Icelandair Group hf.

Condensed Consolidated
Interim Financial Statements
1 January - 31 March 2016

USD

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

Contents

Endorsement and Statement by the Board of Directors and the CEO

The condensed consolidated interim financial statements of Icelandair Group hf. for the period from 1 January to 31 March 2016 have been prepared in accordance with International Financial Reporting Standards (IFRSs) for Interim Financial Statements (IAS 34). The interim financial statements comprise the consolidated interim financial statements of Icelandair Group hf. (the "Company") and its subsidiaries together referred to as the "Group". The condensed consolidated Interim financial statements are stated in thousands of USD.

According to the consolidated statement of comprehensive income, loss for the period from 1 January to 31 March 2016 amounted to USD 17.0 million. Total comprehensive loss for the period was USD 7.8 million. According to the consolidated statement of financial position, equity at the end of the period amounted to USD 421.7 million, including share capital in the amount of USD 40.6 million. Reference is made to the consolidated statement of changes in equity regarding information on changes in equity.

Statement by the Board of Directors and the CEO

The condensed consolidated interim financial statements for the three months ended 31 March 2016 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. The condensed consolidated interim financial statements have not been audited or reviewed by the Company's independent auditors.

According to our best knowledge it is our opinion that the condensed consolidated interim financial statements give a true and fair view of the financial performance of the Group for the three month period ended 31 March 2016, its assets, liabilities and consolidated financial position as at 31 March 2016 and its consolidated cash flows for the period then ended.

Further, in our opinion the condensed consolidated interim financial statements and the endorsement of the Board of Directors and the CEO give a fair view of the development and 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 condensed consolidated interim financial statements of Icelandair Group hf. for the period from 1 January to 31 March 2016 and confirm them by means of their signatures.

Reykjavík, 28 April 2016.

Board of Directors:

Sigurður Helgason, Chairman of the Board
Úlfar Steindórsson
Ásthildur M. Otharsdóttir
Katrín Olga Jóhannesdóttir
Magnús Magnússon

CEO:

Björgólfur Jóhannsson

Consolidated Statement of Comprehensive Income
for the period from 1 January to March 31 2016

	Notes	2016 1.1.-31.3.	2015 1.1.-31.3.
Operating income			
Transport revenue	5	141.858	128.339
Aircraft and aircrew lease		26.337	20.179
Other operating revenue	5	43.642	37.557
		211.837	186.075
Operating expenses			
Salaries and other personnel expenses		71.476	57.087
Aviation expenses		80.149	81.903
Other operating expenses		59.115	49.353
	6	210.740	188.343
Operating profit (loss) before depreciation and amortisation (EBITDA)		1.097	(2.268)
Depreciation and amortisation		(21.768)	(17.011)
Operating loss before net finance costs (EBIT)		(20.671)	(19.279)
Finance income		720	2.427
Finance costs		(1.388)	(1.542)
Net finance (costs) income	7	(668)	885
Share of profit of associates, net of tax		55	90
Loss before tax		(21.284)	(18.304)
Income tax		4.288	3.752
Loss for the period		(16.996)	(14.552)
Other comprehensive loss:			
Foreign currency translation differences of foreign operations		3.780	(3.977)
Effective portion of changes in fair value of cash flow hedge, net of tax		5.395	7.033
Other comprehensive profit for the period		9.175	3.056
Total comprehensive loss for the period		(7.821)	(11.496)
Loss attributable to:			
Owners of the Company		(16.982)	(14.502)
Non-controlling interest		(14)	(50)
Loss for the period		(16.996)	(14.552)
Total Comprehensive loss attributable to:			
Owners of the Company		(7.822)	(11.432)
Non-controlling interest		1	(64)
Total comprehensive loss for the period		(7.821)	(11.496)
Loss per share:			
Basic loss per share in US cent per share		(0,34)	(0,29)
Diluted loss per share in US cent per share		(0,34)	(0,29)

The notes on pages 8 to 14 are an integral part of these interim consolidation financial statements.

