

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

Reykjavik, 7 February 2017.

Board of Directors:

Sigurður Helgason,
Chairman of the Board

Úlfar Steindórsson
Ásthildur Margrét Otharsdóttir
Katrín Olga Jóhannesdóttir
Magnús Magnússon

CEO:

Björgólfur Jóhannsson

Independent Auditors' Report

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

Report on the audit of the Consolidated Financial Statements.

Opinion

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

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

Basis for opinion

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated

financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter

Timing and accuracy of revenue recognition of passenger income

Reference is made to note 7 "Operating income" and 32 "Deferred income".

Passenger ticket sale is presented as deferred income in the consolidated statement of financial position until transportation has been provided. Then the sale is recognised as revenue. Large volume of transactions flow through various computer systems from the date of sale until the revenue is recognised in the consolidated statement of profit or loss.

The recording process is complex which gives rise to an inherent risk of errors, in determining the amount and timing of the revenue recognition. Timing and accuracy in the registration of passenger income is therefore one of the key audit matters of our audit of the consolidated financial statements.

How our audit responded to the key audit matter

Our audit procedures were designed to challenge the accuracy of the revenue recognition. These procedures included testing of controls over the group's systems which govern the passenger ticket sale. We used the service of our IT specialists to test the appropriate controls such as access control, change management control and automated controls of the revenue systems. We also tested non-automated controls.

The purpose of the testing was to assess if the design of controls was likely to ensure the accuracy and timing of the revenue recognition of passenger income

Independent Auditors' Report continued:

and to test operating effectiveness of controls and as such evaluated the management monitoring of controls.

We analysed passenger revenue and used external and internal information to set expectations which were compared to recognised revenue.

We used substantive testing where we tested reconciliations between systems and revenue cut offs.

Key audit matter

Expected recoverable amount of intangible assets and goodwill

Reference is made to note 16 "Intangible assets and goodwill" and 44h "Impairment".

The carrying value of goodwill amounted to USD 139 m. and other intangible assets were USD 35.7 m. at year end 2016 as specified in note 16.

The carrying value of intangible assets has been allocated to the applicable cash generating units within the Group. Management is required to perform an impairment test annually on goodwill and other intangible assets with indefinite useful lives. The purpose of an impairment test is to determine if goodwill and other intangible assets can be recovered through future cash flows.

The recoverable amounts of individual cash generating units are determined by discounting the expected future cash flows generated from the continuing use of the units.

The expected recoverable amount of intangible assets is one of the key audit matters due to the significance to the Group's consolidated statement of financial position, and due to inherent uncertainty involved in forecasting and discounting future cash flows which are the basis of the assessment of the recoverability of the intangible assets.

How our audit responded to the key audit matter

We used the service of our valuation

specialists to assess the valuation models and assumptions used by management in their calculations of expected recoverable amount of each cash generating unit.

We assessed the management assumptions by comparing them to both internal and external industry information.

Our procedures included among others:

- Management forecasts for each cash generating unit for the explicit period were compared to forecasts presented to the Board, historic revenue amounts, growth rates and historic industry statistics. Forecasts from prior periods were also compared to actual results to test its accuracy.

- Assessing the reasonableness of management forecasts of the long term growth rate.

- Assessing the reasonableness of management forecasts for changes in margins, new investments, utilisation and changes in pricing.

- Assessing the reasonableness of the discount rates applied by comparing them to current finance cost and market conditions for the cash generating units.

- Review of information in the notes to the financial statements to confirm that all information required by applicable accounting policies were provided.

Other information

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

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

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

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

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free

Independent Auditors' Report continued:

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit

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

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

independence, and were applicable, related safeguards.

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

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

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

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

Reykjavik, 7 February 2017.

KPMG ehf.

Alexander G. Eðvardsson
Auður Þórisdóttir



 **YEARS OF AVIATION** 1937-2017

Consolidated Statement of Profit or Loss and Other Comprehensive Income for the Year 2016

	Notes	2016	2015 *Restated
Operating income			
Transport revenue	7	947,823	848,868
Aircraft and aircrew lease		84,574	83,356
Other operating revenue	7	253,177	207,475
		<u>1,285,574</u>	<u>1,139,699</u>
Operating expenses			
Salaries and other personnel expenses	8	354,253	278,015
Aviation expenses	8	420,250	401,194
Other operating expenses	8	291,226	233,824
		<u>1,065,729</u>	<u>913,033</u>
Operating profit before depreciation and amortisation (EBITDA)		219,845	226,666
Depreciation and amortisation	10	(101,408)	(83,826)
Operating profit (EBIT)		118,437	142,840
Finance income		6,414	5,134
Finance costs		(5,697)	(8,210)
Net finance income (costs)	11	<u>717</u>	<u>(3,076)</u>
Share of profit of associates	18	<u>957</u>	<u>459</u>
Profit before tax		120,111	140,223
Income tax	21	(31,043)	(29,000)
Profit for the year		<u>89,068</u>	<u>111,223</u>
Other comprehensive income			
Items that are or may be reclassified to profit or loss			
Currency translation differences		9,100	(1,686)
Effective portion of changes in fair value of cash flow hedge, net of tax		40,482	(118)
Other comprehensive income (loss) for the year		<u>49,582</u>	<u>(1,804)</u>
Total comprehensive income for the year		<u>138,650</u>	<u>109,419</u>
Owners of the Company		88,820	111,318
Non-controlling interests		248	(95)
Profit for the year		<u>89,068</u>	<u>111,223</u>

* See note 4

The notes on pages 90 to 122 are an integral part of these consolidated financial statements.

Consolidated Statement of Profit or Loss and Other Comprehensive Income for the Year 2016, continued:

	Notes	2016	2015 *Restated
Total Comprehensive income attributable to:			
Owners of the Company		138,367	109,523
Non-controlling interests		<u>283</u>	<u>(104)</u>
Total comprehensive income for the year		<u>138,650</u>	<u>109,419</u>
Earnings per share:			
Basic earnings per share in US cent per share	28	1.79	2.24
Diluted earnings per share in US cent per share	28	1.79	2.24

* See note 4

The notes on pages 90 to 122 are an integral part of these consolidated financial statements.

Consolidated Statement of Financial Position as at 31 December 2016

	Notes	2016	2015
Assets:			
Operating assets	13-16	602,615	419,071
Intangible assets and goodwill	17-18	174,704	172,694
Investments in associates	18	23,497	18,223
Deferred cost	19	63	118
Receivables and deposits	20	74,098	27,474
Non-current assets		<u>874,977</u>	<u>637,580</u>
Inventories	22	23,963	19,205
Trade and other receivables	23	139,280	101,075
Assets held for sale	24	4,148	0
Short term investments	25	23,236	19,533
Cash and cash equivalents	26	226,889	194,586
Current assets		<u>417,516</u>	<u>334,399</u>
Total assets		<u><u>1,292,493</u></u>	<u><u>971,979</u></u>
Equity:			
Share capital		40,576	40,576
Share premium		154,705	154,705
Reserves		114,849	1,400
Retained earnings		257,696	259,746
Equity attributable to equity holders of the Company	27	<u>567,826</u>	<u>456,427</u>
Non-controlling interests		387	104
Total equity		<u>568,213</u>	<u>456,531</u>
Liabilities:			
Loans and borrowings	29	196,722	55,387
Payables	30	13,289	8,644
Deferred tax liabilities	21	58,179	35,485
Non-current liabilities		<u>268,190</u>	<u>99,516</u>
Loans and borrowings	29	45,660	10,143
Trade and other payables	31	210,543	219,680
Deferred income	32	199,887	186,109
Current liabilities		<u>456,090</u>	<u>415,932</u>
Total liabilities		<u>724,280</u>	<u>515,448</u>
Total equity and liabilities		<u><u>1,292,493</u></u>	<u><u>971,979</u></u>

