

Icelandair Group hf.

**Condensed Consolidated
Interim Financial Statements
1 January - 30 June 2008**

ISK

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

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Endorsement and Statement of the Board of Directors and the CEO

The condensed consolidated interim financial statements of Icelandair Group hf. for the period from 1 January to 30 June 2008 have been prepared in accordance with International Financial Reporting Standards (IFRSs) for Interim Financial Statements (IAS 34). The interim financial statements comprise the consolidated interim financial statements of Icelandair Group hf. and its subsidiaries, which were fifteen at the end of June 2008. Travel Service, owned 80% by Icelandair Group hf. at the end of the period, is consolidated since the beginning of second quarter.

According to the income statement net loss for the period from 1 January to 30 June 2008 amounted to ISK 1.283 million. According to the balance sheet, equity at the end of the period amounted to ISK 27.271 million, including share capital in the amount of ISK 975 million.

Statement by the Board of Directors and the CEO

To the best of our knowledge it is our opinion that the condensed consolidated interim financial statements give a true and fair view of the consolidated financial performance of the Company for the six-month period ended 30 June 2008, its assets, liabilities and consolidated financial position as at 30 June 2008 and its consolidated cash flows for the period then ended.

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

The Board of Directors and the CEO have today discussed the condensed consolidated interim financial statements of Icelandair Group hf. for the period from 1 January to 30 June 2008 and confirm them by means of their signatures.

Reykjavík, 18 August 2008.

Board of Directors:

Gunnlaugur M. Sigmundsson, Chairman of the Board of Directors
Ómar Benediktsson
Ásgeir Baldurs
Einar Sveinsson
Finnur Reyr Stefánsson
Martha Eiríksdóttir
Sigurður Atli Jónsson

CEO:

Björgólfur Jóhannsson

Independent Auditor's Review Report

To the Board of Directors of Icelandair Group hf.

Introduction

We have reviewed the accompanying condensed consolidated interim financial statements of Icelandair Group hf., which comprise the consolidated interim balance sheet as at 30 June 2008 and the consolidated interim income statement, statement of changes in equity and cash flow statement for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with International Financial Reporting Standards as adopted by the EU. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying consolidated interim financial information does not give a true and fair view of the financial position of the entity as at 30 June 2008, and of its financial performance and its cash flows for the six-month period then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavík, 18 August 2008.

KPMG hf.

Jón S. Helgason
Guðný H. Guðmundsdóttir

Consolidated Interim Income Statement for the period from 1 January to 30 June 2008

	Notes	Q2		Q1-Q2	
		2008 1.4.-30.6.	2007 1.4.-30.6.	2008 1.1.-30.6.	2007 1.1.-30.6.
Operating income:					
Transport revenue		12.208	9.686	18.981	16.001
Aircraft and aircrew lease		12.898	3.750	18.085	6.363
Other operating revenue		3.848	2.755	5.898	5.732
		<u>28.954</u>	<u>16.191</u>	<u>42.964</u>	<u>28.096</u>
Operating expenses:					
Salaries and other personnel expenses		6.229	5.329	11.234	9.931
Aircraft fuel		6.538	2.581	9.160	4.260
Aircraft and aircrew lease		3.684	1.665	6.235	3.101
Aircraft servicing, handling and communication		3.752	1.203	4.748	1.941
Aircraft maintenance expenses		2.707	1.079	3.819	2.106
Other operating expenses		4.189	3.012	6.770	5.516
		<u>27.099</u>	<u>14.869</u>	<u>41.966</u>	<u>26.855</u>
Operating profit before depreciation and amortisation (EBITDA)		1.855	1.322	998	1.241
Depreciation and amortisation		(954)	(686)	(1.760)	(1.438)
Operating (loss) profit before net finance costs (EBIT)		901	636	(762)	(197)
Finance income		437	76	931	122
Finance expense		(810)	(508)	(1.671)	(1.323)
Net finance costs	3	<u>(373)</u>	<u>(432)</u>	<u>(740)</u>	<u>(1.201)</u>
Share of profit of associates		127	66	76	127
(Loss) profit before income tax		655	270	(1.426)	(1.271)
Income tax	4	<u>(260)</u>	<u>(65)</u>	<u>143</u>	<u>247</u>
(Loss) profit for the period		<u>395</u>	<u>205</u>	<u>(1.283)</u>	<u>(1.024)</u>
Attributable to:					
Equity holders of the Company		277	202	(1.403)	(1.028)
Minority Interest		118	3	120	4
(Loss) profit for the period		<u>395</u>	<u>205</u>	<u>(1.283)</u>	<u>(1.024)</u>
(Loss) profit per share:					
Basic (loss) earnings per share (ISK)		0,40	0,21	(1,28)	(1,03)
Diluted (loss) earnings per share (ISK)		0,40	0,21	(1,28)	(1,03)