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Consolidated Statement of Financial Position
as at 31 March 2016

	Notes	31.3.2016	31.12.2015
Assets			
Operating assets	8	456.590	419.071
Intangible assets and goodwill		173.889	172.694
Investments in associates		19.678	18.223
Deferred cost		93	118
Receivables and deposits		35.323	27.474
Non-current assets		685.573	637.580
Inventories		19.476	19.205
Trade and other receivables		145.804	101.075
Short term investments		59.868	19.533
Cash and cash equivalents		241.816	194.586
Current assets		466.964	334.399
Total assets		1.152.537	971.979
Equity			
Share capital		40.576	40.576
Share premium		154.705	154.705
Reserves	9	10.560	1.400
Retained earnings		215.796	259.746
Equity attributable to equity holders of the Company		421.637	456.427
Non-controlling interest		105	104
Total equity		421.742	456.531
Liabilities			
Loans and borrowings	10	52.631	55.387
Payables		8.780	8.644
Deferred tax liabilities		34.215	35.485
Non-current liabilities		95.626	99.516
Loans and borrowings	10	10.297	10.143
Trade and other payables		280.206	219.680
Deferred income		344.666	186.109
Current liabilities		635.169	415.932
Total liabilities		730.795	515.448
Total equity and liabilities		1.152.537	971.979

The notes on pages 8 to 14 are an integral part of these interim consolidation financial statements.

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Consolidated Statement of Changes in Equity
for the period from 1 January to 31 March 2016

	Attributable to equity holders of the Company						
1 January to 31 March 2015	**Share capital**	**Share premium**	**Reserves**	**Retained earnings**	**Total**	**Non-con-trolling interest**	**Total equity**
Equity 1.1.2015	40.576	154.705	3.195	166.371	364.847	208	365.055
Total comprehensive loss			3.070	(14.502)	(11.432)	(64)	(11.496)
Dividend (0.36 US cent per share)				(17.943)	(17.943)		(17.943)
Equity 31 March 2015	40.576	154.705	6.265	133.926	335.472	144	335.616
1 January to 31 March 2016							
Equity 1.1.2016	40.576	154.705	1.400	259.746	456.427	104	456.531
Total comprehensive loss			9.160	(16.982)	(7.822)	1	(7.821)
Dividend (0.54 US cent per share)				(26.968)	(26.968)		(26.968)
Equity 31 March 2016	40.576	154.705	10.560	215.796	421.637	105	421.742

Information on changes in reserves are provided in note 9.

The notes on pages 8 to 14 are an integral part of these interim consolidation financial statements.

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Consolidated Statement of Cash Flows for the three months ended 31 March 2016

	Notes	2016 1.1.-31.3	2015 1.1.-31.3
Cash flows from operating activities			
Loss for the period		(16.996)	(14.552)
Adjustments for:			
Depreciation and amortisation		21.768	17.011
Other operating items	18	(1.749)	(1.295)
Working capital from operations		3.023	1.164
Net change in operating assets and liabilities	19	145.769	116.523
Net cash from operating activities		148.792	117.687
Cash flows used in investing activities:			
Acquisition of operating assets		(55.986)	(25.879)
Proceeds from the sale of operating assets		0	123
Acquisition of intangible assets		(362)	(257)
Capitalised deferred cost		(370)	(211)
Non-current receivables, change		(2.917)	(2.982)
Marketable securities, change		(40.166)	(8.405)
Net cash used in investing activities		(99.801)	(37.611)
Cash flows used in financing activities:			
Proceeds from non-current borrowing		0	23.660
Repayment of non-current borrowings		(3.295)	(3.780)
Net cash (used in) from financing activities		(3.295)	19.880
Increase in cash and cash equivalents		45.696	99.956
Effect of exchange rate fluctuations on cash held		1.534	(2.063)
Cash and cash equivalents at beginning of the period		194.586	184.762
Cash and cash equivalents at 31 March		241.816	282.655
Investment and financing without cash flow effect:			
Dividend issued		(26.968)	(17.943)
Trade and other payables		26.968	17.943

Information on interest paid and received are provided in note 20.

