

Icelandair Group hf.
Consolidated Financial Statements
for the year 2013
USD

Icelandair Group hf.
Reykjavíkurlugvöllur
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Iceland
Reg. no. 631205-1780

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Endorsement and Statement by the Board of Directors and the CEO

Operations in the year 2013

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.

In February 2013 Icelandair Group and Boeing finalized 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 is valued at USD 1.6 billion at Boeing list prices. The Company received acceptable discounts which due to confidentiality agreements cannot be disclosed. The acquisition will be funded by internal resources and from aviation finance products.

Profit for the year 2013 amounted to USD 56.4 million and total comprehensive income amounted to USD 61.9 million according to the consolidated statement of comprehensive income. Total equity at year end 2013 amounted to USD 346.1 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 2014 of ISK 2.150 million, equal to USD 18.6 million, which represents 30% of total comprehensive income for the year 2013.

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 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). The Company can purchase up to 10% of the nominal value of the shares of the Company according to the Icelandic Company's Act.

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

The number of shareholders at year end 2013 was 1,833, which is an increase of 375 during the year. At year end 10 largest shareholders were:

Name	Shares in ISK	
	thousand	Shares in %
Lífeyrissjóður verslunarmanna	718,136	14.36
Stefnir - ÍS 15	495,975	9.92
Lífeyrissjóður starfsmanna ríkisins A-deild	370,500	7.41
Framtakssjóður Íslands	350,540	7.01
Stefnir - ÍS 5	308,008	6.16
Gildi - lífeyrissjóður	245,042	4.90
Íslandssjóðir hf.	180,030	3.60
Lífeyrissjóður starfsmanna ríkisins B-deild	171,000	3.42
Stafir lífeyrissjóður	158,079	3.16
Íslandsbanki hf.	149,996	3.00
	<hr/>	<hr/>
	3,147,305	62.94
Other shareholders	1,827,235	37.05
Treasury shares	25,460	0.01
Total issued shares	<hr/>	<hr/>
	5,000,000	100.00

Further information on matters related to share capital is disclosed in note 25. Additional information on shareholders are provided on the Company's website www.icelandairgroup.com.

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

Corporate Governance

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

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

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

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

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

Information on matters related to financial risk management is disclosed in note 31.

Statement by the Board of Directors and the CEO

The consolidated financial statements for the year ended 31 December 2013 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional Icelandic disclosure requirements for consolidated financial statements of listed companies.

According to our best knowledge it is our opinion that the annual consolidated financial statements give a true and fair view of the consolidated financial performance of the Company for the year 2013, its assets, liabilities and consolidated financial position as at 31 December 2013 and its consolidated cash flows for the year 2013.

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 2013 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the consolidated financial statements will be approved at the annual general meeting of Icelandair Group hf.

Reykjavík, 6 February 2014.

Board of Directors:

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

CEO:

Björgólfur Jóhannsson

Independent Auditors' Report

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

We have audited the accompanying consolidated financial statements of Icelandair Group hf., which comprise the consolidated statement of financial position as at 31 December 2013, the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of Icelandair Group as at 31 December 2013, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Report on the Board of Directors report

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

Reykjavík, 6 February 2014.

KPMG ehf.

Alexander G. Eðvardsson
Guðný Helga Guðmundsdóttir

Consolidated Statement of Comprehensive Income for the year 2013

	Notes	2013	2012
Operating income			
Transport revenue	7	702,882	604,499
Aircraft and aircrew lease		117,969	120,815
Other operating revenue	7	202,106	173,552
		<u>1,022,957</u>	<u>898,866</u>
Operating expenses			
Salaries and other personnel expenses	8	239,432	203,815
Aircraft fuel		242,630	220,059
Aircraft and aircrew lease		34,570	46,740
Aircraft maintenance expenses		81,475	78,197
Aircraft handling, landing and communication		74,316	66,467
Other operating expenses	8	206,824	173,942
		<u>879,247</u>	<u>789,220</u>
Operating profit before depreciation and amortisation (EBITDA)		143,710	109,646
Depreciation and amortisation	9	(70,699)	(58,859)
Operating profit (EBIT)		73,011	50,787
Finance income		6,777	17,578
Finance costs		(8,702)	(10,551)
Net finance (costs) income	10	(1,925)	7,027
Share of loss of associates, net of tax	17	(38)	(366)
Profit before tax		71,048	57,448
Income tax	20	(14,630)	(13,173)
Profit for the year		<u>56,418</u>	<u>44,275</u>
Other comprehensive income			
Items that are or may be reclassified to profit or loss			
Currency translation differences		4,204	(2,285)
Net profit (loss) on hedge of investment, net of tax		169	(46)
Net investment hedge reclassified to profit or loss		(111)	(1,417)
Effective portion of changes in fair value of cash flow hedge, net of tax		1,230	(1,673)
Other comprehensive profit (loss) for the year		<u>5,492</u>	<u>(5,421)</u>
Total comprehensive income for the year		<u>61,910</u>	<u>38,854</u>

The notes on pages 11 to 47 are an integral part of these consolidated financial statements.

Consolidated Statement of Comprehensive Income for the year 2013, continued:

	Notes	2013	2012
Profit attributable to:			
Owners of the Company		56,386	44,228
Non-controlling interests		32	47
Profit for the year		56,418	44,275
Total Comprehensive income attributable to:			
Owners of the Company		61,928	38,834
Non-controlling interests		(18)	20
Total comprehensive income for the year		61,910	38,854
Earnings per share:			
Basic earnings per share expressed in USD cent per share	26	1.13	0.89
Diluted earnings per share expressed in USD cent per share	26	1.13	0.89

The notes on pages 11 to 47 are an integral part of these consolidated financial statements.

Consolidated Statement of Financial Position as at 31 December 2013

	Notes	2013	2012
Assets:			
Operating assets	11-14	299,197	282,997
Intangible assets and goodwill	15-16	179,676	176,715
Investments in associates	17	2,035	1,327
Long-term cost	18	258	3,648
Non-current receivables and deposits	19	15,791	9,223
Non-current assets		496,957	473,910
Inventories	21	22,166	17,417
Trade and other receivables	22	114,259	135,085
Marketable securities	23	7,955	15,734
Cash and cash equivalents	24	191,538	117,060
Assets classified as held for sale	6	0	3,689
Current assets		335,918	288,985
Total assets		832,875	762,895
Equity:			
Share capital		40,576	40,576
Share premium		154,705	154,705
Reserves		31,706	26,164
Retained earnings		118,856	74,230
Equity attributable to equity holders of the Company	25	345,843	295,675
Non-controlling interests		239	257
Total equity		346,082	295,932
Liabilities:			
Loans and borrowings	27	78,489	119,358
Payables	28	23,742	22,060
Deferred tax liabilities	20	27,995	19,671
Non-current liabilities		130,226	161,089
Loans and borrowings	27	43,528	31,548
Trade and other payables	29	159,504	152,237
Deferred income	30	153,535	122,089
Current liabilities		356,567	305,874
Total liabilities		486,793	466,963
Total equity and liabilities		832,875	762,895

The notes on pages 11 to 47 are an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Equity for the year 2013

Attributable to equity holders of the Company

2012	Share capital	Share premium	Reserves	Retained earnings	Total	Non-con- trolling interest	Total equity
Balance at 1 January 2012	40,576	154,705	31,557	36,310	263,148	237	263,385
Total comprehensive income			(5,393)	44,228	38,834	20	38,854
Dividend (0.13 USD cent per share) .				(6,308)	(6,308)		(6,308)
Balance at 31 December 2012	<u>40,576</u>	<u>154,705</u>	<u>26,164</u>	<u>74,230</u>	<u>295,674</u>	<u>257</u>	<u>295,932</u>
2013							
Balance at 1 January 2013	40,576	154,705	26,164	74,230	295,674	257	295,932
Total comprehensive income			5,542	56,386	61,928	(18)	61,910
Dividend (0.24 USD cent per share) .				(11,760)	(11,760)		(11,760)
Balance at 31 December 2013	<u>40,576</u>	<u>154,705</u>	<u>31,706</u>	<u>118,856</u>	<u>345,842</u>	<u>239</u>	<u>346,082</u>

Information on changes in other reserves are provided in note 25.

