ICELANDAIR GROUP

Icelandair Group

Annual Report 2018

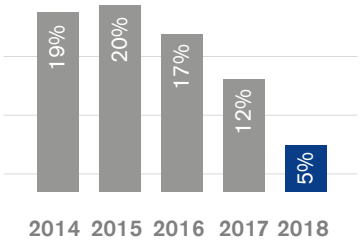
ICELANDAIR GROUP

Contents

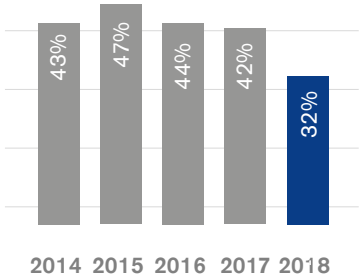
Key Figures

USD thousands	2018	2017*	2016	2015	2014
Operating results					
Total income	1,510,518	1,417,987	1,285,574	1,139,699	1,113,297
EBITDAR	126,893	207,765	254,960	261,710	193,410
EBITDA	76,479	170,076	219,845	226,666	154,338
EBIT	-56,968	49,645	118,437	142,840	79,009
EBT continuing operations	-67,810	48,642	120,111	140,223	79,908
Loss / profit for the period	-55,570	37,538	89,068	111,223	66,499
Balance sheet					
Total assets	1,464,122	1,423,842	1,292,493	971,979	849,220
Total equity	471,379	596,545	568,213	456,531	365,055
Interest-bearing debt	415,801	289,541	242,382	65,530	61,934
Net interest-bearing debt	116,341	64,263	-7,743	-148,589	-153,707
Cash flow					
Net cash from operating activities	61,553	205,603	209,024	245,136	215,315
Net cash used in investing activities	-129,933	-228,419	-291,759	-219,942	-130,156
Net cash from / used in financing activities	149,336	14,554	113,643	-14,320	-88,684
Cash and cash equivalents end of period	299,460	221,191	226,889	194,586	184,762
Key ratios					
Earnings per share in US Cent per share	-1.16	0.75	1.79	2.24	1.34
Intrinsic value	12.07	15.09	13.99	11.24	8.99
Equity ratio	32%	42%	44%	47%	43%
Current ratio	0.71	0.99	0.92	0.8	0.83
Capex USD thousand	331,429	166,131	243,397	210,400	109,293
Tranport revenue as % of total revenues	72%	74%	74%	74%	73%
EBITDAR ratio	8.4%	14.7%	19.8%	22.3%	17.4%
EBITDA ratio	5.1%	12.0%	17.1%	19.2%	13.9%

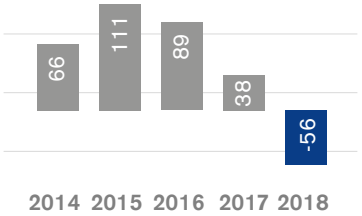
*Restated



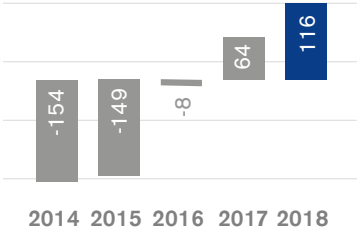
GRAPH 1: EBITDA % 2014–2018



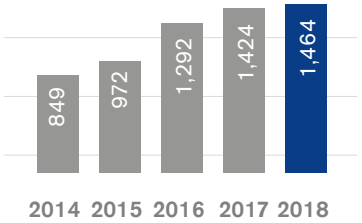
GRAPH 6: Equity ratio 2014–2018



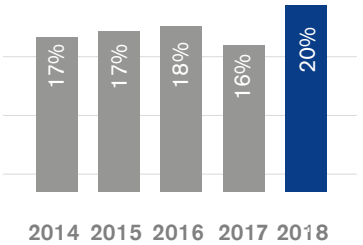
GRAPH 3: Net profit/loss USD million 2014–2018