The notes on pages 90 to 122 are an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Equity for the year 2016

	Attributable to equity holders of the Company					Non-controlling interest	Total equity
	Share capital	Share premium	Reserves	Retained earnings	Total		
2015							
Balance at 1 January 2015 ...	40,576	154,705	3,195	166,371	364,847	208	365,055
Total comprehensive income ..			(1,795)	111,318	109,523	(104)	109,419
Dividend (0.38 USD cent per share)				(17,943)	(17,943)		(17,943)
Balance at 31 December 2015.	<u>40,576</u>	<u>154,705</u>	<u>1,400</u>	<u>259,746</u>	<u>456,427</u>	<u>104</u>	<u>456,531</u>
2016							
Balance at 1 January 2016. ...	40,576	154,705	1,400	259,746	456,427	104	456,531
Total comprehensive income ..			49,547	88,820	138,367	283	138,650
Profit of subsidiaries in excess of dividend received			63,902	(63,902)			
Dividend (0.54 US cent per share)				(26,968)	(26,968)		(26,968)
Balance at 31 December 2016.	<u>40,576</u>	<u>154,705</u>	<u>114,849</u>	<u>257,696</u>	<u>567,826</u>	<u>387</u>	<u>568,213</u>

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

The notes on pages 90 to 122 are an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows for the Year 2016

	Notes	2016	2015
Cash flows from operating activities:			
Profit for the year		89,068	111,223
Adjustments for:			
Depreciation and amortisation	10	101,408	83,826
Other operating items	43	20,325	16,211
		<u>210,801</u>	<u>211,260</u>
Working capital from operations			
Net change in operating assets and liabilities	44	(1,777)	33,876
Net cash from operating activities		<u>209,024</u>	<u>245,136</u>
Cash flows to investing activities:			
Acquisition of operating assets	12	(231,117)	(182,574)
Proceeds from the sale of operating assets		1,160	2,528
Acquisition of intangible assets	16	(1,603)	(1,073)
Deferred cost, change		(10,677)	(26,753)
Investment in subsidiaries and associates		(5,994)	(15,552)
Non-current receivables, change		(39,852)	(7,882)
Short term investments, change		(3,676)	11,364
Net cash used in investing activities		<u>(291,759)</u>	<u>(219,942)</u>
Cash flows to financing activities:			
Dividend paid	27	(26,968)	(17,943)
Proceeds from non-current borrowings		150,700	23,660
Repayment of non-current borrowings		(10,089)	(20,037)
Net cash from (used in) financing activities		<u>113,643</u>	<u>(14,320)</u>
Increase in cash and cash equivalents		30,908	10,874
Effect of exchange rate fluctuations on cash held		1,395	(1,050)
Cash and cash equivalents at beginning of the year		<u>194,586</u>	<u>184,762</u>
Cash and cash equivalents at 31 December	26	<u><u>226,889</u></u>	<u><u>194,586</u></u>

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

The notes on pages 90 to 122 are an integral part of these consolidated financial statements.

Notes

1. Reporting entity

Icelandair Group hf. ("the Company") is a public limited liability company incorporated and domiciled in Iceland. The address of the Company's registered office is at Reykjavíkurlugvöllur in Reykjavík, Iceland. The consolidated financial statements of the Company as at and for the year ended 31 December 2016 comprise the Company and its subsidiaries, together referred to as the "Group" and individually as "Group entities" and the Group's interests in associates. The Group primarily operates in the airline and tourism industry. The Company is listed on the NASDAQ OMX Iceland.

2. Basis of preparation

a. Statement of compliance

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

b. Basis of measurement

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

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

3. Functional and presentation currency

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

4. Changes in presentation

Hedge accounting

The Group has changed its presentation of realised currency translation difference of cash flow hedges in the statement of comprehensive income. After the change the currency difference is presented in the statement of comprehensive income within the same line item as the hedged item is presented. Previously all currency differences on hedges were presented among finance income and expenses. The change had the following effects on comparative numbers:

	2015 Original	Change	2015 Restated
Salaries and other personnel expenses	280,244	2,229	278,015
Aviation expenses	406,649	5,455	401,194
Net finance income (costs)	4,608	(7,684)	(3,076)

5. Use of estimates and judgements

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

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

Assumptions and estimation uncertainties

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

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

Notes, continued:

5. Use of estimates and judgements - continued:

Measurement of fair values

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

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

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

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

Level 1 | quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 | inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);

Level 3 | inputs for the asset or liability that are not based on observable market data (unobservable inputs).

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

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

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

Note 25 | short term investments;

Note 32 | deferred income;

Note 34 | derivatives;

Note 34 | non-derivative financial liabilities.

Notes, continued:

6. Operating segments

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

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

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

Route Network

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

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

Tourism services

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

Shared services

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

Geographic information

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

<i>Revenues</i>	2016	2015
North America	37%	37%
Iceland	25%	24%
West Continental Europe	14%	14%
Scandinavia	8%	9%
United Kingdom	7%	7%
Other	9%	9%
Total revenues	<u>100%</u>	<u>100%</u>

Notes, continued:

6. Operating segments – continued:

Information on reportable segments

	Route network	Tourism services	Shared services	Total
2016				
External revenue	1,106,517	162,488	16,569	1,285,574
Inter-segment revenue	99,013	12,854	74,527	186,394
Segment revenue	<u>1,205,530</u>	<u>175,342</u>	<u>91,096</u>	<u>1,471,968</u>
Segment EBITDAR*	224,921	22,881	7,158	254,960
Operating lease expenses	(22,581)	(12,054)	(480)	(35,115)
Segment EBITDA	<u>202,340</u>	<u>10,827</u>	<u>6,678</u>	<u>219,845</u>
Finance income	15,623	238	8,818	24,679
Finance costs	(4,161)	(2,950)	(16,851)	(23,962)
Depreciation and amortisation	(92,743)	(3,874)	(4,791)	(101,408)
Share of profit of equity accounted investees	32	172	753	957
Reportable segment profit (loss) before tax	<u>121,091</u>	<u>4,413</u>	<u>(5,393)</u>	<u>120,111</u>
Reportable segment assets	897,597	53,590	982,181	1,933,368
Investment in associates	227	714	22,556	23,497
Capital expenditure	195,464	8,971	38,962	243,397
Reportable segment liabilities	549,153	40,424	401,015	990,592
2015				
External revenue	1,004,344	125,204	10,151	1,139,699
Inter-segment revenue	89,237	8,679	53,660	151,576
Segment revenue	<u>1,093,581</u>	<u>133,883</u>	<u>63,811</u>	<u>1,291,275</u>
Segment EBITDAR*	243,028	16,897	1,785	261,710
Operating lease expenses	(23,934)	(10,587)	(523)	(35,044)
Segment EBITDA	<u>219,094</u>	<u>6,310</u>	<u>1,262</u>	<u>226,666</u>
Finance income	3,572	91	5,884	9,547
Finance costs	(7,666)	(1,172)	(3,785)	(12,623)
Depreciation and amortisation	(79,317)	(2,777)	(1,732)	(83,826)
Share of profit of equity accounted investees	19	18	422	459
Reportable segment profit before tax	<u>135,702</u>	<u>2,470</u>	<u>2,051</u>	<u>140,223</u>
Reportable segment assets	756,443	38,516	592,685	1,387,644
Investment in associates	167	466	17,589	18,222
Capital expenditure	197,534	8,445	4,421	210,400
Reportable segment liabilities	509,136	27,349	126,125	662,610

*EBITDAR means EBITDA before operating lease expenses.