The notes on pages 11 to 47 are an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows for the year 2013

	Notes	2013	2012
Cash flows from operating activities:			
Profit for the year		56,418	44,275
Adjustments for:			
Depreciation and amortisation	9	70,699	58,859
Other operating items	41	35,268	38,356
		162,385	141,490
Net change in operating assets and liabilities	42	68,489	25,253
Net cash from operating activities		230,874	166,743
Cash flows to investing activities:			
Acquisition of operating assets	11	(86,916)	(62,529)
Proceeds from the sale of operating assets		1,594	6,822
Acquisition of intangible assets	15	(3,475)	(2,497)
Acquisition of long-term cost		(23,849)	(26,848)
Long-term receivables, change		(8,622)	(2,605)
Marketable securities, change		8,045	11,181
Net cash used in investing activities		(113,223)	(76,476)
Cash flows to financing activities:			
Dividend paid	25	(11,760)	(6,308)
Repayment of long-term borrowings		(33,472)	(45,145)
Net cash used in financing activities		(45,232)	(51,453)
Increase in cash and cash equivalents		72,419	38,814
Effect of exchange rate fluctuations on cash held		2,059	(1,159)
Cash and cash equivalents at beginning of the year		117,060	79,405
Cash and cash equivalents at 31 December	24	191,538	117,060
Investment and financing without cash flow effect:			
Sale of operating assets		2,700	875
Trade and other payables		(2,700)	0
Repayment of long term debt		0	(875)
Acquisition of operating assets		0	(4,000)
Long term receivables		0	4,000

Information on interest paid and received are provided in note 43.

The notes on pages 11 to 47 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 2013 comprise the Company and its subsidiaries, together referred to as the "Group" and individually as "Group entities" and the Group's interests in associates. The Group is primarily involved in the airline and tourism industry. The Company is listed on the Nasdaq OMX Iceland.

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. They were authorised for issue by the Company's board of directors on 6 February 2014.

b. Restatement of comparative figures

When preparing the financial statements for the year 2013, new and improved methods of eliminating intercompany transactions were put in place. As the change affects the classification of cost, comparative figures for 2012 have been adjusted accordingly. The effect on the comparative figures is a reduction in Aircraft and aircrew lease of USD 29 million and comparative increase in Aircraft maintenance expenses. Insignificant adjustments were made to other line items of operating expenses. The restatement of the comparative amounts has no other effect on the consolidated financial statements.

c. Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except that derivative financial instruments are stated at their fair values.

Details of the Group's accounting policies, including changes during the year, are included in Note 45.

3. Functional and presentation currency

These Consolidated Financial Statements are presented in U.S dollars (USD), which is the Company's functional currency. All financial information presented in USD has been rounded to the nearest thousand, unless otherwise indicated.

4. 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 2013 is included in the following notes:

Note 16 - measurement of the recoverable amounts of cash-generating units;

Note 32 - provisions and valuation of financial instruments;

Note 37 - reassessment of taxes.

Notes, contd.:

4. contd.:

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 management has overall responsibility for overseeing all significant fair value measurements, including Level 3 fair values.

The management 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.

Significant valuation issues are reported to the Group Audit Committee.

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 23 - marketable securities;

Note 30 - deferred income;

Note 32 - derivatives;

Note 32 - non-derivative financial liabilities.

Notes, contd.:

5. Operating segments

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

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

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

Route network

Seven companies are categorised as being part of the Route Network: Air Iceland, Fjárvakur - Icelandair Shared Services, Feria, Icelandair, Icelandair Cargo, Icelandair Ground Services and Loftleidir Icelandic.

Tourism services

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

Information on reportable segments

	Route network		Tourism services		Total	
	2013	2012	2013	2012	2013	2012
External revenue	916,178	817,121	103,777	78,315	1,019,955	895,436
Inter-segment revenue	154,661	148,055	5,252	4,278	159,913	152,333
Segment revenue	<u>1,070,839</u>	<u>965,176</u>	<u>109,029</u>	<u>82,593</u>	<u>1,179,868</u>	<u>1,047,769</u>
Segment EBITDAR*	176,753	153,351	14,580	12,361	191,333	165,712
Operating lease expenses	(36,967)	(47,810)	(9,193)	(8,316)	(46,160)	(56,126)
Segment EBITDA	<u>139,786</u>	<u>105,541</u>	<u>5,387</u>	<u>4,045</u>	<u>145,173</u>	<u>109,586</u>
Finance income	7,387	16,564	158	179	7,545	16,743
Finance costs	(6,741)	(7,861)	(1,125)	(951)	(7,866)	(8,812)
Depreciation and amortisation	(67,786)	(55,585)	(1,742)	(1,504)	(69,528)	(57,089)
Share of profit (loss) of equity accounted investees	<u>12</u>	<u>1</u>	<u>(50)</u>	<u>(290)</u>	<u>(38)</u>	<u>(289)</u>
Reportable segment profit before income tax	72,658	58,660	2,628	1,479	75,286	60,139
Reportable segment assets	668,005	615,880	28,411	21,933	696,416	637,813
Investment in associates	763	24	543	503	1,306	527
Capital expenditure	111,611	93,467	2,586	2,361	114,197	95,828
Reportable segment liabilities	479,463	459,263	23,788	17,948	503,251	477,211

*EBITDAR means EBITDA before operating lease expenses.

Notes, contd.:

5. contd.:

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

	2013	2012
Revenue		
Total revenue for reportable segments	1,179,868	1,047,769
Other revenue	3,002	3,430
Elimination of inter-segment revenue	(159,913)	(152,333)
Consolidated revenue	<u>1,022,957</u>	<u>898,866</u>
Profit or loss		
Total profit of reportable segments	75,286	60,139
Unallocated corporate expenses	(4,238)	(2,691)
Consolidated profit before tax	<u>71,048</u>	<u>57,448</u>
Assets		
Total assets for reportable segments	696,416	637,813
Investments in associates	1,306	527
Other assets	135,153	124,555
Consolidated total assets	<u>832,875</u>	<u>762,895</u>
Liabilities		
Total liabilities for reportable segments	503,251	477,211
Elimination of inter-segment liabilities	(16,458)	(10,248)
Consolidated total liabilities	<u>486,793</u>	<u>466,963</u>

Other material items 2013

	Reportable segment totals	Adjust- ments	Consoli- dated totals
Segment EBITDAR	191,333	(1,463)	189,870
Segment EBITDA	145,173	(1,463)	143,710
Finance income	7,545	(768)	6,777
Finance costs	(7,866)	(836)	(8,702)
Depreciation and amortisation	(69,528)	(1,171)	(70,699)
Share of loss of associates	(38)	0	(38)
Capital expenditure	114,197	43	114,240

Other material items 2012

Segment EBITDAR	165,712	60	165,772
Segment EBITDA	109,586	60	109,646
Finance income	16,743	835	17,578
Finance costs	(8,812)	(1,739)	(10,551)
Depreciation and amortisation	(57,089)	(1,770)	(58,859)
Share of loss of associates	(289)	(77)	(366)
Capital expenditure	95,828	46	95,874

Notes, contd.:

6. Assets and liabilities classified as held for sale

At year end 2012 assets held for sale consisted of 30% shareholding in Travel Service. In January 2013 an agreement was reached on the sale of the shares for USD 3.7 million.