GRAPH 7: Net interest-bearing debt USD million 2014–2018



GRAPH 5: Total assets USD million 2014–2018



GRAPH 8: Cash as % of revenues

ICELANDAIR GROUP
AT A GLANCE

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

Icelandair Destinations in 2018

North America: 21

Europe: 23

ICELANDAIR GROUP IN NUMBERS 2018

80+ successful years in aviation

51 planes

55 destinations

4.4 million passengers

41K freight tonnes

327k hotel nights

34K BH charter

4,606 FTEs

OUR BRANDS

ICELANDAIR
+ Our international flight operations

Air Iceland Connect
+ Our domestic flight operator

LOFTLEIDIR ICELANDIC
+ Our aircraft leasing and consulting business

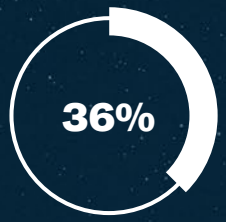
Icelandair Hotels
www.icelandairhotels.com
+ Our hospitality business

Iceland Travel
+ A leading travel company focusing on trips to Iceland

vita
+ Travel agency focusing on trips from Iceland

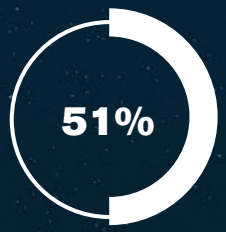
ICELANDAIR GROUP AT A GLANCE

Our Icelandair customers



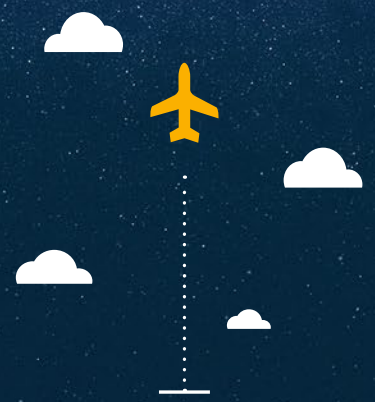
TO
The tourist market with Iceland as a destination

FROM
The domestic market in Iceland

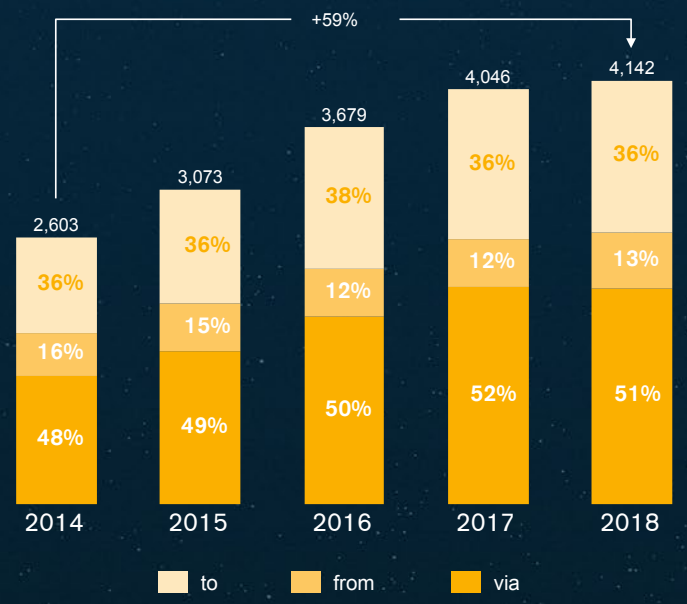


VIA
The international market between Europe and North America

25% of via passengers make a Stopover in Iceland



4.6 MILLION
passengers forecasted in 2019



Chairman's Address

Ulfar Steindorsson
Chairman

Transforming Iceland into a year-round destination

Over the past decade, Icelandair Group has been at the forefront of transforming Iceland into a year-round tourist destination. Through our efforts and significant investments, we have played a leading role in the development of Icelandic tourism, benefiting not only our own operations but the entire Icelandic travel industry. Our focus on steadily expanding our route network over the years has been key to enhancing Iceland's position as an international connecting hub.