Notes, continued:

6. Operating segments – continued:

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

	2016	2015
Revenue		
Total revenue for reportable segments	1,471,968	1,291,275
Elimination of inter-segment revenue	(186,394)	(151,576)
Consolidated revenue	<u>1,285,574</u>	<u>1,139,699</u>
Profit or loss		
Consolidated profit before tax	<u>120,111</u>	<u>140,223</u>
Assets		
Total assets for reportable segments	1,933,368	1,387,644
Investments in associates	23,497	18,222
Elimination of inter-segment assets	(664,372)	(433,887)
Consolidated total assets	<u>1,292,493</u>	<u>971,979</u>
Liabilities		
Total liabilities for reportable segments	990,592	662,610
Elimination of inter-segment liabilities	(266,312)	(147,162)
Consolidated total liabilities	<u>724,280</u>	<u>515,448</u>

Other material items

	Reportable segment totals	Adjustments	Consolidated totals
2016			
Segment EBITDAR	254,960		254,960
Segment EBITDA	219,845		219,845
Finance income	24,679	(18,265)	6,414
Finance costs	(23,962)	18,265	(5,697)
Depreciation and amortisation	(101,408)		(101,408)
Share of profit of associates	957		957
Capital expenditure	243,397		243,397
2015			
Segment EBITDAR	261,710		261,710
Segment EBITDA	226,666		226,666
Finance income	9,547	(4,413)	5,134
Finance costs	(12,623)	4,413	(8,210)
Depreciation and amortisation	(83,826)		(83,826)
Share of loss of associates	459		459
Capital expenditure	210,400		210,400

Notes, continued:

7. Operating income

Transport revenue is specified as follows:

	2016	2015
Passengers	895,614	806,555
Cargo and mail	52,209	42,313
Total transport revenue	<u>947,823</u>	<u>848,868</u>

Other operating revenue is specified as follows:

Sale at airports and hotels	93,142	65,948
Revenue from tourism	109,980	91,555
Aircraft and cargo handling services	23,597	27,453
Maintenance revenue	2,797	3,439
Gain on sale of operating assets	782	1,529
Other operating revenue	22,879	17,551
Total other operating revenue	<u>253,177</u>	<u>207,475</u>

8. Operating expenses

Salaries and other personnel expenses are specified as follows:

Salaries	232,204	181,566
Contributions to pension funds	33,885	23,492
Other salary-related expenses	28,912	24,731
Other personnel expenses	59,252	48,226
Total salaries and other personnel expenses	<u>354,253</u>	<u>278,015</u>

Average number of full year equivalents	3,900	3,384
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Aviation expenses are specified as follows:

Aircraft fuel	213,418	223,828
Aircraft lease	20,687	22,896
Aircraft handling, landing and communication	108,784	85,662
Aircraft maintenance expenses	77,361	68,808
Total aviation expenses	<u>420,250</u>	<u>401,194</u>

Other operating expenses are specified as follows:

Operating cost of real estates and fixtures	26,298	22,140
Communication	23,135	18,038
Advertising	28,609	23,902
Booking fee and commissions	54,727	48,910
Cost of goods sold	27,888	21,092
Customer services	29,486	20,578
Tourism expenses	70,450	52,301
Other operating expenses	30,633	26,863
Total other operating expenses	<u>291,226</u>	<u>233,824</u>

9. Auditor's fee

Auditor's fee are specified as follows:

Audit	421	324
Other services	85	104
Total auditor's fee	<u>506</u>	<u>428</u>

Notes, continued:

10. Depreciation and amortisation

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

	2016	2015
Depreciation of operating assets, see note 12	99,179	80,146
Amortisation of intangible assets, see note 16	2,229	3,680
Depreciation and amortisation recognised in profit or loss	<u>101,408</u>	<u>83,826</u>

11. Finance income and finance costs

Finance income and finance costs are specified as follows:

Interest income on bank deposits	3,157	2,074
Other interest income	173	860
Net currency exchange gain	3,084	2,200
Finance income total	<u>6,414</u>	<u>5,134</u>
Interest expense on loans and borrowings	4,798	7,338
Other interest expenses	899	872
Finance costs total	<u>5,697</u>	<u>8,210</u>
Net finance income (costs)	<u>717</u>	<u>(3,076)</u>

12. Operating assets

Operating assets are specified as follows:

	Aircraft and flight equipment	Buildings	Other property and equipment	Total
Cost				
Balance at 1 January 2015	420,276	31,719	50,940	502,935
Additions	159,565	9,299	13,710	182,574
Sales and disposals	(49,877)	(248)	(3,589)	(53,714)
Effects of movements in exchange rates	(32)	(567)	(731)	(1,330)
Balance at 31 December 2015	<u>529,932</u>	<u>40,203</u>	<u>60,330</u>	<u>630,465</u>
Additions	180,018	34,417	16,682	231,117
Additions due to acquisition of subsidiary	0	43,791	0	43,791
Sales and disposals	(56,496)	0	(1,354)	(57,850)
Reclassification of assets held for sale	(9,878)	0	0	(9,878)
Effects of movements in exchange rates	529	10,432	6,673	17,634
Balance at 31 December 2016	<u>644,105</u>	<u>128,843</u>	<u>82,331</u>	<u>855,279</u>
Depreciation and impairment losses				
Balance at 1 January 2015	155,795	8,713	19,087	183,595
Depreciation	72,552	1,570	6,024	80,146
Sales and disposals	(48,131)	(176)	(3,349)	(51,656)
Effects of movements in exchange rates	(13)	(191)	(487)	(691)
Balance at 31 December 2015	<u>180,203</u>	<u>9,916</u>	<u>21,275</u>	<u>211,394</u>
Depreciation	88,366	2,168	8,645	99,179
Additions due to acquisition of subsidiary	0	387	0	387
Sales and disposals	(56,135)	0	(1,363)	(57,498)
Reclassification of assets held for sale	(5,730)	0	0	(5,730)
Effects of movements in exchange rates	126	1,661	3,145	4,932
Balance at 31 December 2016	<u>206,830</u>	<u>14,132</u>	<u>31,702</u>	<u>252,664</u>
Carrying amounts				
At 1 January 2015	<u>264,481</u>	<u>23,006</u>	<u>31,853</u>	<u>319,340</u>
At 31 December 2015	<u>349,729</u>	<u>30,287</u>	<u>39,055</u>	<u>419,071</u>
At 31 December 2016	<u>437,275</u>	<u>114,711</u>	<u>50,629</u>	<u>602,615</u>
Depreciation ratios	6–20%	2–6%	5–33%	

Notes, continued:

12. Operating assets – continued:

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

13. Mortgages and commitments

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

14. Insurance value of aircraft and flight equipment

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

	Insurance value		Carrying amount	
	2016	2015	2016	2015
Boeing - 31 / 26 aircraft	638,000	581,000	346,122	263,311
Other aircraft	58,466	78,300	42,353	42,187
Flight equipment	<u>84,862</u>	<u>63,998</u>	<u>48,800</u>	<u>44,231</u>
Total aircraft and flight equipment	<u>781,328</u>	<u>723,298</u>	<u>437,275</u>	<u>349,729</u>