7. Operating income

Transport revenue is specified as follows:

	2013	2012
Passengers	659,992	564,886
Cargo and mail	42,890	39,613
Total transport revenue	<u>702,882</u>	<u>604,499</u>

Other operating revenue is specified as follows:

Sale at airports and hotels	66,358	57,496
Revenue from tourism	73,543	61,235
Aircraft and cargo handling services	28,700	26,534
Revenue from maintenance and aircraft handling	18,207	11,416
Gain on sale of operating assets	1,100	2,805
Other operating revenue	14,198	14,066
Total other operating revenue	<u>202,106</u>	<u>173,552</u>

8. Operating expenses

Salaries and other personnel expenses are specified as follows:

Salaries	153,953	133,700
Contribution to pension funds	20,351	17,697
Other salary-related expenses	21,187	16,980
Other personnel expenses	43,941	35,438
Total salaries and other personnel expenses	<u>239,432</u>	<u>203,815</u>

Average number of full year equivalents	2,848	2,566
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Other operating expenses are specified as follows:

Operating cost of real estates and fixtures	21,909	18,921
Communication expenses	13,703	12,379
Advertising expenses	20,704	18,242
Booking fee and commission expenses	37,597	30,162
Cost of goods sold	20,926	19,366
Customer services	15,383	12,277
Tourism expenses	44,326	34,201
Other operating expenses	32,276	28,394
Total other operating expenses	<u>206,824</u>	<u>173,942</u>

9. Depreciation and amortisation

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

Depreciation of operating assets, see note 11	67,956	57,733
Amortisation of intangible assets, see note 15	2,743	1,126
Depreciation and amortisation recognised in profit or loss	<u>70,699</u>	<u>58,859</u>

Notes, contd.:

10. Finance income and finance costs

Finance income and finance costs are specified as follows:

	2013	2012
Interest income on bank deposits	1,538	1,219
Other interest income	1,173	2,196
Net currency exchange gain	4,066	14,163
Finance income total	<u>6,777</u>	<u>17,578</u>
Interest expense on loans and borrowings	7,860	9,900
Other interest expenses	842	302
Loss from sale of shares	0	349
Finance costs total	<u>8,702</u>	<u>10,551</u>
Net finance (costs) income	<u>(1,925)</u>	<u>7,027</u>

11. Operating assets

Operating assets are specified as follows:

Cost	Aircraft and flight equipment	Buildings	Other property and equipment	Total
Balance at 1 January 2012	345,163	23,662	25,245	394,070
Additions	57,264	4,306	4,959	66,529
Sales and disposals	(29,669)	(106)	(756)	(30,531)
Reclassification from long-term cost	2,132	0	0	2,132
Reclassification from intangible assets	293	0	0	293
Reclassification	0	(1,153)	1,153	0
Effect of movements in exchange rates	(110)	(1,199)	(1,441)	(2,750)
Balance at 31 December 2012	<u>375,073</u>	<u>25,510</u>	<u>29,160</u>	<u>429,743</u>
Additions	78,899	1,767	6,250	86,916
Sales and disposals	(48,355)	(198)	(574)	(49,127)
Reclassification to long-term cost	(1,386)	0	0	(1,386)
Reclassification to non-current receivables and deposits	(1,680)	0	0	(1,680)
Effect of movements in exchange rates	279	3,268	3,850	7,397
Balance at 31 December 2013	<u>402,830</u>	<u>30,347</u>	<u>38,686</u>	<u>471,863</u>

Depreciation and impairment losses

Balance at 1 January 2012	101,150	5,954	10,791	117,895
Depreciation	53,019	1,246	3,468	57,733
Sales and disposals	(26,861)	(106)	(709)	(27,676)
Reclassification	0	(408)	408	0
Effect of movements in exchange rates	(56)	(342)	(808)	(1,206)
Balance at 31 December 2012	<u>127,252</u>	<u>6,344</u>	<u>13,150</u>	<u>146,746</u>
Depreciation	62,463	1,455	4,038	67,956
Sales and disposals	(44,648)	(198)	(460)	(45,306)
Effect of movements in exchange rates	123	933	2,214	3,270
Balance at 31 December 2013	<u>145,190</u>	<u>8,534</u>	<u>18,942</u>	<u>172,666</u>

Carrying amounts

At 1 January 2012	244,013	17,708	14,454	276,175
At 31 December 2012	<u>247,821</u>	<u>19,166</u>	<u>16,010</u>	<u>282,997</u>
At 31 December 2013	<u>257,640</u>	<u>21,813</u>	<u>19,744</u>	<u>299,197</u>
Depreciation ratios	5-29%	2-6%	5-33%	

Acquisition of operating assets 2013 includes four Boeing 757 aircraft and engine overhauls amounting to USD 56.5 million.

Notes, contd.:

12. 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 107.6 million at year end 2013 (2012: USD 137.5 million). The Group owns 26 aircraft, of which 15 are unencumbered, including 8 Boeing 757.

13. 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	
	2013	2012	2013	2012
Boeing - 19 / 15 aircraft	527,000	417,000	213,512	198,836
Other aircraft	42,608	64,000	22,441	29,691
Flight equipment	71,816	66,900	21,687	19,294
Total aircraft and flight equipment	641,424	547,900	257,640	247,821

14. Insurance value of buildings and other operating assets

The principal buildings owned by the Group are the following:

	Official assessment value		Insurance value		Carrying amount	
	2013	2012	2013	2012	2013	2012
Maintenance hangar, Keflavík	15,263	13,897	32,061	28,021	4,960	4,858
Freight building, Keflavík	3,683	3,197	7,267	6,400	2,489	2,367
Office building, Reykjavík	7,875	5,948	11,949	10,444	7,722	5,611
Service building, Keflavík	4,079	3,518	7,830	6,842	1,261	1,263
Other buildings in Reykjavík	6,504	4,475	10,343	9,050	2,001	2,020
Other buildings	3,742	3,134	10,604	9,410	3,380	3,047
Buildings total	41,146	34,169	80,054	70,167	21,813	19,166

Official valuation of the Group's leased land for buildings at 31 December 2013 amounted to USD 7.9 million (2012: USD 6.8 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 50.9 million at year end 2013 (2012: USD 46.8 million). The carrying amount at the same time was USD 19.7 million (2012: USD 16.0 million).

Notes, contd.:

15. 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 2012	149,494	35,971	5,228	9,951	200,644
Additions	0	0	0	2,497	2,497
Sales and disposals	0	0	(57)	(5,907)	(5,964)
Reclassification to operating assets	0	0	0	(293)	(293)
Effect of movements in exchange rates	(980)	(13)	(17)	(35)	(1,045)
Balance at 31 December 2012	148,514	35,958	5,154	6,213	195,839
Additions	0	0	0	3,475	3,475
Sales and disposals	0	0	0	(416)	(416)
Effect of movements in exchange rates	2,132	27	48	98	2,305
Balance at 31 December 2013	150,646	35,985	5,202	9,370	201,203
Amortisation and impairment losses					
Balance at 1 January 2012	11,427	2,602	3,817	6,134	23,980
Amortisation	0	0	348	778	1,126
Sales and disposals	0	0	(57)	(5,907)	(5,964)
Effect of movements in exchange rates	4	3	(6)	(19)	(18)
Balance at 31 December 2012	11,431	2,605	4,102	986	19,124
Amortisation	0	0	342	2,401	2,743
Sales and disposals	0	0	0	(416)	(416)
Effect of movements in exchange rates	0	0	36	40	76
Balance at 31 December 2013	11,431	2,605	4,480	3,011	21,527
Carrying amounts					
At 1 January 2012	138,067	33,369	1,411	3,817	176,664
At 31 December 2012	137,083	33,353	1,052	5,227	176,715
At 31 December 2013	139,215	33,380	722	6,359	179,676

Notes, contd.:

16. 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:

	2013	2012
Goodwill	139,215	137,083
Trademarks and airport slots	33,380	33,353
Total	<u>172,595</u>	<u>170,436</u>

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

For the purpose of impairment testing, goodwill is allocated to the subsidiaries 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	
	2013	2012	2013	2012
Route network	136,778	134,750	33,380	33,353
Tourism services	2,437	2,333	0	0
Total goodwill	<u>139,215</u>	<u>137,083</u>	<u>33,380</u>	<u>33,353</u>

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

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

	Route network		Tourism services	
	2013	2012	2013	2012
Long term growth rate	2,5-4,0%	2,5-4,0%	4.0%	4.0%
Revenue growth:				
Weighted average 2013 / 2012	6.4%	9.6%	19.9%	27.3%
2014 - 2024 / 2013 - 2023	8.1%	9.8%	11.9%	11.0%
Budgeted EBITDA growth	5.4%	11.1%	10.4%	9.0%
WACC	10,0-14,8%	8,7-13,7%	12.4%	11.9%
Debt leverage	18,0-56,5%	18,0-64,0%	23.5%	19.0%
Interest rate for debt	7,7-9,4%	7,1-8,8%	6.7%	6.0%
Recoverable amounts	775,398	896,055	39,307	25,720

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

	2013	2012
Long term growth rate - 1%	0 (921)
WACC +1%	0 (2,352)
EBITDA - 5%	0	0

No impairment loss is recognised in the Financial Statements.