This has been our focus since 2012 when we created our future vision "to unlock Iceland's potential as a year-round-destination, to strengthen Iceland's position as a connecting hub, and to maintain our focus on flexibility and experience." It is safe to say that we have reached our goals and fulfilled this vision. Iceland is already a popular year-round destination and now serves as a strong connecting hub between Europe and North America.

We can be proud of Icelandair Group's role in this development and growth across the Icelandic travel industry. Large part of the projects has been our own marketing initiatives, but we have also partnered up with the Icelandic Government and other parties in projects such as Inspired by Iceland, Meet in Reykjavík, Iceland naturally, and more. Our subsidiary Iceland Travel is one of the major travel companies in Iceland, offering a diverse product portfolio and top-quality services aimed at creating unique experiences for travellers visiting Iceland. Through Iceland Travel we have serviced over 450 thousand tourists between 2012 and 2018. Furthermore, through our subsidiary Icelandair Hotels, we have developed high quality hospitality services over the years through a cohesive mix of international and local brands who have added great value to Iceland as a quality destination.

In 2018, we transported 4.1 million passengers, which is more than 100% increase from the year 2012 when the total number of our passengers was around 2 million. Since 2012, the number of passengers travelling over the winter months has increased by over 150% and we now transport more passengers during the so-called shoulder seasons than we did in the summer 2011.
We see a dramatic increase over the last decade when it comes to the total number of tourists traveling to Iceland, from 673 thousand tourists in 2012 to 2.3 million in 2018, which is a 242% increase. In 2012, around half of the tourists visited Iceland in the summer time compared to only a third in 2018, showing how popular Iceland has become all year round.

Furthermore, these efforts have also had a positive impact on employment in Iceland. The number of people working in the travel industry has doubled, from 16 thousand people in the summer 2011 to 32 thousand people in the summer 2018. Today, more people work in the travel industry over the winter time than over the high season in the summers of 2011 and 2012, or 25 thousand people.

Strategic highlights of the year

The year 2018 was challenging. The financial performance of the Company was heavily impacted by both external factors as well as internal challenges. In 2017, decisions that were made regarding our sales and marketing activities and our route network ended up having a considerable negative impact on our operations and overall performance. This challenging time resulted in the resignation of our former President and CEO, Bjorgolfur Johannsson. I want to take this opportunity to thank him for his significant contribution of driving the growth and success of Icelandair Group for over 10 years.

A number of measures are already being taken to address the issues we were faced with in 2018 and these projects are in the capable hands of our new Executive Management, which is led by our new President and CEO, Bogi Nils Bogason, who was appointed in December 2018 after having served as Interim President and CEO since August 2018.

Chairman's Address, continued:

New vision, mission and values

Since 1937, we have brought the resourceful and innovative spirit of Iceland to the world. Icelandair was in many ways a pioneer of modern-day travel. The Company has grown tremendously over the decades and, as mentioned above, contributed to the vast growth of the travel industry in Iceland and strengthened Iceland as a connecting hub between continents.

We believe that now is the right time to look to the future. We need to be clear on how we are going to position the Company within our markets and what is going to be our differentiator and competitive advantage. Over the past years, we have been focusing on providing an Icelandic experience, but it is crucial that we now shift our focus to creating a simple and comfortable customer experience. We are different, our location is unique in the middle of the Atlantic, and we deliver quality service and value-for-money. We also recognise our responsibility to build a diverse workforce, establish a sustainable business model and devise a strategy to reduce our long-term environmental impact.

With our route network remaining at the core of our business model, our new vision, which describes our future aspirations, is "to exceed expectations by bringing the spirit of Iceland, its resourcefulness, responsibility and flexibility to the world." Our mission, or what we strive to deliver every day, is "to take care of every journey with passion". But how are we going to succeed? How we conduct ourselves impacts our colleagues, our customers and our community. In order to be successful, we must be true to the core values that characterise us. The values that strongly emerged from our work with employees and are already guiding us in all our work are passion, simplicity and responsibility.