The notes on pages 8 to 14 are an integral part of these interim consolidation financial statements.

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Notes

1. Reporting entity

Icelandair Group hf. (the "Company") is a public limited liability company incorporated and domiciled in Iceland. The condensed consolidated interim financial statements of the Company as at and for the three months ended 31 March 2016 comprise the Company and its subsidiaries (together referred to as the “Group”) and the Group´s interests in associates. The Group primarily operates in the airline transportation and tourism industry. The Company is listed on the Nasdaq OMX Iceland.

The Group´s consolidated financial statements as at and for the year ended 31 December 2015 are available upon request from the Company's registered office at Reykjavíkurflugvöllur in Reykjavík, Iceland or at its website address, www.icelandairgroup.is and at The Icelandic Stock Exchange website, www.nasdaqomx.com.

2. Basis of accounting

These interim financial statements have been prepared in accordance with IAS 34, *Interim Financial Reporting.* They do not include all the information requred for a complete set of IFRS financial statements. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Group's financial position and performance since the last annual consolidated financial statements as at and for the year ended 31 December 2015.

These interim financial statements were approved for issue by the Board of Directors on 28 April 2016.

3. Use of judgements and estimates

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

The significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended 31 December 2015.

a. Measurement of fair values

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 catagorised 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.

Notes, contd.:

4. Operating segment

Segment information is presented in the interim 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.

Route network

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

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

Tourism services

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

Reportable segments for the three months ended 31 March 2016

	Route network		Tourism services		Total	
	2016	**2015**	**2016**	**2015**	**2016**	**2015**
External revenue	189.865	168.740	21.933	16.920	211.798	185.660
Inter-segment revenue	39.832	31.480	1.382	924	41.214	32.404
Segment revenue	229.697	200.220	23.315	17.844	253.012	218.064
Segment EBITDAR*	11.391	6.516	(773)	14	10.618	6.530
Segment EBITDA	5.552	228	(3.340)	(2.170)	2.212	(1.942)
Loss before taxes	(17.217)	(14.170)	(4.677)	(2.606)	(21.894)	(16.776)
Segment assets	978.400	763.652	44.156	30.835	1.022.556	794.487

Reconciliation of reportable segment income

	2016 1.1.-31.3	2015 1.1.-31.3
Total loss for reportable segments	(21.894)	(16.776)
Unallocated amounts:		
Other corporate income (expenses)	555	(1.618)
Share of profit of equity accounted investees	55	90
Consolidated loss before income tax	(21.284)	(18.304)

Other material items 31 March 2016

	Reportable segment	Adjust-ments	Consolid-ated
Segment EBITDAR*	10.618	(1.115)	9.503
Segment EBITDA	2.212	(1.115)	1.097

* EBITDAR means EBITDA before operating lease expences.

Seasonality

The Group's business is highly seasonal with highest demand during the summer months.

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Notes, contd.:

5. Operating income

Transport revenue is specified as follows:

	2016 1.1.-31.3.	2015 1.1.-31.3.
Passengers	130.829	118.157
Cargo and mail	11.029	10.182
Total transport revenue	141.858	128.339

Other operating revenue is specified as follows:

Sale at airports and hotels	14.767	12.503
Revenue from tourism	16.303	14.201
Aircraft and cargo handling services	7.280	6.535
Maintenance revenue	371	516
Gain on sale of operating assets	0	103
Other operating revenue	4.921	3.699
Total other operating revenue	43.642	37.557

6. Operating expenses

Salaries and other personnel expenses are specified as follows:

Salaries	43.052	35.385
Salary-related expenses	16.000	11.302
Other personnel expenses	12.424	10.400
Total salaries and personnel expenses	71.476	57.087

Aviation expenses are specified as follows:

Aircraft fuel	34.137	43.610
Aircraft lease	5.418	5.688
Aircraft handling, landing and communication	19.643	14.882
Aircraft maintenance expenses	20.951	17.723
Total aviation expenses	80.149	81.903

Other operating expenses are specified as follows:

Operating cost of real estate and fixtures	5.685	5.058
Communication	4.889	4.363
Advertising	7.520	5.963
Booking fees and commission expenses	15.364	12.377
Cost of goods sold	4.848	4.213
Customer services	5.340	3.997
Tourism expenses	8.312	6.989
Allowance for bad debt	375	(182)
Other operating expenses	6.782	6.575
Total other operating expenses	59.115	49.353

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7. Finance income and finance costs

Finance income and finance costs are specified as follows:

	2016 1.1.-31.3.	2015 1.1.-31.3.
Interest income on bank deposits	388	437
Other interest income	332	138
Net foreign exchange gain	0	1.852
Finance income total	720	2.427
Interest expenses on loans and borrowings	922	1.364
Other interest expenses	206	178
Net foreign exchange loss	260	0
Finance costs total	1.388	1.542
Net finance (costs) income	(668)	885

8. Operating assets

Aquisition of operating assets in the first three months of 2016 amounted to USD 56.0 million. Included are two Boeing 757 aircraft, overhaul of own engines and aircraft spare parts in the amount of USD 31.0 million.

9. Equity

Reserves are specified as follows:

	Hedging reserve	Translation reserve	Total reserves
Reserves 1.1.2015	(23.941)	27.136	3.195
Changes during the period	7.033	(3.963)	3.070
Reserves 31.3.2015	(16.908)	23.173	6.265
Reserves 1.1.2016	(24.059)	25.459	1.400
Changes during the period	5.395	3.765	9.160
Reserves 31.3.2016	(18.664)	29.224	10.560

10. 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.

	31.3.2016	31.12.2015
Non-current loans and borrowings are specified as follows:		
Secured bank loans	28.817	30.852
Unsecured loans	34.111	34.678
	62.928	65.530
Current maturities	(10.297)	(10.143)
Total non-current loans and borrowings	52.631	55.387

Terms and debt repayment schedule:

	Currency	Nominal interest rates	Year of maturity	Total remaining balance 31.3.2016	31.12.2015
Secured bank loans	USD	4,8%	2017-2022	27.080	29.256
Secured bank loans	ISK	0,0%	0	0	870
Secured bank loans, indexed	ISK	4,3%	2026	1.737	726
Unsecured bond issue	USD	4,3%	2020	23.600	23.596
Unsecured bond issue, indexed	ISK	5,7%	2023	10.511	11.082
Total interest-bearing liabilities				62.928	65.530

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11. Contractual repayments of loans and borrowings

Repayments of loans and borrowings are specified as follows:

	2016	2015
Repayments in 2016 (9 months)(2015: 12 months)	6.763	10.143
Repayments in 2017	10.243	10.189
Repayments in 2018	5.568	5.524
Repayments in 2019	2.368	2.332
Repayments in 2020	26.144	26.118
Subsequent repayments	11.842	11.224
Total loans and borrowings	62.928	65.530

12. Financial instruments and fair values

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

	31.3.2016		31.12.2015	
	Carrying amount	Fair value	Carrying amount	Fair value
Derivatives, included in loans and receivables	1.551	1.551	3.104	3.104
Short term investments	59.868	59.868	19.533	19.533
Unsecured bond issue	(34.111)	(33.177)	(34.678)	(33.438)
Secured loans	(28.817)	(28.238)	(30.852)	(30.769)
Derivatives, included in payables and prepayments	(22.011)	(22.011)	(33.075)	(33.075)
Total	(23.520)	(22.007)	(75.968)	(74.645)