Notes, contd.:

17. Investment in associates

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

	Ownership	
	2013	2012
Ábyrg spilamennska ehf.	50%	50%
EBK ehf.	25%	25%
Gufa ehf.	36%	36%
Icelandair ehf.	25%	25%
Landsbréf - Icelandic Tourism Fund I slhf.	29%	-
Tjarnir ehf.	22%	22%
Assets	7,146	4,863
Liabilities	3,807	3,188
Revenues	1,663	1,222
Expenses	2,365	2,015
Net loss	(702)	(793)
Share of loss of associates	(38)	(366)

18. Long-term cost

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

	2013	2012
Long-term cost	1,025	8,365
Current portion, classified as prepayments among receivables	(767)	(4,717)
Total long-term cost	258	3,648

Long-term cost will be expensed as follows:

Expensed in 2013	-	4,717
Expensed in 2014	767	3,187
Expensed in 2015	89	310
Expensed in 2016	52	46
Expensed in 2017	56	51
Expensed in 2018	61	54
Total long-term cost, including current maturities	1,025	8,365

19. 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.

	2013	2012
Long-term receivables and deposits are specified as follows:		
Loans, effective interest rate 6%	466	233
Interest bearing receivable, interest rate 5%	0	7,969
Deposits	13,510	13,595
Prepayments on aircraft purchases	9,612	1,680
	23,588	23,477
Current maturities	(7,797)	(14,254)
Long-term receivables and deposits total	15,791	9,223

Notes, contd.:

19. contd.:

Contractual repayments are specified as follows:	2013	2012
Repayments in 2013	-	14,254
Repayments in 2014	7,797	5,262
Repayments in 2015	2,156	649
Repayments in 2016	99	494
Repayments in 2017	934	475
Repayments in 2018	9,627	409
Subsequent	2,975	1,934
Total non-current receivables and deposits, including current maturities	<u>23,588</u>	<u>23,477</u>

Long-term receivables and deposits denominated in currencies other than the functional currency comprise USD 1.3 million (2012: USD 1.4 million).

20. Taxes

Tax recognised in profit or loss	2013	2012
<i>Current tax expense</i>		
Current year	6,613	0
	<u>6,613</u>	<u>0</u>
<i>Deferred tax expense</i>		
Origination and reversal of temporary differences	8,256	14,022
Exchange rate difference	(239)	(849)
	<u>8,017</u>	<u>13,173</u>
Total tax expense recognised in profit or loss	<u>14,630</u>	<u>13,173</u>

Tax recognised in other comprehensive income

Net profit on hedge of net investment in foreign operations	(28)	279
Effective portion of changes in fair value of cash flow hedge	0	328
Total tax recognised in other comprehensive income	<u>(28)</u>	<u>607</u>

Tax recognised directly in equity

Currency exchange	(40)	33
Total tax recognised directly in equity	<u>(40)</u>	<u>33</u>

Reconciliation of effective tax rate

		2013		2012
Profit before tax		<u>71,048</u>		<u>57,448</u>
Income tax according to current tax rate	20.0%	14,210	20.0%	11,490
Tax exempt revenue	(0.0%)	(27)	(0.0%)	(18)
Non-deductible expenses	0.2%	175	0.3%	151
Other items	0.4%	272	2.7%	1,550
Effective tax rate	<u>20.6%</u>	<u>14,630</u>	<u>22.9%</u>	<u>13,173</u>

Notes, contd.:

20. contd.:

Recognised deferred tax liabilities

Deferred tax liabilities are specified as follows:

	2013	2012
Deferred tax liabilities 1 January	19,671	6,289
Exchange rate difference	239	849
Income tax recognised in profit or loss	14,630	13,173
Income tax recognised in other comprehensive income	28	(607)
Income tax recognised directly in equity	40	(33)
Income tax payable	(6,613)	0
Deferred tax liabilities 31 December	27,995	19,671

Deferred tax liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2013	2012	2013	2012	2013	2012
Operating assets	0	0	(26,173)	(22,732)	(26,173)	(22,732)
Intangible assets	0	0	(2,206)	(2,007)	(2,206)	(2,007)
Derivatives	60	90	0	0	60	90
Trade receivables	661	601	0	0	661	601
	721	691	(28,379)	(24,739)	(27,658)	(24,048)
Tax loss carry-forwards	0	4,967	0	0	0	4,967
Other items	0	0	(337)	(590)	(337)	(590)
Deferred income tax	721	5,658	(28,716)	(25,329)	(27,995)	(19,671)

Movements in deferred tax balance during the year

				Recognised			
				in profit	Exchange		
2013	1 January	or loss	rate	prehensive	and equity	31 December	
Operating assets	(22,732)	(3,923)	482	0	(26,173)		
Intangible assets	(2,007)	(336)	137	0	(2,206)		
Derivatives	90	0	(2)	(28)	60		
Trade receivables	601	53	7	0	661		
Tax loss carry-forwards	4,967	(4,062)	(905)	0	0		
Other items	(590)	251	42	(40)	(337)		
	(19,671)	(8,017)	(239)	(68)	(27,995)		
2012							
Operating assets	(21,451)	(1,338)	57	0	(22,732)		
Intangible assets	(702)	(1,291)	(14)	0	(2,007)		
Derivatives	(285)	47	0	328	90		
Trade receivables	628	(27)	0	0	601		
Tax loss carry-forwards	14,396	(9,177)	(252)	0	4,967		
Other items	1,125	(1,387)	(640)	312	(590)		
	(6,289)	(13,173)	(849)	640	(19,671)		

The tax calculations above do not take into consideration the effects of reassessment of taxes for the years 2007 to 2011 that took place in December 2013. The management does not agree with the ruling and an appeal to the State Internal Revenue Board is in process. The reassessment did not result in payments of taxes as it only reduced the Company's carry forward losses. If the reassessment will however be confirmed the Company's net equity will be reduced by approximately USD 11 million. Further information on the reassessment is provided in note 37.

Notes, contd.:

21. Inventories

Inventories are specified as follows:

	2013	2012
Spare parts	17,500	13,444
Other inventories	4,666	3,973
Inventories total	<u>22,166</u>	<u>17,417</u>

22. Trade and other receivables

Trade and other receivables are specified as follows:

Trade receivables	76,537	90,764
Maintenance prepayments	767	4,717
Other prepayments	3,138	3,812
Restricted cash	8,686	7,472
Derivatives used for hedging	1,853	0
Current maturities of long term-receivables	7,797	14,254
Other receivables	15,481	14,066
Trade and other receivables total	<u>114,259</u>	<u>135,085</u>

At year end trade receivables are presented net of an allowance for doubtful debts of USD 11.9 million (2012: USD 8.7 million).