In February 2019, a new organisational structure was presented to further reflect our clear shift to flight operations. At the same time, we announced that we had decided to divest ourselves of our remaining travel-industry-related operations. Icelandair Hotels have been in sales process since October 2018 and we have now started preparing the sales process for Iceland Travel.

Broad shareholder base

Icelandair Group benefits from having the backing of strong shareholders. Icelandair Group had 3,016 shareholders at the end of 2018. In the course of the year, the Company purchased 47.9 million shares for ISK 750 million according to a share purchase programme authorised at the Company's Annual General Meeting in 2017. Icelandair Group is planning an equity issuance of up to ISK 625 million in nominal value in the first half of 2019, as announced on 30 November and 19 December 2018, to strengthen the financial position of the Company for future growth. In 2018, Icelandair Group's shareholders were paid a dividend amounting to 0.15 US cents per share. Icelandair Group's Board of Directors proposes that no dividends will be paid out to shareholders for the year 2019.

A step towards the future

It is clear that operating conditions will remain challenging. However, we are up for the challenge and we are already taking well-considered steps into the future. The Company stands on solid foundations, it's financial position is strong and we benefit from the great experience, expertise and spirit of our employees. With this, coupled with a strong vision and a new strategy, I believe we are ready to deliver a good and profitable long-term business.

President and CEO's Address

Bogi Nils Bogason
President and CEO
Icelandair Group

Difficult Year Behind Us – Opportunities Ahead

The year 2018 was challenging. The Company's performance fell short of our projections and was both affected by several external factors as well as internal challenges. Our operating environment was characterised by strong competition that resulted in low and sometimes irrational airfares and we were faced with significant fuel and carbon price increases during the year. At the same time, decisions that were taken in 2017 regarding our sales and marketing operations as well as changes in our route network in 2018 also had a negative impact on our 2018 performance. We have already taken a number of measures, both on the revenue side and expense side, which should result in improved performance in 2019.

Despite a challenging backdrop, we transported a record number of 4.4 million passengers in 2018. We flew to 48 destinations in Europe and North America, three destinations in Iceland, and four in Greenland, with a fleet of 39 aircraft within our passenger network. Our total fleet comprised 51 aircraft including our leasing and cargo businesses. We also transported 41 thousand tonnes of freight and sold 34 thousand block hours on charter flights, or 23% more than last year, as well as 301 thousand hotel nights. Our financial position is strong, with assets amounting to USD 1,464 million at year end 2018, net debt amounting to USD 116 million, cash of USD 300 million and equity ratio of 32%.

Measures taken to improve international flight operations

Our flight schedule for 2018 was the largest in the Company's history, growing by 7% from the year before. The number of Icelandair passengers in 2018 was just over 4.1 million, a 2% increase from the previous year. Six new destinations were added to the route network: Dallas, Cleveland, Kansas City, Baltimore, San Francisco and Dublin. Also, the frequency of flights to various existing destinations in North America and Europe was increased. In 2018, our international passenger fleet comprised 26 Boeing 757 aircraft and four Boeing 767 aircraft. In addition, we received three new Boeing 737 MAX 8 aircraft during the year, which fit well into our route network, increasing flexibility and reducing fuel costs. As for product development, we introduced, for example, three new cabin options for seating class in 2018: Economy Flex, Saga Premium and Saga Premium Flex. With more cabin options we have increased the focus on ancillary revenues.

Our route network serves three independent and distinct passenger markets – to, from, and via Iceland. The via market is the largest and has been the main driving force of the growth of our route network in recent years. The proportion of via passengers has grown from 38% in 2010 to 51% of the total passenger numbers in 2018. The market to Iceland accounted for 36% of Icelandair's operation, and from Iceland accounted for 13% in 2018.