Consolidated Interim Balance Sheet

as at 30 June 2008

	Notes	30.6.2008	31.12.2007
Assets:			
Operating assets		27.762	22.832
Intangible assets		31.351	26.846
Deferred tax asset		149	0
Investments in associates		938	2.335
Prepaid aircraft acquisitions		2.188	249
Long-term receivables and deposits		3.909	1.788
Total non-current assets		66.297	54.050
Inventories		1.919	1.301
Trade and other receivables		14.530	7.284
Receivables from sale of aircrafts		0	1.753
Prepayments		779	366
Cash and cash equivalents		6.299	2.006
Total current assets		23.527	12.710
Total assets		89.824	66.760
Equity:			
Share capital		975	981
Share premium		25.459	25.593
Reserves		2.467	(1.296)
Accumulated deficit		(1.696)	(293)
Total equity attributable to equity holders of the Company		27.205	24.985
Minority interest		66	48
Total equity	5	27.271	25.033
Liabilities:			
Loans and borrowings		18.836	14.040
Prepayments	6	1.425	0
Deferred income tax liability		14	134
Total non-current liabilities		20.275	14.174
Loans and borrowings		10.550	11.058
Trade and other payables		21.056	12.591
Deferred income		10.672	3.904
Total current liabilities		42.278	27.553
Total liabilities		62.553	41.727
Total equity and liabilities		89.824	66.760

Consolidated Interim Statement of Changes in Equity for the period from 1 January to 30 June 2008

	Attributable to equity holders of the Company							Total	Minority Interest	Total equity
	Share capital	Share premium	Share option reserve	Hedging reserve	Translation reserve	Accumulated deficit	Reserves			
1 January to 30 June 2007										
Equity 1.1.2007	1.000	26.090	0	(159)	(425)	(544)	25.962	42	26.004	
Foreign currency translation differences for foreign operations					(1.215)		(1.215)		(1.215)	
Net profit on hedge of net investment in foreign operation					15		15		15	
Effective portion of changes in fair value of cash flow hedges, net of tax				394			394		394	
Net income and (expense) recognised directly in equity				394	(1.200)		(806)		(806)	
Loss for the period						(1.028)	(1.028)	4	(1.024)	
Total recognised income (expense)				394	(1.200)	(1.028)	(1.834)	4	(1.830)	
Own shares, change	(15)	(393)					(408)		(408)	
Stock option expense			99				99		99	
Equity 30.6.2007	985	25.697	99	235	(1.625)	(1.572)	23.819	46	23.865	
1 January to 30 June 2008										
Equity 1.1.2008	981	25.593	168	(24)	(1.440)	(293)	24.985	48	25.033	
Foreign currency translation differences for foreign operations					2.676		2.676	11	2.687	
Effective portion of changes in fair value of cash flow hedges, net of tax				1.059			1.059	(3)	1.056	
Net income and (expense) recognised directly in equity				1.059	2.676		3.735	8	3.743	
Loss for the period						(1.403)	(1.403)	120	(1.283)	
Total recognised income (expense)				1.059	2.676	(1.403)	2.332	128	2.460	
Minority interest arising on business combination								(110)	(110)	
Own shares, change	(6)	(134)					(140)		(140)	
Stock option expense			28				28		28	
Equity 30.6.2008	975	25.459	196	1.035	1.236	(1.696)	27.205	66	27.271	