Prepaid expenses which relate to subsequent periods amounted to USD 3.1 million (2012: USD 3.8 million) at year end. The prepayments consist mainly of insurance premiums and prepaid leases.

Restricted cash is held in bank accounts pledged against credit card, derivative 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 31.

23. Marketable securities

Marketable securities at year end consist of securities listed on the Nasdaq OMX Iceland and are accounted for at fair value at year end, based on market value.

24. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	2013	2012
Securities	4,956	17,414
Bank deposits	186,192	99,217
Cash on hand	390	429
Cash and cash equivalents total	<u>191,538</u>	<u>117,060</u>

Notes, contd.:

25. Equity

(i) Share capital

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

The Company held treasury shares in the amount of ISK 25 million at year end 2013 (2012: ISK 25 million).

(ii) 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.

(iii) Other reserves

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

The translation reserve comprises all 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.

Other reserves are specified as follows:

	Hedging reserve	Translation reserve	Total reserves
Balance 1 January 2012	335	31,222	31,557
Currency translation differences		(2,257)	(2,257)
Currency translation differences reclassified to profit or loss		(46)	(46)
Net loss on hedge of investment, net of tax		(1,417)	(1,417)
Effective portion of changes in fair value of cash flow hedges, net of tax	(1,673)		(1,673)
Balance at 31 December 2012	(1,338)	27,502	26,164
Currency translation differences		4,254	4,254
Net profit on hedge of investment, net of tax		169	169
Net investment hedge reclassified to profit or loss		(111)	(111)
Effective portion of changes in fair value of cash flow hedges, net of tax	1,230		1,230
Balance at 31 December 2013	(108)	31,814	31,706

(iv) Dividends

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

Dividend amounting to USD 11.8 million was paid to shareholders in the year 2013 (2012: USD 6.3 million).

The Board of Directors proposes a dividend payment to shareholders in 2014 of ISK 2.150 million, equal to USD 18.6 million, which represents 30% of total comprehensive income for the year 2013.

Notes, contd.:

26. Earnings per share

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

	2013	2012
Basic earnings per share:		
Profit for the year attributable to equity holders of the parent company	56,386	44,228
Weighted average number of shares for the year	4,974,540	4,974,540
Basic earnings per share of ISK 1 expressed in USD cent per share	1.13	0.89
Diluted earnings per share expressed in USD cent per share	1.13	0.89

27. Loans and borrowings

This note provides information on the contractual terms of the Group's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 31.

Loans and borrowings are specified as follows:

Secured bank loans	107,621	137,532
Unsecured loans	14,396	13,374
Total loans and borrowings	122,017	150,906
Current maturities	(43,528)	(31,548)
Total non-current loans and borrowings	78,489	119,358

Terms and debt repayment schedule:

	Currency	Nominal interest rates year end 2013	Year of maturity	Total remaining balance	
				2013	2012
Secured bank loans	USD	4.7%	2014-2018	74,921	103,110
Secured bank loans	EUR	3.7%	2017	15,518	16,972
Secured bank loans	ISK	7.7%	2017-2023	16,209	16,538
Secured bank loans, indexed	ISK	6.3%	2021-2028	973	912
Unsecured bond issue, indexed	ISK	5.7%	2023	14,396	13,374
Total interest bearing liabilities				122,017	150,906

Repayments of loans and borrowings are specified as follows:

Repayments in 2013	-	31,548
Repayments in 2014	43,528	44,678
Repayments in 2015	15,898	15,379
Repayments in 2016	16,350	15,851
Repayments in 2017	29,471	28,055
Repayments in 2018	7,430	7,267
Subsequent repayments	9,340	8,128
Total loans and borrowings	122,017	150,906

Notes, contd.:

28. Non-current payables

Non-current payables correspond to accrued engine overhaul cost of leased aircraft and security deposits from lease contracts to be realized after 2014. Non-current obligations are specified as follows:

	2013	2012
Non-current payables	43,907	49,247
Current portion, classified in trade and other payables	(20,165)	(27,187)
Total non-current payables	<u>23,742</u>	<u>22,060</u>

Non-current payables will be repaid as follows:

Repayments in 2013	-	27,187
Repayments in 2014	20,165	6,913
Repayments in 2015	19,417	10,158
Repayments in 2016	900	3,239
Repayments in 2018	1,750	1,750
Subsequent repayments	1,675	0
Total non-current payables, including current maturities	<u>43,907</u>	<u>49,247</u>

29. Trade and other payables

Trade and other payables are specified as follows:

Trade payables	38,125	43,985
Current portion of engine overhaul and security deposits from lease contracts	20,165	27,187
Derivatives used for hedging	2,050	1,610
Income tax payable	6,613	0
Other payables	92,551	79,455
Total trade and other payables	<u>159,504</u>	<u>152,237</u>

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in Note 31.

30. Deferred income

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

	2013	2012
Deferred income is specified as follows:		
Sold unused tickets	129,373	95,431
Frequent flyer points	12,610	12,677
Other prepayments	11,552	13,981
Total deferred income	<u>153,535</u>	<u>122,089</u>

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

31. 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 above risks, the Group's objectives, policies, and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

Risk management framework

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

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

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

Credit risk

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

Exposure to credit risk

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

	Note	Carrying amount	
		2013	2012
Long-term receivables and deposits	19	15,791	9,223
Trade and other receivables	22	110,354	126,556
Marketable securities	23	7,955	15,734
Cash and cash equivalents	24	191,538	117,060
		<u>325,638</u>	<u>268,573</u>

Notes, contd.:

31. contd.:

Trade and other receivables

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

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

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

Guarantees

The Group's policy is to provide financial guarantees only to wholly-owned subsidiaries. However at year end 2013 the Group is still guaranteeing from divested companies (see note 38), the PDP payments of one 787 Boeing Dreamliner order but the economical proceeds from these orders have been sold to the creditors in relation to the Group's financial restructuring in the year 2010.

Impairment losses

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

	Allowance for		Allowance for	
	Gross 2013	Impairment 2013	Gross 2012	Impairment 2012
Not past due	52,815	(569)	61,784	(239)
Past due 0-30 days	5,861	(523)	6,327	(185)
Past due 31-120 days	6,578	(462)	22,637	(3,644)
Past due 121-365 days	19,422	(7,602)	6,572	(3,271)
More than one year	3,770	(2,753)	2,112	(1,329)
Total	88,446	(11,909)	99,432	(8,668)

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

	2013	2012
Balance at 1 January	8,668	8,507
Exchange rate difference	48	(26)
Impairment loss allowance, increase	3,193	187
Balance at 31 December	11,909	8,668

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

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

Notes, contd.:

31. contd.:

Liquidity risk

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

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

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

	Carrying amount	Contractual cash flows	Within 12 months	1-2 years	2-5 years	More than 5 years
31 December 2013						
Financial liabilities						
Unsecured bank loans	14,396	19,282	1,928	1,928	5,785	9,641
Secured bank loans	107,621	124,844	47,683	19,689	56,082	1,390
Payables & prepayments	183,246	183,246	159,504	19,417	2,650	1,675
Exposure to liquidity risk	305,263	327,372	209,115	41,034	64,517	12,706
31 December 2012						
Financial liabilities						
Unsecured bond issue	13,374	18,369	1,665	1,670	5,011	10,023
Secured bank loans	137,532	159,703	37,222	49,141	66,180	7,160
Payables & prepayments	174,297	174,297	152,237	6,913	15,147	0
Exposure to liquidity risk	325,203	352,369	191,124	57,724	86,338	17,183

Unused loan commitments at year end 2013 amounted to USD 4.3 million (2012: USD 3.9 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 are provided in note 33 and 36.