Despite several good developments over the year, our international flight operations were heavily impacted by the external and internal factors discussed above. We have already taken a number of measures to address these issues. Mid-year 2018, for example, we decided to increase our focus on the relationship with our customers, following an extensive review of the Company's future strategy, and established a new division, Customer Experience. This was an important step that has resulted in simplified processes and improved customer service.

Other measures that we are currently taking include modifications in capacity to achieve a better balance in our route network between Europe and North America and the implementation of a new revenue management system.

Our Air Freight and Logistics operation (Icelandair Cargo) performed well in 2018, leveraging our passenger route network in addition to scheduled air cargo flights to and from North America and Europe. Carried freight measured in freight tonne kilometres (FTK) amounted to 125.8 million FTKs in 2018, increasing by 7% from the previous year.

Investments in aviation and travel

Loftleidir Icelandic, our aircraft leasing and consulting company, has consistently performed well over the years, including in the year 2018. One of the highlights of the year was that the company strengthened its position considerably in the global VIP market segment. Loftleidir Icelandic now

President and CEO's Address, continued:

operates VIP charters on behalf of some of the largest VIP travel companies in the world on a year-round basis. At the beginning of March 2019, Loftleidir Cabo Verde, a subsidiary of Loftleidir Icelandic, became a majority shareholder in Cabo Verde Airlines with a 51% stake. We see opportunities in developing a similar business model in Cape Verde as in Iceland – by creating an ideal hub in Cape Verde for efficient flight connections between four continents: Europe, South America, Africa, and North America.

Our domestic flight operator Air Iceland Connect transported over 300 thousand passengers in around eight thousand flights in 2018. However, the operations were difficult, with performance declining between years. As a result, our domestic flight operations are now under a thorough review.

The year was also challenging for Iceland Travel, one of the leading travel companies in Iceland. Leisure sales dropped considerably during the high season as a result of weakened competitive position due to a strong ISK at the start of the year. This was accompanied by high prices from service providers and increased competition from other destinations in the Nordic region.

Icelandair Hotels has grown steadily alongside the growth of the tourism industry in Iceland in recent years. However, as predicted, the growth has slowed down with the number of visitors to Iceland growing by 4.5% in 2018 compared to 20–30% annual growth in previous years. The number of sold hotel nights at Icelandair Hotels increased by 8% during the year.

Working with employees on mapping the future

At the beginning of 2018 we decided to sharpen the focus on our core business, flight operations. We started a formal process in the spring of reviewing the Company's strategy and set new goals for the future – work that has been ongoing for the last 12 months. With the input from around 600 employees who participated in 25 strategic workshops, we have now developed a new vision "to exceed expectations by bringing the spirit of Iceland, its resourcefulness, responsibility and flexibility to the world". Our mission is "to take care of every journey with passion". The values that strongly emerged from the work with our employees were "passion, simplicity and responsibility".

Now we have a strong strategic direction – an ambitious vision for the future. At the same time we need to stay focused on delivering value every day to our shareholders and other stakeholders. Therefore, we have established five strategic initiatives for the next five years. These are:

- Strong culture of passion and performance
- The most customer-focused airline in our markets
- Excellence in all operations
- Sustainable and profitable growth
- Industry leader in responsibility

The Executive Management team will work on a five-year action plan based on these strategic initiatives.