15. Insurance value of buildings and other operating assets

The principal buildings owned by the Group are the following:

	Maintenance hangars	Hotels	Office buildings	Other buildings	Under construction	Total
2016						
Official assessment value	24,860	30,983	23,398	8,259	18,703	106,203
Insurance value	42,173	43,491	39,937	10,408	31,760	167,769
Carrying amounts	4,703	71,819	23,278	3,426	11,485	114,711
Square metres	19,135	24,577	17,850	8,263	15,343	85,168
Vacant space (square metres)		380				380
2015						
Official assessment value	17,654	2,099	16,624	4,162	0	40,539
Insurance value	36,038	7,130	34,354	8,504	0	86,026
Carrying amounts	4,448	1,910	21,244	2,685	0	30,287
Square metres	19,135	2,678	17,850	7,215	0	46,878

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

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

Notes, continued:

16. Intangible assets and goodwill

Intangible assets and goodwill are specified as follows:

Cost	Goodwill	Trademarks and slots	Customer relations	Other intangibles	Total
Balance at 1 January 2015	148,516	35,961	5,158	9,595	199,230
Additions	0	0	0	1,073	1,073
Sales and disposals	0	0	(5,142)	(604)	(5,746)
Effect of movements in exchange rates	(615)	(5)	(16)	(76)	(712)
Balance at 31 December 2015	147,901	35,956	0	9,988	193,845
Additions	0	0	0	1,603	1,603
Sales and disposals	0	0	0	(6,689)	(6,689)
Effect of movements in exchange rates	2,547	34	0	115	2,696
Balance at 31 December 2016	150,448	35,990	0	5,017	191,455
Amortisation and impairment losses					
Balance at 1 January 2015	11,431	2,605	4,801	4,420	23,257
Amortisation	0	0	355	3,325	3,680
Sales and disposals	0	0	(5,142)	(604)	(5,746)
Effect of movements in exchange rates	0	0	(14)	(26)	(40)
Balance at 31 December 2015	11,431	2,605	0	7,115	21,151
Amortisation	0	0	0	2,229	2,229
Sales and disposals	0	0	0	(6,689)	(6,689)
Effect of movements in exchange rates	0	0	0	60	60
Balance at 31 December 2016	11,431	2,605	0	2,715	16,751
Carrying amounts					
At 1 January 2015	137,085	33,356	357	5,175	175,973
At 31 December 2015	136,470	33,351	0	2,873	172,694
At 31 December 2016	139,017	33,385	0	2,302	174,704

17. Impairment test

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

	2016	2015
Goodwill	139,017	136,470
Trademarks and airport slots	33,385	33,351
Total	172,402	169,821

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

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

	Goodwill		Trademarks and slots	
	2016	2015	2016	2015
Route network	137,149	134,541	33,385	33,351
Tourism services	1,868	1,929	0	0
Total goodwill	139,017	136,470	33,385	33,351

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

Notes, continued:

17. Impairment test – continued:

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

	Route network		Tourism services	
	2016	2015	2016	2015
Long term growth rate	2.5–4.0%	2.5–4.0%	4.0%	4.0%
Revenue growth:				
Weighted average 2016 / 2015	11.4%	3.0%	25.9%	23.2%
2016 - 2026 / 2015 - 2025	8.9%	9.0%	17.3%	12.4%
Budgeted EBITDA growth	8.4%	4.2%	28.1%	28.0%
WACC	9.3–14.2%	8.2–12.8%	9.1%	10.9%
Debt leverage	10.2–56.9%	10.2–53.2%	33.4%	19.1%
Interest rate for debt	5.0–7.5%	5.1–7.8%	3.1%	4.4%

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

18. Investment in associates

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

	Investment 2016	Operating result 2016	Investment 2015	Operating result 2015
Lindarvatn ehf	16,590	(5)	14,457	0
ITF 1 slhf	5,649	588	2,744	64
Other investments	1,258	374	1,022	395
Total investments in associates	<u>23,497</u>	<u>957</u>	<u>18,223</u>	<u>459</u>

Lindarvatn ehf. is the owner of the property and other properties located near Austurvöllur. In total the properties are 15,000 square metres but the new hotel is expected to be 11,000 square metres.

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

19. Deferred cost

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

	2016	2015
Deferred cost	120	405
Current portion, classified as prepayments among receivables	(57)	(287)
Total deferred cost	<u>63</u>	<u>118</u>

Deferred cost will be expensed as follows:

Expensed in 2016	-	287
Expensed in 2017	57	63
Expensed in 2018	63	55
Total deferred cost, including current maturities	<u>120</u>	<u>405</u>

Notes, continued:

20. Non-current receivables and deposits

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

	2016	2015
Non-current receivables and deposits are specified as follows:		
Loans, effective interest rate 6% / 6%.....	208	359
Security deposits	5,795	8,426
Prepayments on aircraft purchases	68,419	22,348
	<u>74,422</u>	<u>31,133</u>
Current maturities	(324)	(3,659)
Non-current receivables and deposits total	<u>74,098</u>	<u>27,474</u>

Contractual repayments mature as follows:

Maturities in 2016	-	3,659
Maturities in 2017	324	554
Maturities in 2018	38,098	12,919
Maturities in 2019	25,988	7,350
Maturities in 2020	5,514	2,525
Maturities in 2021	1,527	1,832
Subsequent	2,971	2,294
Total non-current receivables and deposits, including current maturities	<u>74,422</u>	<u>31,133</u>

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

21. Taxes

Tax recognised in profit or loss	2016	2015
<i>Current tax expense</i>		
Current year	14,024	22,606
Reassessment of taxes due to prior years	8,099	(2,238)
	<u>22,123</u>	<u>20,368</u>

Deferred tax expense

Origination and reversal of temporary differences.....	12,576	10,828
Exchange rate difference.....	(3,656)	42
	<u>8,920</u>	<u>10,870</u>

Total tax expense recognised in profit or loss	<u>31,043</u>	<u>29,000</u>
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Tax recognised in other comprehensive income

Effective portion of changes in fair value of cash flow hedge	(10,118)	30
Exchange rate difference	0	(6)
Total tax recognised in other comprehensive income	<u>(10,118)</u>	<u>24</u>

Reconciliation of effective tax rate

	2016		2015	
Profit before tax.....		<u>120,111</u>		<u>140,223</u>
Income tax according to current tax rate	20.0%	24,022	20.0%	28,045
Non-deductible expense.....	0.5%	547	0.2%	324
Reassessment of taxes due to prior years	6.7%	8,099		0
Other items	(1.4%)	(1,625)	0.4%	631
Effective tax rate.....	<u>25.8%</u>	<u>31,043</u>	<u>20.6%</u>	<u>29,000</u>

Notes, continued:

21. Taxes – continued:

Recognised deferred tax liabilities	2016	2015
<i>Deferred tax liabilities are specified as follows:</i>		
Deferred tax liabilities 1 January.....	35,485	24,681
Exchange rate difference.....	3,656	(36)
Deferred tax recognised in profit or loss.....	8,920	10,870
Income tax recognised in other comprehensive income	10,118	(30)
Deferred tax liabilities 31 December	<u>58,179</u>	<u>35,485</u>