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 income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

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

Notes, contd.:

31. contd.:

Currency risk

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

The Group seeks to reduce its foreign exchange exposure arising from transactions in various currencies through a policy of matching receipts and payments in each individual currency. Then internal trades across the range of subsidiaries are arranged by the Group as far possible. Nevertheless, the USD cash inflow falls short of USD outflow due to fuel costs, lease and capital related payments which are to a large extent denominated in USD. This shortage is financed by a surplus of European currencies, most importantly EUR and Scandinavian currencies. The Group follows a hedging policy of 40-80% of net exposure with a 9 month horizon and uses most importantly spot and forwards, but also options.

Exposure to currency risk

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

2013	ISK	EUR	GBP	DKK	SEK	NOK
Net balance sheet exposure	(25,872)	(18,759)	(7,072)	919	2,715	1,911
Forecast revenue	339,060	237,680	73,705	39,890	47,195	43,760
Forecast purchases	(409,650)	(167,882)	(40,722)	(14,670)	(4,141)	(4,799)
Forward FX contracts	0	(64,711)	0	0	0	0
Net currency exposure	(96,462)	(13,672)	25,911	26,139	45,769	40,872

2012	ISK	EUR	GBP	DKK	SEK	NOK
Net balance sheet exposure	(31,402)	(18,824)	(3,135)	12,123	7,561	8,684
Forecast revenue	314,927	227,843	69,769	37,616	43,468	45,331
Forecast purchases	(347,343)	(160,576)	(41,066)	(13,017)	(3,351)	(4,939)
Forward FX contracts	0	(25,882)	0	0	0	0
Net currency exposure	(63,818)	22,561	25,568	36,722	47,678	49,076

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

	Average rate		Reporting date spot rate	
	2013	2012	2013	2012
ISK	0.0082	0.0080	0.0087	0.0078
EUR	1.33	1.29	1.38	1.32
GBP	1.56	1.59	1.65	1.62
DKK	0.18	0.17	0.18	0.18
SEK	0.15	0.15	0.16	0.15
NOK	0.17	0.17	0.16	0.18

Notes, contd.:

31. contd.:

Sensitivity analysis

A 10% strengthening of the USD against the following currencies at 31 December would have increased (decreased) post-tax equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. This analysis is performed on the same basis as for 2012.

	Equity	Profit or loss
2013		
ISK	7,717	7,717
EUR	1,094	864
GBP	(2,073)	(2,073)
DKK	(2,091)	(2,091)
SEK	(3,662)	(3,662)
NOK	(3,270)	(3,270)
2012		
ISK	5,105	5,294
EUR	(1,805)	(2,022)
GBP	(2,045)	(2,045)
DKK	(2,938)	(2,938)
SEK	(3,926)	(3,926)
NOK	(3,814)	(3,814)

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 risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group follows a policy of hedging 40-80% of the net interest rate exposure of long-term financing with up to a 5-year horizon. This is achieved by using fixed rate loan and swaps contracts.

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

	Carrying amount	
	2013	2012
<i>Fixed rate instruments</i>		
Financial liabilities	(42,206)	(50,205)
	<u>(42,206)</u>	<u>(50,205)</u>
<i>Variable rate instruments</i>		
Financial assets	186,192	99,217
Financial liabilities	(79,811)	(100,701)
	<u>106,381</u>	<u>(1,484)</u>

Fair value sensitivity analysis for fixed rate instruments

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

A change of 100 basis points in interest rates would have immaterial effects on the fair value.

Notes, contd.:

31. contd.:

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 2013		
Variable rate instruments	(205)	112
Cash flow sensitivity (net)	<u>(205)</u>	<u>112</u>
31 December 2012		
Variable rate instruments	(156)	156
Cash flow sensitivity (net)	<u>(156)</u>	<u>156</u>

Other market price risk

Fuel price risk

The Group maintains a policy of hedging fuel price exposure by a ratio from 40% and up to 60%, 6 months forward and 20% from 7 to 9 months forward.

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	
	2013	2012	2013	2012
Increase in fuel prices by 10%	6,800	2,909	0	0
Decrease in fuel prices by 10%	(6,800)	(2,909)	0	0

Capital management

The Board's policy is to maintain strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The policy is to have an average of three months operating cost available as liquidity where 30% of the liquidity can be in the form of unused lines of credit. Furthermore according to the policy the equity ratio shall be no less than 35%.

Notes, contd.:

32. Financial instruments and fair values

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

	Carrying amount 2013	Fair value 2013	Carrying amount 2012	Fair value 2012
Derivatives, included in loans and receivables	1,853	1,853	0	0
Marketable securities	7,955	7,955	15,734	15,734
Unsecured bond issue	(14,396)	(17,398)	(13,374)	(16,378)
Secured bond loans	(107,621)	(117,219)	(137,532)	(153,598)
Derivatives, included in payables and prepayments	(2,050)	(2,050)	(1,610)	(1,610)
Total	(114,259)	(126,859)	(136,782)	(155,852)

Fair value hierarchy:

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

31 December 2013	Level 1	Level 2	Level 3	Total
Derivatives, included in loans and receivables		1,853		1,853
Marketable securities	7,955			7,955
Unsecured bond issue			(17,398)	(17,398)
Secured bond loans			(117,219)	(117,219)
Derivatives, included in payables and prepayments		(2,050)		(2,050)
Total	7,955	(197)	(134,617)	(126,859)

31 December 2012

Marketable securities	15,734			15,734
Unsecured bond issue			(16,378)	(16,378)
Secured bond loans			(153,598)	(153,598)
Derivatives, included in payables and prepayments		(1,610)		(1,610)
Total	15,734	(1,610)	(169,976)	(155,852)

The basis for determining the levels is disclosed in note 4.

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

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

Notes, contd.:

33. Off-balance sheet items

Leases as lessee

As a lessee the Group has in place operating leases for 11 aircraft at year end 2013. The leases are for 3 Boeing 737 aircraft, 5 Boeing 757 aircraft and 3 Boeing 767 aircraft. The Group also has in place operating leases for storage facilities, hotels, equipment and fixtures for its operations, the longest until the year 2037. During the year USD 46.2 million was recognised as an expense in profit or loss in respect of operating leases (2012: USD 56.1 million). At year end 2013 the leases are payable as follows in nominal amounts for each year:

	Real estate	Aircraft	Other	Total 2013	Total 2012
In the year 2013	-	-	-	-	46,118
In the year 2014	13,849	24,593	2,466	40,908	29,973
In the year 2015	13,675	22,325	858	36,858	25,813
In the year 2016	14,296	16,230	749	31,275	19,985
In the year 2017	13,902	13,113	721	27,736	17,331
In the year 2018	13,815	11,185	0	25,000	16,351
Subsequent	160,030	10,575	0	170,605	113,042
Total	<u>229,567</u>	<u>98,021</u>	<u>4,794</u>	<u>332,382</u>	<u>268,613</u>

34. Leases as lessor

As a lessor the Company leases aircraft on wet, dry and other various leases, both on short and long term leases. Lease income for the year 2013 amounted to USD 118.0 million (2012; USD 120.8 million). Contracted leases at year end were as follows:

	2013	2012
In the year 2013	-	63,632
In the year 2014	62,458	37,982
In the year 2015	66,429	30,093
In the year 2016	59,946	26,224
In the year 2017	43,190	26,618
In the year 2018	42,983	26,196
Subsequent	35,646	0
Total	<u>310,652</u>	<u>210,745</u>

Notes, contd.:

35. Related parties

Identity of related parties

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

Transactions with management and key personnel

Salaries and benefits of management paid for their service to Group companies during the year 2013 and the number of shares in the Company held by management are specified below:

	Salaries and benefits	Number of shares held at year-end 2013 in thousands
Board of Directors:		
Sigurður Helgason, Chairman of the Board	65.2	14,000
Ásthildur Margrét Otharsdóttir	36.3	
Herdís Dröfn Fjeldsted	35.0 *	
Katrín Olga Jóhannesdóttir	48.5	413
Úlfar Steindórsson	49.5	
Magnús Magnússon, alternative board member	13.3 **	
Key employees:		
Björgólfur Jóhannsson CEO of Icelandair Group hf.	362.3	1,300
Bogi Nils Bogason, CFO of Icelandair Group hf.	299.9	1,000
Birkir Hólm Guðnason, CEO of Icelandair ehf.	301.3	
Seven MD's of Group companies	1,395.5	7,111

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

*The salary of one board member is paid to Framtakssjóður Íslands slhf.