President and CEO's Address, continued:

New structure to support the new strategy

A new organisational chart was introduced in January 2018 to reflect the focus on our core business. Icelandair Group and Icelandair were integrated under the leadership of one CEO. The companies' financial divisions were also merged and Icelandair Ground Services (IGS) and Icelandair Cargo became part of Icelandair. As part of this, Icelandair Group's business activities were divided into two segments: International Flight Operations and Equity Investments. Then, as mentioned above, a new division, Customer Experience, was established mid-year 2018. In February 2019, a new organisational structure was presented to further reflect the new strategic focus. Today, three out of four core business divisions focus on maximising the potential and creating value from our international route network: Sales and Customer Experience, Operations and Air Freight and Logistics. The fourth core division, Aircraft Leasing and Consulting, uses Icelandair's expertise, experience and operating resources to provide leasing charter and consulting services to airline operators around the world. The four supporting functions are Finance, People and Culture, Digital Development and Information Technology, and Fleet and Network. The Executive Directors of these division form the Executive Management team.

In this new setup, a new, merged division, Sales and Customer Experience, is responsible for all sales, marketing and customer experience activities. All functions that will shape the Company's digital and technological future have been integrated in one place, in a new division called Digital Development and Information Technology. In addition, Icelandair Group's subsidiary, Icelandair Shared Services (Fjarvakur), that has provided the Group with a range of financial services over the years, will be moved closer to Icelandair Group's Finance division.

As a result of these changes, a decision was made to start preparing the sales process of Iceland Travel, in addition to Icelandair Hotels which have been in sales process for a few months. Our other subsidiaries, Air Iceland Connect and VITA, will become a part of our core operations.

Corporate social responsibility

We are always improving as a Company in the area of corporate social responsibility. With a new vision and strategy, we will be placing even further emphasis on this area. Last year, we decided to start a formal reporting process through the Nasdaq's Environmental, Social and Governance guide (ESG), which is reflected for the first time in this annual report.

Outlook

Our route network in 2019 is set to expand by 10% over the last year's schedule. The number of passengers in 2019 is projected to around 4.6 million. The route network will comprise 23 European destinations and 21 North American destinations.

Six new Boeing 737 MAX aircraft will be added to our fleet in 2019, while the number of B757-200 aircraft will be reduced by three. A new connection bank will be added alongside the current connection bank in the spring 2019, to improve resource utilisation and flight punctuality.

Our priorities for 2019 are clear: to improve the Company's profitability and strengthen our operations for the future. We are, however, faced with uncertainty in our operating environment and the competition remains tough. Despite that, our financial position is strong, and I am therefore convinced that we are well positioned to take on the challenges and seize the opportunities that lie ahead.

I would like to thank our employees for their great work during challenging times and the members of our Board of Directors for their valuable contribution. I know that together we will drive improved performance by focusing on what we do best, aviation. We are going to continue to provide excellent customer service and at the same time improve and simplify our operations to drive sustainable profitable growth for the future. We will do this responsibly and with the passion that we have always been known for.