Deferred tax liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2016	2015	2016	2015	2016	2015
Operating assets	0	0	(51,580)	(40,170)	(51,580)	(40,170)
Intangible assets	0	0	(955)	(812)	(955)	(812)
Derivatives	0	6,015	(4,103)	0	(4,103)	6,015
Trade receivables	0	132	(898)	0	(898)	132
	<u>0</u>	<u>6,147</u>	<u>(57,536)</u>	<u>(40,982)</u>	<u>(57,536)</u>	<u>(34,835)</u>
Tax loss carry-forwards	1,595	611	0	0	1,595	611
Other items	0	0	(2,238)	(1,261)	(2,238)	(1,261)
Deferred income tax	<u>1,595</u>	<u>6,758</u>	<u>(59,774)</u>	<u>(42,243)</u>	<u>(58,179)</u>	<u>(35,485)</u>

Movements in deferred tax balance during the year

	1 January	Recognised in profit or loss	Exchange rate difference	Recognised in other comprehensive income and equity	31 December
2016					
Operating assets	(40,170)	(8,302)	(3,108)	0	(51,580)
Intangible assets	(812)	(155)	12	0	(955)
Derivatives	6,015	0	0	(10,118)	(4,103)
Trade receivables	132	(1,020)	(10)	0	(898)
Tax loss carry-forwards	611	266	18	0	895
Other items	(1,261)	291	(568)	0	(1,538)
	<u>(35,485)</u>	<u>(8,920)</u>	<u>(3,656)</u>	<u>(10,118)</u>	<u>(58,179)</u>
2015					
Operating assets	(29,810)	(10,403)	43	0	(40,170)
Intangible assets	(1,217)	412	(7)	0	(812)
Derivatives	5,991	0	(6)	30	6,015
Trade receivables	199	(64)	(3)	0	132
Tax loss carry-forwards	557	55	(1)	0	611
Other items	(401)	(870)	10	0	(1,261)
	<u>(24,681)</u>	<u>(10,870)</u>	<u>36</u>	<u>30</u>	<u>(35,485)</u>

The effect of a reassessment of taxes due to prior years of USD 8.0 million is included in the tax expense of the year in profit or loss. Further information on the reassessment is provided in note 40.

Notes, continued:

22. Inventories

Inventories are specified as follows:	2016	2015
Spare parts	18,574	15,030
Other inventories	5,389	4,175
Inventories total	<u>23,963</u>	<u>19,205</u>

23. Trade and other receivables

Trade and other receivables are specified as follows:		
Trade receivables	84,065	66,449
Prepayments	9,096	3,716
Restricted cash	3,423	8,693
Derivatives used for hedging	20,560	3,104
Current maturities of long term-receivables	324	3,659
Other receivables	21,812	15,454
Trade and other receivables total	<u>139,280</u>	<u>101,075</u>

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

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

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

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

24. Assets classified as held for sale

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

25. Short term investments

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

26. Cash and cash equivalents

Cash and cash equivalents are specified as follows:	2016	2015
Securities	71,772	4,324
Bank deposits	154,785	189,912
Cash on hand	332	350
Cash and cash equivalents total	<u>226,889</u>	<u>194,586</u>

27. Equity

Share capital

The Company's share capital amounts to ISK 5.0 billion according to its Articles of Association. Shareholders are entitled to receive dividends as declared from A442:N447 to time and are entitled to one vote per share of one ISK.

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

Share premium

Share premium represents excess of payment above nominal value (ISK 1 per share) that shareholders have paid for shares sold by the Company. According to Icelandic Companies Act, 25% of the nominal value of share capital must be held in reserve. The balance of the share premium account can be used to offset losses not covered by other reserves or to offset stock splits.

Reserves

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

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

Notes, continued:

27. Equity – continued:

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

Reserves are specified as follows:

	Hedging reserve	Translation reserve	Other reserves	Total reserves
Balance 1 January 2015	(23,941)	27,136	0	3,195
Currency translation differences		(1,677)		(1,677)
Effective portion of changes in fair value of cash flow hedges, net of tax	(118)			(118)
Balance at 31 December 2015	(24,059)	25,459	0	1,400
Share in profit of subsidiaries and associates			108,016	108,016
Dividend received			(44,114)	(44,114)
Currency translation differences		9,065		9,065
Effective portion of changes in fair value of cash flow hedges, net of tax	40,482			40,482
Balance at 31 December 2016	<u>16,423</u>	<u>34,524</u>	<u>63,902</u>	<u>114,849</u>

Dividend

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

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

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

28. Earnings per share

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

	2016	2015
Basic earnings per share:		
Profit for the year attributable to equity holders of the parent company	88,820	111,318
Weighted average number of shares for the year	4,974,540	4,974,540
Basic earnings per share in US cent per share	1.79	2.24
Diluted earnings per share in US cent per share	1.79	2.24

29. Loans and borrowings

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

Loans and borrowings are specified as follows:

Secured bank loans	58,195	30,852
Unsecured bonds	184,187	34,678
Total loans and borrowings	<u>242,382</u>	<u>65,530</u>
Current maturities	(45,660)	(10,143)
Total non-current loans and borrowings	<u>196,722</u>	<u>55,387</u>

Current loans and borrowings are specified as follows:

Current maturities of non-current liabilities	45,660	10,143
Total loans and borrowings	<u>242,382</u>	<u>65,530</u>

Notes, continued:

29. Loans and borrowings – continued:

Terms and debt repayment schedule:

	Currency	Nominal interest rates year end 2016	Year of maturity	Total remaining balance	
				2016	2015
Secured bank loans	USD	4.4%	2017–2022	21,082	29,256
Secured bank loans	ISK			0	870
Secured bank loans, indexed	ISK	4.3%	2025	1,728	726
Unsecured bond issue	USD	4.6%	2020–2021	172,527	23,596
Unsecured bond issue, indexed	ISK	5.7%	2023	11,660	11,082
Secured bank loans - short term	ISK	6.6%	2017	35,385	0
Total interest bearing liabilities				<u>242,382</u>	<u>65,530</u>

Repayments of loans and borrowings are specified as follows:

Repayments in 2016	–	10,143
Repayments in 2017	45,660	10,189
Repayments in 2018	5,585	5,524
Repayments in 2019	2,390	2,332
Repayments in 2020	26,175	26,118
Repayments in 2021	152,661	2,567
Subsequent repayments	9,911	8,657
Total loans and borrowings	<u>242,382</u>	<u>65,530</u>

30. Non-current payables

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

	2016	2015
Non-current payables	16,573	19,334
Current portion, classified in trade and other payables	(3,284)	(10,690)
Total non-current payables	<u>13,289</u>	<u>8,644</u>

Non-current payables will be repaid as follows:

Repayments in 2016	–	10,690
Repayments in 2017	3,284	3,255
Repayments in 2018	5,852	2,454
Repayments in 2019	3,487	1,199
Repayments in 2020	976	736
Repayments in 2021	2,974	1,000
Total non-current payables, including current maturities	<u>16,573</u>	<u>19,334</u>

31. Trade and other payables

Trade and other payables are specified as follows:

Trade payables	55,977	41,569
Current portion of engine overhaul and security deposits from lease contracts	3,284	10,690
Derivatives used for hedging	436	33,075
Income tax payable	14,048	20,368
Other payables	136,798	113,978
Total trade and other payables	<u>210,543</u>	<u>219,680</u>

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

Notes, continued:

32. Deferred income

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

Deferred income is specified as follows:

	2016	2015
Sold unused tickets	164,580	158,958
Frequent flyer points	18,800	16,660
Other prepayments	16,507	10,491
Total deferred income	<u>199,887</u>	<u>186,109</u>

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

33. Financial risk management

Overview

The Group has exposure to the following financial risks:

- credit risk
- liquidity risk
- market risk

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

Risk management framework

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

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

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

Credit risk

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

Exposure to credit risk

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

		Carrying amount	
	Note	2016	2015
Non-current receivables and deposits	20	74,098	27,474
Trade and other receivables	23	130,184	97,359
Short term investments	25	23,236	19,533
Cash and cash equivalents	26	<u>226,889</u>	<u>194,586</u>
		<u>454,407</u>	<u>338,952</u>

Notes, continued:

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

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

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

	2016	2015
Credit cards	51,609	45,835
Trade receivables	32,456	20,614
	<u>84,065</u>	<u>66,449</u>
Other receivables	55,215	34,626
	<u>139,280</u>	<u>101,075</u>

Impairment losses

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

	Allowance for		Allowance for	
	Gross	Impairment	Gross	Impairment
	2016	2016	2015	2015
Not past due	65,172	(510)	47,888	(397)
Past due 1–30 days	12,010	(53)	14,224	(102)
Past due 31–120 days	6,540	(899)	4,360	(586)
Past due 121–365 days	1,248	(450)	1,370	(627)
More than one year	4,248	(3,241)	4,964	(4,645)
Total	<u>89,218</u>	<u>(5,153)</u>	<u>72,806</u>	<u>(6,357)</u>

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

	2016	2015
Balance at 1 January	6,357	5,390
Impairment loss allowance, increase (decrease)	811	1,785
Amounts written off	(2,048)	(781)
Exchange rate difference	(33)	(37)
Balance at 31 December	<u>5,153</u>	<u>6,357</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. If the Group believes that no recovery is possible the financial asset is written off directly. the financial asset is written off directly.

Notes, continued:

33. Financial risk management – continued:

Guarantees

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

Liquidity risk

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

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

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

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

	Carrying amount	Contractual cash flows	Within 12 months	1–2 years	2–5 years	More than 5 years
31 December 2016						
Non-derivative financial liabilities						
Unsecured bank loans	184,187	232,639	13,065	10,415	205,026	4,133
Secured loans	58,195	61,395	46,015	4,701	4,872	5,807
Payables & prepayments	223,832	223,832	210,543	5,852	7,437	0
Exposure to liquidity risk	466,214	517,866	269,623	20,968	217,335	9,940
Derivative financial liabilities						
Commodity derivatives	11,788	12,171	12,259	(88)	0	0
Forward exchange contracts	8,415	12,338	12,338	0	0	0
Interest rate swaps	79	(64)	(170)	(192)	298	0
Exposure to liquidity risk	20,124	24,445	24,427	(280)	298	0
31 December 2015						
Non-derivative financial liabilities						
Unsecured bond issue	34,678	42,294	3,272	2,769	30,962	5,291
Secured loans	30,852	35,649	10,923	9,584	7,999	7,143
Payables & prepayments	228,324	228,324	219,680	3,255	4,389	1,000
Exposure to liquidity risk	293,854	306,267	233,875	15,608	43,350	13,434
Derivative financial liabilities						
Commodity derivatives	(33,075)	(33,215)	(33,215)	0	0	0
Forward exchange contracts	3,333	5,183	5,183	0	0	0
Exposure to liquidity risk	(29,742)	(28,032)	(28,032)	0	0	0

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

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

Market risk

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

Notes, continued:

33. Financial risk management – continued:

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

Fuel risk

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

Sensitivity analysis

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

	Effect on equity		Effect on profit before tax	
	2016	2015	2016	2015
Increase in fuel prices by 10%	11,963	7,126	0	0
Decrease in fuel prices by 10%	(11,963)	(7,126)	0	0

Currency risk

The Group is exposed to currency risk on sales, purchases, trade and other receivables, short term investments, cash and cash equivalents, secured bank loans and trade payables that are denominated in a currency other than the respective functional currencies of Group entities.

The Group seeks to reduce its foreign exchange exposure arising from currency mismatch in the cash flow by netting receipts and payments in each individual currency and by internal trading within the Group. The shortfall of USD and ISK are financed by a surplus of European currencies, most importantly EUR and Scandinavian currencies but also GBP and CAD. The exposure is hedged 50-80% 9-12 months forward with spot and forward contracts.

Exposure to currency risk

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

2016	ISK	EUR	GBP	DKK	SEK	CAD
Receivables / payables, net	(42,193)	(24,156)	(12,718)	(3,468)	(3,203)	(11,252)
Cash and cash equivalents	23,325	20,534	7,530	3,186	3,662	5,468
Secured bank loans	(11,660)	0	0	0	0	0
Forward exchange contracts	118,302	(27,954)	(19,780)	(17,024)	(22,239)	(26,104)
Net statement of financial position exposure	87,774	(31,576)	(24,968)	(17,306)	(21,780)	(31,888)
Next 12 months forecast sales	286,721	310,523	71,745	26,879	30,077	84,236
Next 12 months forecast purchases	(551,029)	(256,163)	(26,571)	(11,038)	(3,405)	(15,931)
Net 12 months currency exposures	(176,534)	22,784	20,206	(1,456)	4,892	36,417
2015						
Receivables / payables, net	(68,709)	(25,218)	(14,926)	(3,396)	(4,512)	(10,057)
Cash and cash equivalents	16,339	19,487	9,337	1,449	5,990	14,637
Secured bank loans	(11,082)	0	0	0	0	0
Forward exchange contracts	54,054	(45,748)	(14,820)	0	(11,862)	(14,040)
Net statement of financial position exposure	(9,398)	(51,479)	(20,409)	(1,947)	(10,384)	(9,460)
Next 12 months forecast sales	273,482	221,278	82,080	18,793	40,847	27,688
Next 12 months forecast purchases	(358,773)	(122,137)	(3,317)	(10,094)	(5,954)	(19,443)
Net 12 months currency exposures	(94,689)	47,662	58,354	6,752	24,509	(1,215)

Notes, continued:

33. Financial risk management – continued:

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

	Average rate		Year-end spot rate	
	2016	2015	2016	2015
ISK	0.0083	0.0076	0.0088	0.0077
EUR	1.11	1.11	1.05	1.09
GBP	1.36	1.53	1.24	1.48
CAD	0.76	0.78	0.75	0.72
DKK	0.15	0.15	0.14	0.15
SEK	0.12	0.12	0.11	0.12

Sensitivity analysis

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

	Equity	Profit or loss
2016		
ISK	(7,022)	2,442
EUR	2,526	290
GBP	1,997	415
DKK	1,384	(1,339)
SEK	1,742	(37)
CAD	2,551	463
2015		
ISK	752	5,076
EUR	4,118	458
GBP	1,633	447
DKK	156	156
SEK	831	(118)
CAD	757	(366)

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

Interest rate risk

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

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

	Carrying amount	
	2016	2015
<i>Fixed rate instruments</i>		
Financial assets	3,230	2,945
	<u>3,230</u>	<u>2,945</u>
Effect of derivatives	20,124	(29,742)
	<u>23,354</u>	<u>(26,797)</u>
<i>Variable rate instruments</i>		
Financial assets	246,563	210,824
Financial liabilities	(165,209)	(22,005)
	<u>81,354</u>	<u>188,819</u>

Notes, continued:

33. Financial risk management – continued:

Fair value sensitivity analysis for fixed rate instruments

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

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

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

Cash flow sensitivity analysis for variable rate instruments

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

	100 bp increase	100 bp decrease
31 December 2016		
Variable rate instruments	651	(651)
Cash flow sensitivity (net)	<u>651</u>	<u>(651)</u>
31 December 2015		
Variable rate instruments	1,511	(1,511)
Cash flow sensitivity (net)	<u>1,511</u>	<u>(1,511)</u>