13. Off-balance sheet items

As a lessee the Group has in place operating leases for storage facilities, hotels, equipment and fixtures for its operations, the longest until the year 2041. The group as also in place operating leases for aircraft which last from 1,5 months to 5,25 years. At the end of March 2016 the leases are payable as follows in nominal amounts for each year:

	Real estate	Aircraft	Other	Total 31.3.2016
In Q2 - Q4 2016	11.875	13.878	5.541	31.293
In the year 2017	16.717	15.663	2.893	35.273
In the year 2018	21.671	13.761	2.358	37.790
In the year 2019	21.528	7.560	2.358	31.446
In the year 2020	21.432	6.160	2.418	30.010
Subsequent	284.922	1.530	35.262	321.714
Total	378.145	58.552	50.830	487.526

14. 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 2017. 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 31.4 million (ISK 4.0 billion), however the maximum guarantee is USD 3.9 million (ISK 0.5 billion). Based on the managements estimate the Company has fully provided for potential losses due to the guarantee.

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15. 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 was valued at USD 1.6 billion at Boeing list prices when the agreement was finalized. The Company received acceptable discounts which due to confidentiality agreements cannot be disclosed. Prepayments according to the agreement will be made over the construction period. The acquisition will be funded by internal resources and from aviation finance products.

The delivery plan is as follows:

	2018	2019	2020	2021
Boeing 737 Max 8	3	3	2	1
Boeing 737 Max 9		3	3	1
Total	3	6	5	2

16. Reassessment of taxes

On 15 April 2015 the Internal Revenue Board issued a ruling where a decision made by the Director of Internal Revenue was confirmed. The ruling disallows the Company to recognize as expenses for tax purposes certain interest expenses on loans that were transferred to the Company as a result of a reverse acquisition in 2006. The management does not agree with the ruling and an appeal to the District Court of Reykjavik is in process. The effect of the ruling has not been recognized in the financial statements, but if the court case will be lost the Company's equity would be reduced by USD 7.9 million.

17. Group entities

The Company held twelve subsidiaries at the end of March 2016. The subsidiaries included in the consolidated interim financial statements are as follows:

	Share
Route network:	
Air Iceland ehf.	100%
Feria ehf.	100%
Fjárvakur - Icelandair Shared Services ehf.	100%
Icelandair ehf.	100%
Icelandair Cargo ehf.	100%
IGS ehf.	100%
IGS fasteignir ehf.	100%
Loftleiðir - Icelandic ehf.	100%
Tourism services:	
Iceland Travel ehf.	100%
Icelandair Hotels ehf.	100%
Other operations:	
A320 ehf.	100%
IceCap Ltd., Guernsey	100%

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

18. Statement of cash flows

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

	2016 1.1.-31.3.	2015 1.1.-31.3.
Expensed deferred cost	2.285	2.891
Exchange rate differences	292	(241)
Loss (gain) on sale of operating assets	17	(103)
Share in profit of associates	(55)	(90)
Income tax	(4.288)	(3.752)
Other operating items total	(1.749)	(1.295)

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

Inventories, (increase) decrease	(233)	1.552
Trade and other receivables, increase	(61.218)	(18.925)
Trade and other payables, increase	49.166	10.606
Deferred income, increase	158.054	123.290
Net change in operating assets and liabilities	145.769	116.523

20. Additional cash flow information:

Interest expenses paid	1.773	1.978
Interest income received	314	477

21. Ratios

The Group's primary ratios are specified as follows:

	31.3.2016	**31.12.2015**
Current ratio	0,74	0,80
Equity ratio	0,37	0,47
Intrinsic value of share capital	10,39	11,25

22. Significant accounting policies

The accounting policies and methods of computation applied in these interim financial statements are the same as those applied by the Group in its consolidated financial statements as at and for the year ended 31 December 2015.

These interim 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, except when otherwise indicated.

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