BUSINESS REVIEW

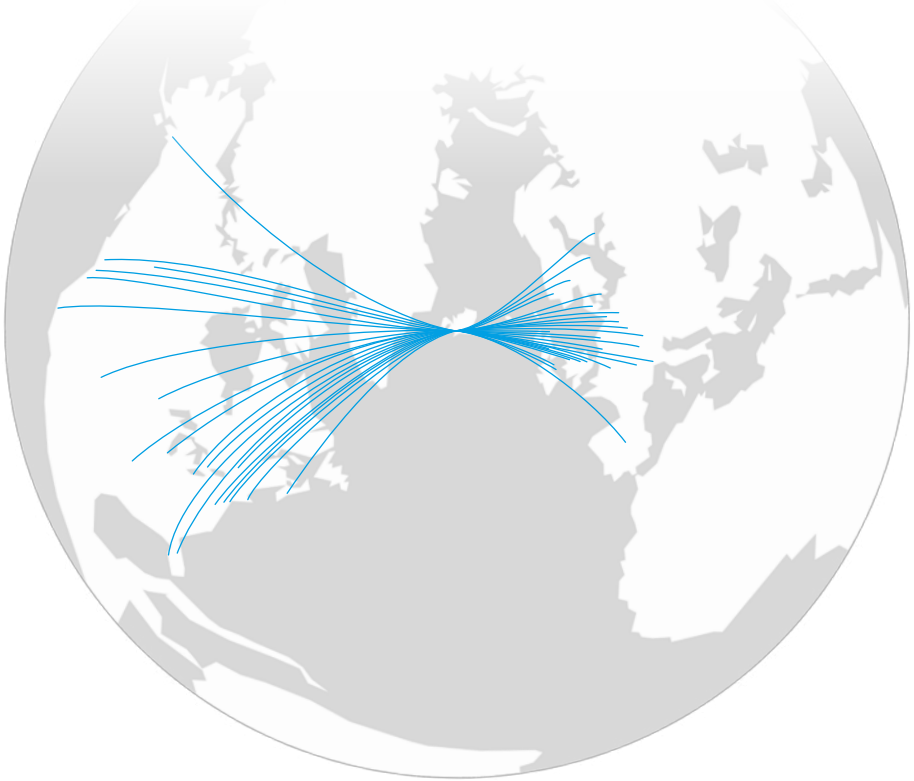
We connect

For more than 80 years, we have taken passengers on exciting transatlantic adventures, offering new opportunities and broadening horizons. What makes us unique is our ideal location midway between Europe and North America. Our route network includes more than 40 destinations. Since the 1960s we have encouraged passengers to enhance their journey by enjoying a Stopover at no additional airfare, exploring the wonders of Iceland.

Vision

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

Icelandair Group has been at the forefront of devising a long-term strategy for Iceland as a year-round destination. Through our efforts and significant investments, we have played a leading role in the development of Icelandic tourism, benefiting not only our own operations but the entire Icelandic travel industry. Our focus on steadily expanding our route network over the years has been key to enhancing Iceland's position as an international connecting hub. Finally, our values of flexibility and experience are underpinned by our unique talent pool which remains our primary source of strength.



Operating pillars

Sustainable value creation for our shareholders and other stakeholders lies at the heart of our business model. It consists of three operating pillars that support our vision.

Sustainable value creation

Iceland tourism growth

Taking a driving-seat role in increasing tourism to Iceland across seasons from both existing and new markets.

Via growth

Network growth to strengthen the Iceland hub, maintaining short connection times at KEF through operational efficiency.

Flexibility and experience

Enabling rapid reactions to disruptive factors – a structure and culture that foster adaptability and nimbleness.

Strategy

Our route network with Iceland as the focal point is the cornerstone of our strategy. We operate flights based on the hub-and-spoke concept, taking advantage of the country's geographical location by efficiently connecting flights between Europe and North America via the hub in Iceland. To maximise the value creation from our route network and other operations, we have set a strategic focus that remains firmly centred around five key points.

1 Focusing on route networks and tourism service

2 Reducing seasonality in the Group's operations

3 Focusing on organic growth and business development

4 Achieving greater synergies between Group companies

5 Improving efficiency with special emphasis on continuous cost control

Values

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

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

Planned strategy shift in 2019

Icelandair Group has grown rapidly since its vision and strategy were implemented in 2012. The Company's efforts and significant investments have resulted in great achievements, both in strengthening Iceland as a world-class destination all year round and establishing Iceland as a strong connecting hub between Europe and North America. In mid-year 2018, it was therefore decided to review the Company's strategy and set new goals for the future. A new vision, mission, values and five strategic initiatives will be presented in March 2019 – work that is based on the input from around 600 employees who participated in 25 strategic workshops held in May 2018.

Structure

Process started to sharpen focus on core business

A new organisational chart was introduced in January 2018 to sharpen the focus on the Company's core business – international flight operations. Icelandair Group and Icelandair were integrated under the leadership of one Chief Executive Officer. The companies' financial divisions were also merged and Icelandair Ground Services (IGS) and Icelandair Cargo became part of the Company. Following this restructuring, Icelandair Group's business activities were divided into two segments: International Flight Operations and Equity Investments.