**One board member has waived his rights to salaries, instead the board agreed to contribute equal amounts to Icelandair's Special Children's Travel Fund.

Transaction with associates

During the year 2013 the Group purchased services from associates for USD 0.1 million (2012: USD 0.1 million). The Group's revenues were USD 0.1 million from associates (2012: USD 0.2 million). The Group has not granted repayment of loans for its associates. Transactions with associates are priced on an arm's length basis.

Transaction with shareholders

There are no shareholders with significant influence at year end 2013. Companies which members of the Board and key employees control have been identified as being eleven. 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 2013 from these entities amounted to USD 0.1 million (2012: USD 0.1 million). Total sales amounted to USD 0.1 million (2012: USD 0.1 million).

36. Capital commitments

In February 2013 Icelandair Group and Boeing finalized 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 is valued at USD 1.6 billion at Boeing list prices. 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.

37. Reassessment of taxes

In December 2013 the Directorate of Internal Revenue ruled that interest expenses on loans that had been transferred to the Company as a result of a reverse acquisition in 2006 did not qualify as tax deductible expenses and reassessed tax calculations for the years 2007 to 2011. As the Company had carry forward losses no tax payments will result directly from the ruling. The Company's management does not agree with the reasoning for the ruling and an appeal to the State Internal Revenue Board is in process. The management is of the opinion that the ruling by the tax authorities will be overruled and the effect of reassessment is therefore not included in the financial statements. If the ruling will however be confirmed the Company's net equity will be reduced by approximately USD 11 million.

38. Guarantees

IG Invest, a former subsidiary of the Company, has signed an agreement with Boeing for the purchase of one Boeing 787 Dreamliner aircraft to be delivered in the year 2015. Despite the disposal of IG Invest, Icelandair Group is still guarantor for these capital commitments.

As a part of the financial restructuring of the Company's balance sheet in 2010 the Company divested assets to its creditors for USD 59.1 million. Icelandair Group guarantees that the final sale price will be at least USD 34.7 million (ISK 4.0 billion), however the maximum guarantee is USD 4.3 million (ISK 0.5 billion). If the creditors will receive more than USD 59.1 million (ISK 7.6 billion) plus REIBOR+3% interest on the sale of the assets, Icelandair Group will receive 50% of the upside. Based on the managements estimate the Company has fully provided for potential losses due to the guarantee.

39. Litigations and claims

In 2012 the Supreme Court of Iceland ruled that the Company had violated competition law in 2004 on flights to Copenhagen due to predatory pricing. Following the ruling a former competitor filed a suit claiming ISK 300 million (appr. USD 2.6 million) for alleged damages arising from the violations.

The Winding-up Board of a financial institution has filed a suit claiming rescission of a money market deposit payment received in November 2008 of ISK 586 million (appr. USD 5 million).

Both claims have been rejected by management which is of the opinion that either court rulings will be in favor of the Company or settlements will be reached. The possible effects of the claims have not been recognized in the financial statements.

Notes, contd.:

40. Group entities

The Company held eleven subsidiaries at year end 2013 which are all included in the consolidated financial statements. They are as follows:

	Ownership interest	
	2013	2012
Route network:		
Air Iceland ehf.	100%	100%
Fjárvakur - Icelandair Shared Services ehf.	100%	100%
Feria ehf.	100%	100%
Icelandair ehf.	100%	100%
Icelandair Cargo ehf.	100%	100%
IGS ehf.	100%	100%
Loftleiðir - Icelandic ehf.	100%	100%
Tourism services:		
Iceland Travel ehf.	100%	100%
Icelandair Hotels ehf.	100%	100%
Other operation:		
A320 ehf.	100%	100%
IceCap Ltd., Guernsey	100%	100%

The subsidiaries further own 16 subsidiaries that are included in the consolidated financial statements.

41. Statement of cash flows

Other operating items in the statement of cash flows are specified as follows:	2013	2012
Expensed long term cost	24,852	26,250
Exchange rate difference and indexation of liabilities and assets	3,461	1,023
Gain on the sale of operating assets	(1,100)	(2,805)
Share of loss of associates	38	366
Income tax	8,017	13,173
Other items	0	349
Total other operating items in the statement of cash flows	<u>35,268</u>	<u>38,356</u>

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

Inventories, increase	(4,791)	(2,337)
Trade and other receivables, decrease (increase)	22,934	(11,471)
Trade and other payables, increase	18,910	17,991
Deferred income, increase	31,436	21,070
Net change in operating assets and liabilities in the statement of cash flows	<u>68,489</u>	<u>25,253</u>

43. Additional cash flow information:

Interest paid	8,081	10,129
Interest received	3,531	3,715

44. Ratios

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

Current ratio	0.94	0.94
Equity ratio	0.42	0.39
Intrinsic value of share capital	8.52	7.29

Notes, contd.:

45. 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.

The Group has adopted the following new standards and amendments to standards, including any consequential amendments to other standards, with a date of initial application of 1 January 2013.

- IFRS 13 Fair Value Measurement
- Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)
- Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36) (2013)

The nature and effects of the changes are explained below.

(i) Fair value measurement

IFRS 13 establishes a single framework for measuring fair value and making disclosures about fair value measurements when such measurements are required or permitted by other IFRSs. It unifies the definition of fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It replaces and expands the disclosure requirements about fair value measurements in other IFRSs, including IFRS 7. As a result, the Group has included additional disclosures in this regard.

In accordance with the transitional provisions of IFRS 13, the Group has applied the new fair value measurement guidance prospectively and has not provided any comparative information for new disclosures. Notwithstanding the above, the change had no significant impact on the measurements of the Group's assets and liabilities.

(ii) Presentation of items of Other Comprehensive Income

As a result of the amendments to IAS 1, the Group has modified the presentation of items of OCI in its statement of profit or loss and OCI, to present separately items that would be reclassified to profit or loss from those that would never be. Comparative information has been re-presented accordingly.

(iii) Disclosures of recoverable amount for non-financial assets

The Group has early adopted the amendments to IAS 36 (2013). As a result, the Group has expanded its disclosures of recoverable amounts when they are based on fair value less costs of disposals and an impairment is recognised (see Note 16).

a. Basis of consolidation

(i) Subsidiaries

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

(ii) Loss of control

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

Notes, contd.:

45. contd.:

(iii) Investments in associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity. Investment in associates are accounted for using the equity method and are recognised initially at cost. The cost of the investment includes transaction costs. The consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the carrying amount of the interests that form part thereof, including any long-term investments is reduced to zero, and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the investee.

(iv) Transactions eliminated on consolidation

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

b. 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, contd.:

45. contd.:

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

(iii) Hedge of net investment in foreign operations

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

Currency differences arising on the translation of a financial liability designated as a hedge of a net investment in a subsidiary are recognised in other comprehensive income to the extent that the hedge is effective, and are presented in the translation reserve within equity. To the extent that the hedge is ineffective, such differences are recognised in profit or loss. When the hedged net investment is disposed of, the relevant amount in the translation reserve is transferred to profit or loss as part of the gain or loss on disposal.

c. Financial instruments

(i) Non-derivative financial assets

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

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

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

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

Financial assets at fair value through profit or loss

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

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 equivalent and trade and other receivables.

Notes, contd.:

45. contd.:

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.

(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 32). Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss as incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below. The Group holds no trading derivatives.

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

Notes, contd.:

45. contd.:

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.