Capital management

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

34. Financial instruments and fair values

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

	Carrying amount 2016	Fair value 2016	Carrying amount 2015	Fair value 2015
Derivatives, included in loans and receivables	20,560	20,560	3,104	3,104
Short term investments	23,236	23,236	19,533	19,533
Unsecured bond issue	(184,187)	(189,963)	(34,678)	(33,438)
Secured loans	(58,195)	(58,138)	(30,852)	(30,769)
Derivatives, included in payables and prepayments	(436)	(436)	(33,075)	(33,075)
Total	<u>(199,022)</u>	<u>(204,741)</u>	<u>(75,968)</u>	<u>(74,645)</u>

Notes, continued:

34. Financial instruments and fair values – continued:

Fair value hierarchy:

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

	Level 1	Level 2	Level 3	Total
31 December 2016				
Derivatives, included in loans and receivables		20,560		20,560
Short term investments	23,236			23,236
Unsecured bond issue			(189,963)	(189,963)
Secured loans			(58,138)	(58,138)
Derivatives, included in payables and prepayments		(436)		(436)
Total	<u>23,236</u>	<u>20,124</u>	<u>(248,101)</u>	<u>(204,741)</u>
31 December 2015				
Derivatives, included in loans and receivables		3,104		3,104
Short term investments	19,533			19,533
Unsecured bond issue			(33,438)	(33,438)
Secured loans			(30,769)	(30,769)
Derivatives, included in payables and prepayments		(33,075)		(33,075)
Total	<u>19,533</u>	<u>(29,971)</u>	<u>(64,207)</u>	<u>(74,645)</u>

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

Non-derivative financial liabilities

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

Derivatives

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

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

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

35. Off-balance sheet items

Leases as lessee

As a lessee the Group has in place operating leases for storage facilities, hotels, equipment and fixtures for its operations, the longest until the year 2041. The Group has also in place operating leases for aircraft with duration from 1.4 years to 6.25 years. During the year USD 35.1 million was recognised as an expense in profit or loss in respect of operating leases (2015: USD 35.0 million). At year end 2016 the leases are payable as follows in nominal amounts for each year:

	Real estate	Aircraft	Other	Total
2016				
In the year 2017	13,281	16,761	10,067	40,109
In the year 2018	16,794	15,225	3,049	35,068
In the year 2019	19,922	9,024	3,333	32,279
In the year 2020	19,694	7,624	3,003	30,321
In the year 2021	18,961	2,994	2,440	24,395
Subsequent	231,271	1,830	33,165	266,266
Total	<u>319,923</u>	<u>53,458</u>	<u>55,057</u>	<u>428,438</u>

Notes, continued:

35. Off-balance sheet items – continued:

2015	Real estate	Aircraft	Other	Total
In the year 2016	14,813	19,688	6,111	40,612
In the year 2017	16,522	15,663	1,968	34,153
In the year 2018	21,017	13,761	2,249	37,027
In the year 2019	20,778	7,560	2,242	30,580
In the year 2020	20,871	6,160	2,298	29,329
Subsequent	277,594	1,530	33,520	312,644
Total	<u>371,595</u>	<u>64,362</u>	<u>48,388</u>	<u>484,345</u>

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

36. Leases as lessor

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

	2016	2015
In the year 2016	–	63,274
In the year 2017	72,138	51,619
In the year 2018	77,036	51,511
In the year 2019	33,231	19,777
In the year 2020	29,146	13,559
In the year 2021	11,142	5,152
Total	<u>222,693</u>	<u>204,892</u>

37. Guarantees

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

38. Capital commitments

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

The delivery plan is as follows:

	2018	2019	2020	2021
Boeing 737 Max 8	3	3	2	1
Boeing 737 Max 9		3	3	1
Total	<u>3</u>	<u>6</u>	<u>5</u>	<u>2</u>

39. Related parties

Identity of related parties

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

Notes, continued:

39. Related parties – continued:

Transactions with management and key personnel

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

	2016 Salaries and benefits ISK	Number of shares held at year-end 2016 in thousands	2015 Salaries and benefits ISK	Number of shares held at year-end 2015 in thousands
Board of Directors:				
Sigurður Helgason, Chairman of the Board	8,750	14,000	8,100	14,000
Ásthildur Margrét Otharsdóttir	4,850		4,500	
Katrín Olga Jóhannesdóttir	6,500	13	6,000	413
Magnús Magnússon	4,080		4,500	
Úlfar Steindórsson	6,625		6,150	
Key employees:				
Björgólfur Jóhannsson CEO of Icelandair Group hf.	54,002	1,400	53,619	1,300
Eight MD's of Group companies and CFO of Icelandair Group hf.	297,950	1,111	273,181	6,111

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

Transaction with associates

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

Transaction with shareholders

There are no shareholders with significant influence at year end 2016. Companies which members of the Board and key employees control have been identified as being 13. These companies have been identified as related. Transactions with them consist of purchase and sale of services in the ordinary course of business on an arm's length basis. Total purchases in 2016 from these entities amounted to USD 0.1 million (2015: USD 0.1 million). Total sales amounted to USD 0.1 million (2015: USD 0.1 million).

40. Reassessment of taxes

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

41. Litigations and claims

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

Notes, continued:

42. Group entities

The Company held 12 subsidiaries at year end 2016 which are all included in the consolidated financial statements. They are as follows:

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

The subsidiaries further own 14 subsidiaries that are also included in the consolidated financial statements. Four of those have non-controlling shareholders.

43. Statement of cash flows

Other operating items in the statement of cash flows are specified as follows:	2016	2015
Expensed deferred cost	8,418	6,874
Exchange rate difference and indexation of liabilities and assets	4,820	455
Gain on the sale of operating assets	(782)	(1,529)
Gain on sale of investments	(94)	0
Share in profit of associates	(957)	(459)
Income tax.	8,920	10,870
Total other operating items in the statement of cash flows	<u>20,325</u>	<u>16,211</u>

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

Inventories, (increase) decrease.	(3,800)	3,639
Trade and other receivables, increase	(9,573)	(3,948)
Trade and other payables, (decrease) increase.	(2,219)	22,762
Deferred income, increase	13,815	11,423
Net change in operating assets and liabilities in the statement of cash flows	<u>(1,777)</u>	<u>33,876</u>
Additional cash flow information:		
Interest paid	5,267	7,947
Interest received	3,298	2,849
Taxes paid	30,139	8,880

Notes, continued:

45. Ratios

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

	2016	2015
Current ratio	0.92	0.80
Equity ratio	0.44	0.47
Intrinsic value of share capital	14.00	11.25

46. Significant accounting policies

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

a. Basis of consolidation

(i) Subsidiaries

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

(ii) Investments in associates

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

(iii) Transactions eliminated on consolidation

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

b. Currency exchange

(i) Currency transactions

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

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

(ii) Subsidiaries with other functional currency

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

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

Notes, continued:

46. Significant accounting policies – 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 derecognised financial assets that is created or retained by the Group is recognised as a separate asset or liability.

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

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

Financial assets at fair value through profit or loss

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

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

Loans and receivables

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

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

Cash and cash equivalents

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

(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.

Notes, continued:

46. Significant accounting policies

c. Financial instruments – continued:

(iii) Share capital

Ordinary shares

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

Repurchase and reissue of share capital

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

(iv) Derivative financial instruments, including hedge accounting

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

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

Cash flow hedges

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

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

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.