Consolidated Interim Statement of Cash Flows for the Six Months Ended 30 June 2008

	Notes	2008 1.1.-30.6.	2007 1.1.-30.6.
Cash flows from operating activities:			
Loss for the period .....	(	1.283)	(1.024)
Adjustments for:			
Depreciation and amortisation		1.760	1.438
Other operating items	8	888	(2.095)
Working capital from (used in) operations		1.365	(1.681)
Net change in operating assets and liabilities		6.254	5.266
Net cash from operating activities		7.619	3.585
Cash flows from investing activities:			
Acquisition of operating assets .....	(	3.110)	(3.591)
Proceeds from the sale of operating assets		259	2.972
Acquisition of intangible assets .....	(	64)	(344)
Long-term receivables, decrease, (increase)		1.311	(307)
Investment in subsidiary net of cash received	2	(750)	0
Net cash used in investing activities		(2.354)	(1.270)
Cash flows from financing activities:			
Acquisition of own shares .....	(	139)	(409)
Proceeds from borrowings		3.988	8.440
Repayment of long term borrowings .....	(	8.051)	(6.887)
Repayment of short term borrowings		1.422	(1.945)
Prepayments		1.295	0
Net cash used in financing activities		(1.485)	(801)
Increase in cash and cash equivalents		3.780	1.514
Effect of exchange rate fluctuations on cash held		513	(104)
Cash and cash equivalents at 1 January		2.006	2.776
Cash and cash equivalents at 30 June		6.299	4.186
Investment and financing without cash flow effect:			
Receivables from sale of operating assets		0	3.995

Notes

Significant accounting policies

a. *Reporting entity*

Icelandair Group hf. (the "Company") is a limited liability company incorporated and domiciled in Iceland. The address of the Company's registered office is at Reykjavíkurlugvöllur in Reykjavík, Iceland. The consolidated interim financial statements of the Company as at and for the six-month period ended 30 June 2008 comprise the Company and its subsidiaries (together referred to as the "Group") and the Group's interests in associates. The Group's operations are in the airline transportation and tourism industry.

b. *Statement of compliance*

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standard IAS 34, *Interim Financial Reporting*. They do not include all of the information required for a complete set of consolidated annual financial statements, and should be read in conjunction with the consolidated financial statements of the Company as at and for the year ended 31 December 2007.

The condensed consolidated interim financial statements were approved by the board of directors on 18 August 2008.

c. *Significant accounting policies*

The accounting policies and methods of computation applied by the Company in these condensed interim consolidated financial statements are the same as those applied by the Company in its consolidated financial statements as at and for the year ended 31 December 2007. The consolidated financial statements for the year ended 31 December 2007 are available at the Company's office and website, www.icelandairgroup.is and at The Icelandic Stock Exchange website, www.omxgroup.com.

The condensed consolidated interim financial statements are prepared in Icelandic kronas, which is the Company's functional currency, rounded to the nearest million. They are prepared on the historical cost basis except that derivative financial instruments are stated at their fair value.

d. *Use of estimates and judgements*

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

Notes, contd.:

Segment reporting

1. Business segments

1 January to 30 June 2008

	Scheduled airline & tourism operations	Global capacity and aircraft trading	Shared services	Eliminations	Consolidated
External revenue	24.574	18.280	110		42.964
Inter-segment revenue	7.369	306	298	(7.973)	
Segment revenue	31.943	18.586	408	(7.973)	42.964
Segment EBITDAR	2.074	4.407	(497)		5.984
Segment EBITDA	(22)	1.517	(497)		998
Segment results	(1.367)	1.115	(510)		(762)
Net finance costs	(112)	200	(828)		(740)
Share of loss of associates	1	75	0		76
Income tax	229	(194)	108		143
(Loss) profit for the period	(1.249)	1.196	(1.230)		(1.283)
Segment assets	48.846	19.981	53.392	(33.333)	88.886
Investments in associates	103	832	3		938
Total assets	48.949	20.813	53.395	(33.333)	89.824
Segment liabilities	43.391	16.779	25.178	(22.795)	62.553
Capital expenditure	2.049	1.109	16		3.174
Depreciation	1.212	306	11		1.529
Amortisation of intangible assets	133	96	2		231

Notes, contd.:

Segment reporting

1. Business segments, contd.:

1 January to 30 June 2007

	Scheduled airline & tourism operations	Global capacity and aircraft trading	Shared services	Eliminations	Consolidated
External revenue	21.392	6.652	52		28.096
Inter-segment revenue	6.263	11	286	(6.560)	
Segment revenue	<u>27.655</u>	<u>6.663</u>	<u>338</u>	<u>(6.560)</u>	<u>28.096</u>
Segment EBITDAR	<u>2.195</u>	<u>1.711</u>	<u>(255)</u>		<u>3.651</u>
Segment EBITDA	<u>471</u>	<u>1.025</u>	<u>(255)</u>		<u>1.241</u>
Segment results	(664)	730	(263)		(197)
Net finance costs	(378)	(190)	(633)		(1.201)
Share of profit of associates	0	127	0		127
Income tax	174	(145)	218		247
(Loss) profit for the period	<u>(868)</u>	<u>522</u>	<u>(678)</u>		<u>(1.024)</u>
Segment assets	37.096	12.452	42.652	(22.771)	69.429
Investments in associates	20	2.149	0		2.169
Total assets	<u>37.116</u>	<u>14.601</u>	<u>42.652</u>	<u>(22.771)</u>	<u>71.598</u>
Segment liabilities	32.098	12.286	18.088	(14.739)	47.733
Capital expenditure	<u>2.559</u>	<u>1.353</u>	<u>23</u>		<u>3.935</u>
Depreciation	983	147	4		1.134
Amortisation of intangible assets	153	148	3		304

Notes, contd.:

Business Combination

2. On 18 September 2007 the Company signed a purchase agreement for the acquisition of the Czech airline Travel Service, the largest private airline in the Czech Republic. Travel Service operates charter flights to and from Prague and Budapest and also owns and operates the low cost airline Smart Wings. According to the agreement Icelandair Group hf. purchases the shares in two stages, 50% of the shares in 2007 and 50% during 2008. The 50% share in Travel Service acquired in 2007 was acquired through the holding company, Lerox CZ s.r.o. which is 100% owned by Icelandair Group hf. The 50% share of Travel Service was accounted for using the equity method within Lerox CZ s.r.o. from the acquisition date of Lerox CZ s.r.o. as of 1 November 2007 until 1 April 2008, the acquisition date, when Icelandair Group hf. obtained control of Travel Service due to resolution of constraints in the share purchase agreement.

During the 2nd Quarter, Icelandair Group hf. acquired the second 50% part of the shares in Travel Service directly and at the same time transferred the ownership of the 50% from Lerox to Icelandair Group hf. According to the purchase agreement the sellers had option to buy back 20% of the shares at the completion date in 2008. The sellers exercised this option so Icelandair Group hf. owns 80% of Travel Service at the end of the period. The Sellers have put option on 20% which can be exercised at any time before 31 December 2009.

The acquisition had the following effect on the Group's assets and liabilities on acquisition date:

	Travel Service
Non-current assets	2.051
Current assets	2.548
Non-current liabilities	(1.632)
Current liabilities	(3.237)
Net assets	(270)
Goodwill on acquisition	2.383
Total purchase price, satisfied in cash	2.113
Paid in 2007	(960)
Cash and cash equivalents acquired	(403)
Net cash outflow	750

The purchase price includes ISK 104 million direct cost related to the transaction.