(ii) Aircraft and flight equipment

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

(iii) Subsequent costs

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

(iv) Depreciation

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

Notes, contd.:

45. contd.:

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	4-20 years
Engines	Cycles flown
Buildings	17-50 years
Other property and equipment	3-20 years

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

e. Intangible assets

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

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

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

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

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

(ii) Other intangible assets

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

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

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

(iii) Subsequent expenditure

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

Notes, contd.:

45. contd.:

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.

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

(ii) Non-financial assets

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

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

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

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

Notes, contd.:

45. contd.:

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

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

i. Assets held for sale

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

Intangible assets and operating assets once classified as held for sale or distribution are not amortised or depreciated, and any equity-accounted investee is no longer equity accounted.

j. Provisions

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

Overhaul commitments relating to aircraft under operating lease

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

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

k. Deferred income

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

Icelandair's frequent flyer program

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

Notes, contd.:

45. contd.:

I. Operating income

(i) Transport revenue

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

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

(ii) Aircraft and aircrew lease

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

(iii) Other operating revenue

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

m. Lease payments

Operating lease payments

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

n. Finance income and finance costs

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

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

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.

Notes, contd.:

45. contd.:

o. Income tax

Income tax expense 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 the taxable income for the period, using tax rates enacted at the reporting date.

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

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

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

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

p. Earnings per share

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

q. Segment reporting

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

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

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

Corporate Governance Statement

The framework

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

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

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

Internal audit and risk management

The Group's Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group's Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee. The committee shall oversee the annual accounts of the Company and the Group's consolidated accounts. The committee is responsible for evaluation of the independence and the eligibility of both the Company's auditor and auditing firm. The committee shall make suggestions to the Board of Directors regarding the selection of the Company's auditor. The Audit Committee held nine meetings in the year 2013.

Audit Committee:

Katrín Olga Jóhannesdóttir, Chairman

Ásthildur Margrét Otharsdóttir

Herdís Dröfn Fjeldsted

Values and code of ethics and corporate responsibility

The company's values are:

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

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

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

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

Compensation Committee

The purpose of the Compensation Committee is to avoid placing the Company's management in control of their own remuneration and, furthermore, to ensure that the management's remuneration is structured so as to serve the long-term interests of shareholders. The main tasks of the Compensation Committee are policy making with respect to the management's performance related bonuses, including stock options. The Committee conducts evaluations of management remuneration and monitors the management's acquisition of stock in the Company. The Compensation Committee held four meetings in the year 2013.

Compensation Committee

Sigurður Helgason, Chairman

Úlfar Steindórsson

Corporate Governance Statement, contd.:

The Board of Directors and Executive Committee

Board of Directors

Sigurður Helgason, Chairman

Sigurður Helgason was born in 1946 and he joined the Board on 6 August 2009. 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.

Úlfar Steindórsson, Deputy Chairman

Úlfar Steindórsson was born in 1956 and is CEO 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., Bergey 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, Blue Lagoon international ehf., Eldvörp ehf., Hótel Bláa Lónið ehf., Bláa Lónið Heilsuvörur ehf., UK fjárfestingar ehf, Johan Rönnung hf, S.Guðjónsson ehf., Skorri ehf., and UK fjárfestingar ehf. Úlfar holds a Cand. Oecon degree from the University of Iceland and an MBA from Virginia Commonwealth University.

Ásthildur Margrét Otharsdóttir

Ásthildur was born in 1968 and is an independent management consultant with prior business experience as Global Director of Treasury and Corporate Development at Össur hf., Senior Account Manager at Kaupthing Bank hf. and Management Consultant at Accenture in Copenhagen. She is Chairman of the Board of Directors of Marel hf. and JÖR ehf. Ásthildur is a member of the Board of Directors of Marorka ehf., and the Research Center 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.

Herdís Dröfn Fjeldsted

Herdís Dröfn Fjeldsted was born in 1971 and is an investment manager at the Iceland Enterprise Investment Fund, holds a B.Sc. degree in business administration, an M.Sc. degree in corporate finance from Reykjavik University and is a certified securities broker. Herdís has years of experience in the private equity sector. Previously, she was a member of the investment team at Thule Investments. Herdís is Chairman of the Board of Icelandic Group hf., a Vice-Chairman of the Board of Promens hf., a member of the Board of Copeinca ASA, Icelandic Group Investments ehf. and Invent Farma ehf.

Katrín Olga Jóhannesdóttir

Katrín Olga Jóhannesdóttir was born in 1962 and is the former Chief Strategy Officer of Skipti hf. and the current Chairman of Já upplýsingaveitur hf. 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., Reykjavik University, 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.

Corporate Governance Statement, contd.:

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

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

Corporate Governance Statement, contd.:

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

On 12 September 2007 the Board of Directors approved Rules on Working Procedures for the Board of Directors that was 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 eighteen times in the year and all Board Members attended almost all meetings. All the Members of the Board of Directors are independent from the Company, except Ásthildur Margrét Otharsdóttir. Sigurður Helgason, Katrín Olga Jóhannesdóttir, Ásthildur Margrét Otharsdóttir and Úlfar Steindórsson were independent from the Company's major shareholders in 2013.

Quarterly statements (unaudited)

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

	Q1	Q2	Q3	Q4	Total
Year 2013					
Operating income	173,045	265,600	371,662	212,650	1,022,957
Operating expenses					
without depreciation	(181,359)	(222,664)	(269,421)	(205,803)	(879,247)
Operating (loss) profit bef. depr. (EBITDA)	(8,314)	42,936	102,241	6,847	143,710
Depreciation	(14,684)	(18,167)	(20,073)	(17,775)	(70,699)
Operating (loss) profit (EBIT)	(22,998)	24,769	82,168	(10,928)	73,011
Net finance income (expense)	29	(1,409)	(306)	(239)	(1,925)
Share of profit (loss) of associates	46	(55)	(11)	(18)	(38)
(Loss) profit before income tax	(22,923)	23,305	81,851	(11,185)	71,048
Income tax	4,634	(4,815)	(16,526)	2,077	(14,630)
(Loss) profit	(18,289)	18,490	65,325	(9,108)	56,418
Other comprehensive income (loss)	1,549	(777)	1,756	2,964	5,492
Total comprehensive (loss) income	(16,740)	17,713	67,081	(6,144)	61,910
Working capital (used in) from operations	(1,481)	48,154	111,138	4,574	162,385
Net cash from (used in) operating activities	78,453	106,436	30,272	15,713	230,874
Net cash used in investing activities	(40,795)	(15,477)	(24,288)	(32,663)	(113,223)
Net cash used in financing activities	(11,239)	(15,690)	(10,361)	(7,942)	(45,232)
Year 2012					
Operating income	157,698	234,395	317,351	189,422	898,866
Operating expenses					
without depreciation	(160,746)	(205,577)	(239,412)	(183,485)	(789,220)
Operating (loss) profit bef. depr. (EBITDA)	(3,048)	28,818	77,939	5,937	109,646
Depreciation	(13,675)	(14,304)	(16,792)	(14,088)	(58,859)
Operating (loss) profit (EBIT)	(16,723)	14,514	61,147	(8,151)	50,787
Net finance income (expense)	139	3,317	3,767	(196)	7,027
Share of loss of associates	(43)	(20)	(157)	(146)	(366)
(Loss) profit before income tax	(16,627)	17,811	64,757	(8,493)	57,448
Income tax	3,438	(3,492)	(13,395)	276	(13,173)
(Loss) profit	(13,189)	14,319	51,362	(8,217)	44,275
Other comprehensive (loss) income	(2,570)	(1,945)	1,314	(2,220)	(5,421)
Total comprehensive (loss) income	(15,759)	12,374	52,676	(10,437)	38,854
Working capital from operations	2,457	38,429	89,771	10,833	141,490
Net cash from (used in) operating activities	86,138	72,214	10,106	(1,715)	166,743
Net cash used in investing activities	(12,509)	(16,826)	(21,489)	(25,652)	(76,476)
Net cash used in financing activities	(25,714)	(10,214)	(9,401)	(6,124)	(51,453)