Notes, continued:

46. Significant accounting policies

d. Operating assets – continued:

(ii) Aircraft and flight equipment

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

(iii) Subsequent expenditure

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

(iv) Depreciation

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

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

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

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

e. Intangible assets and goodwill

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

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

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

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

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

(ii) Other intangible assets

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

	Useful life
Software	3 years
Other intangible assets	6–10 years

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

Notes, continued:

46. Significant accounting policies

e. Intangible assets and goodwill – continued:

(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..

h. Impairment

(i) Non-derivative financial assets

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

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

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

(ii) Non-financial assets

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

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

Impairment losses are recognised in profit or loss. Impairment losses recognised in 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 other assets in the CGU (group of CGUs) on a pro rata basis.

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

Notes, continued:

46. Significant accounting policies

(ii) Non-financial assets – continued:

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. Provisions

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

Overhaul commitments relating to aircraft under operating lease

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

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

j. Deferred income

Sold unused tickets, fair value of unutilised 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 recognised as revenue when they are utilised or when they expire.

k. Operating income

(i) Transport revenue

Passenger ticket sales are not recognised as revenue until transportation has been provided. Sold refundable documents not used within 12 months from the month of sale are recognised as revenue. Non-refundable documents are recognised as revenue two months after expected transport if not used. Revenue from mail and cargo transportation is recognised when transportation has been provided.

(ii) Customer loyalty programmes

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

(iii) Aircraft and aircrew lease

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

(iv) Other operating revenue

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

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

Notes, continued:

46. Significant accounting policies – continued:

i. Employee benefits

(i) Short-term employee benefits

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

(ii) Defined contribution plans

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

m. Lease payments

Operating lease payments

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

n. Finance income and finance costs

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

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

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

o. Income tax

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

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

Deferred tax is 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. Deferred tax is not recognised for goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that do not affect accounting, or taxable profit or differences relating to investment in subsidiaries.

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 used. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

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

p. Earnings per share

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

q. Segment reporting

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

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

Notes, continued:

46. Significant accounting policies

q. Segment reporting – continued:

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

47. Standards issued but not yet effective

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

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

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

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

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

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

Corporate Governance Statement

The Framework

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

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

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

Internal Audit and Risk Management

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

Audit Committee:

Katrín Olga Jóhannesdóttir, Chairman
Ásthildur Margrét Otharsdóttir
Magnús Magnússon

Values, Code of Ethics and Corporate Responsibility

The Company's values are:

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

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

Compensation Committee

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

Compensation Committee:

Sigurður Helgason, Chairman
Úlfar Steindórsson

Corporate Governance Statement, continued:

The Board of Directors and Executive Committee

Board of Directors

Sigurður Helgason, Chairman

Sigurður Helgason was born in 1946. He was President & CEO of Flugleidir/FL-Group/Icelandair 1985–2005. He was Director of Cash Management 1974–1980, Senior Vice-President of Finance 1980–1983 and General Manager of The Americas 1983–1985 for Flugleidir/Icelandair. He was Chairman of the Board of The Icelandic International Development Fund 2005–2008. He is the Chairman of the Icelandair Special Children Travel Fund since 2005. He was a member of the IATA board of 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.

Úlfar Steindórsson, Deputy Chairman

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

Ásthildur Margrét Otharsdóttir, Board Member

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

Katrín Olga Jóhannesdóttir, Board Member

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

Magnús Magnússon, Board Member

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

Corporate Governance Statement, continued:

Executive committee

Björgólfur Jóhannsson, President and CEO

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

Bogi Nils Bogason, CFO

Birkir Hólm Guðnason, CEO of Icelandair

Magnea Þórey Hjálmarsdóttir, Managing Director of Icelandair Hotels

Board of Directors

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

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

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

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

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

Corporate Governance Statement, continued:

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

The Board of Directors elects the members of the two sub-committees; the Compensation Committee and the Audit Committee. The sub-committees adhere to the Rules on Working Procedures. The Board of Directors convened 18 times in the year and all Board Members attended almost all meetings. All the Members of the Board of Directors are independent from the Company, except Ásthildur Margrét Otharsdóttir. All Board members were independent of the Company's major shareholders in 2016.

Non-Financial Reporting

About Icelandair Group ehf.

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

Icelandair Group and Society

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

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

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

Environment

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

Employees

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

Society

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

Environment

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

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

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

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

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

Non-Financial Reporting, continued:

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

Employees

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

Society

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

Anti-corruption and bribery policy

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

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

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

Responsibility

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

Quarterly Statements (unaudited)

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

Year 2016	Q1	Q2	Q3	Q4	Total
Operating income	211,837	331,355	485,910	256,472	1,285,574
Operating expenses excluding depreciation	(210,083)	(277,467)	(324,160)	(254,019)	(1,065,729)
Operating profit before depreciation (EBITDA)	1,754	53,888	161,750	2,453	219,845
Depreciation	(21,768)	(23,198)	(29,622)	(26,820)	(101,408)
Operating (loss) profit (EBIT)	(20,014)	30,690	132,128	(24,367)	118,437
Net finance (expense) income	(1,325)	2,132	(1,666)	1,576	717
Share of profit (loss) of associates	55	(58)	363	597	957
(Loss) profit before income tax	(21,284)	32,764	130,825	(22,194)	120,111
Income tax	4,288	(6,595)	(28,060)	(676)	(31,043)
(Loss) profit	(16,996)	26,169	102,765	(22,870)	89,068
Other comprehensive profit	9,175	22,647	9,562	8,198	49,582
Total comprehensive (loss) income	(7,821)	48,816	112,327	(14,672)	138,650
Working capital from (used in) operations	3,023	57,310	161,169	(10,701)	210,801
Net cash from (used in) operating activities	148,792	119,636	(19,933)	(39,471)	209,024
Net cash used in investing activities	(99,801)	(58,277)	(63,695)	(69,986)	(291,759)
Net cash (used in) from financing activities	(3,295)	(28,500)	(2,289)	147,727	113,643
Year 2015					
Operating income	186,075	294,212	429,446	229,966	1,139,699
Operating expenses excluding depreciation	(188,083)	(244,100)	(273,826)	(207,024)	(913,033)
Operating (loss) profit before depreciation (EBITDA)	(2,008)	50,112	155,620	22,942	226,666
Depreciation	(17,011)	(21,872)	(23,869)	(21,074)	(83,826)
Operating (loss) profit (EBIT)	(19,019)	28,240	131,751	1,868	142,840
Net finance income (expense)	625	(317)	(1,378)	(2,006)	(3,076)
Share of profit (loss) of associates	90	0	381	(12)	459
(Loss) profit before income tax	(18,304)	27,923	130,754	(150)	140,223
Income tax	3,752	(5,558)	(27,611)	417	(29,000)
(Loss) profit	(14,552)	22,365	103,143	267	111,223
Other comprehensive profit (loss)	3,056	15,206	(4,695)	(15,371)	(1,804)
Total comprehensive (loss) income	(11,496)	37,571	98,448	(15,104)	109,419
Working capital from operations	1,164	49,611	157,406	3,079	211,260
Net cash from operating activities	117,687	86,724	4,085	36,640	245,136
Net cash used in investing activities	(37,611)	(34,559)	(60,265)	(87,507)	(219,942)
Net cash from (used in) financing activities	19,880	(20,716)	(2,868)	(10,616)	(14,320)

80 YEARS OF AVIATION 1937-2017