Necessary information to work on the purchase price allocation were not obtained before the reporting date so it is only provisional. The allocation will be finalized during the second half of the year 2008.

Consolidated revenues increased by ISK 8.595 million and loss decreased by ISK 647 million by consolidating Travel Service from 1 April 2008.

Notes, contd.:

Finance income and finance expense

	2008	2007
	1.1.-30.6.	1.1.-30.6.
3. Finance income and finance expense are specified as follows:		
Interest income on bank deposits	81	61
Other interest income	111	61
Gain from sale of derivatives	303	0
Net foreign exchange gain	436	0
Finance income total	<u>931</u>	<u>122</u>
Interest expense on loans and borrowings	1.612	1.220
Other interest expenses	59	77
Net foreign exchange loss	0	26
Finance expense total	<u>1.671</u>	<u>1.323</u>
Net finance expense	<u>(740)</u>	<u>(1.201)</u>

Income tax

4. The effective tax rate for the period 1 January to 30 June 2008 was 10% (1 January to 30 June 2007: 19%) The change is mainly attributable to non-deductible expenses, effect of tax rates in foreign jurisdictions and the change in the Company's domestic tax rate.

In May 2008 the Icelandic Parliament approved a decrease in the income tax rate from 18% to 15% as of 1 January 2008 and the change will become effective in the tax assessment of the year 2009. Due to this the deferred tax liability at year-end 2007 has decreased by ISK 22,4 million. The decrease is recognised as a part of income tax in the income statement.

Equity

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

Share premium

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

Share option reserve

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

Notes, contd.:

Equity

5. Contd.:

Hedging reserve

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

Translation reserve

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

Prepayments

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

Group entities

7. The Company holds fifteen subsidiaries, which are all included in the consolidated interim financial statements. They are:

	Share
Scheduled airline operations and tourism:	
Air Iceland ehf.	100%
Iceland Travel ehf.	100%
Icelandair ehf.	100%
Icelandair Cargo ehf.	100%
Icelandair Ground Services ehf. (IGS)	100%
Icelandair Hotels ehf.	100%
Global capacity solutions and aircraft trading:	
Bluebird Cargo ehf.	100%
IceLease ehf.	100%
IG Invest ehf.	100%
Loftleiðir - Icelandic ehf.	100%
Latcharter Airlines, Latvia	100%
Lerox CZ s.r.o., dormant	100%
Travel Service, Czech Republic	80%
Shared services:	
IceCap Ltd., Guernsey	100%
Icelandair Shared Services ehf.	100%

The subsidiaries own 18 subsidiaries that are all included in the consolidated interim financial statements.

Notes, contd.:

Statement of cash flows

	2008	2007
	1.1.-30.6.	1.1.-30.6.
8. Other operating items in the statement of cash flows are specified as follows:		
Gain on the sale of assets	(97)	(1.260)
Exchange rate difference and indexation of liabilities and assets	1.025	(1.002)
Share of profit of associates	(76)	(127)
Income tax	(313)	(247)
Other items	349	541
Total other operating items in the statement of cash flows	<u>888</u>	<u>(2.095)</u>

Ratios

	30.6.2008	31.12.2007
9. The Group's primary ratios are specified as follows:		
Working capital ratio - current assets/current liabilities	0,56	0,46
Equity ratio - equity/total assets	0,30	0,37
Intrinsic value of share capital - equity/share capital	27,97	25,52

Other

10. During the first half of 2007 the Competition Authorities fined the subsidiary, Icelandair ehf., due to an alleged breach of the competition law. The penalty amounts to ISK 130 million after it was lowered by 30% after the decision was appealed. Icelandair Group hf. has decided to take this case to court and considers it more likely than not that the fine will be withdrawn in full. Nothing has been expensed in the interim financial statements on this case.