The International Flight Operations were divided into five divisions: Finance, Business Development and Strategy, Human Resources, Operations and Sales and Marketing. The Company's Equity Investments were divided into aviation investments – comprising the subsidiaries Air Iceland Connect, Loftleidir Icelandic and VITA – and tourism investments, comprising Icelandair Hotels and Iceland Travel.

Further changes to reflect customer focus

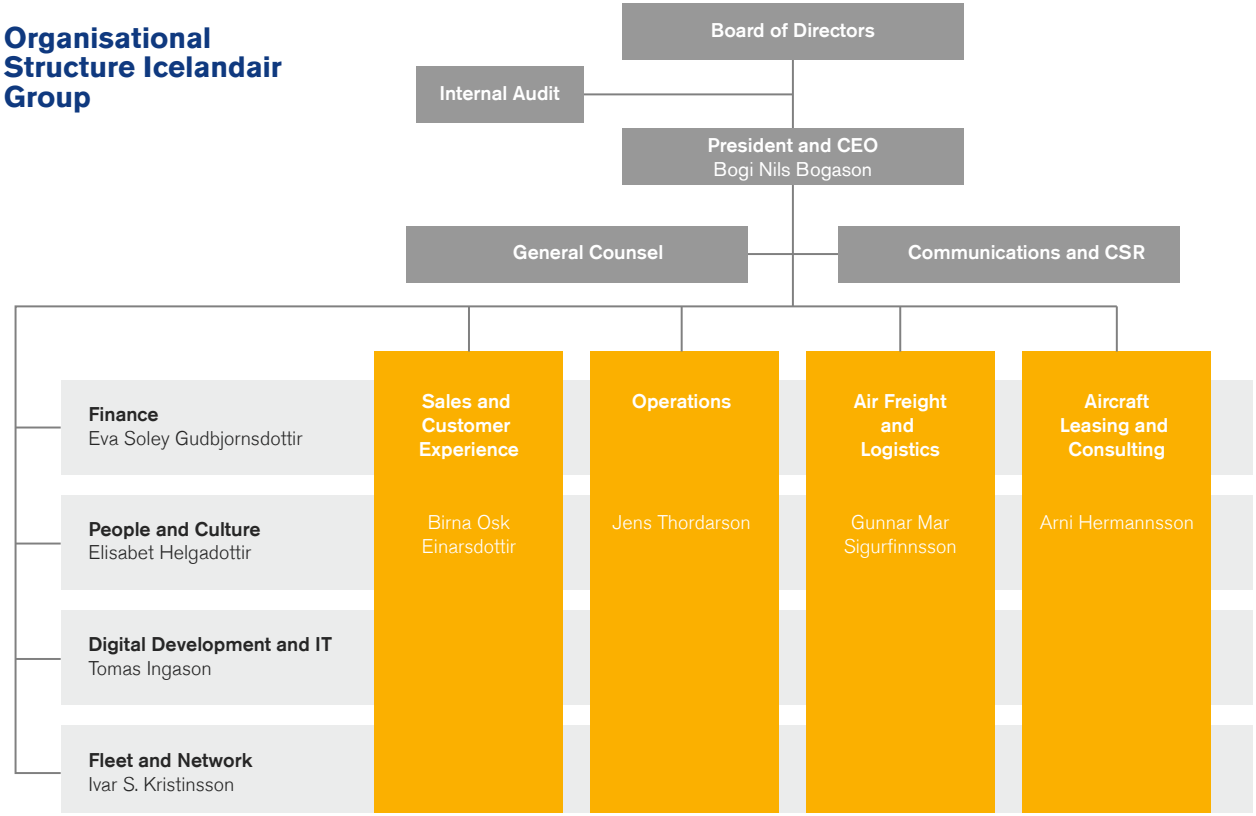
Mid-year 2018, a decision was made to increase the Company's focus on customer relations, following an extensive review of the Company's future strategy. To reflect this, a new division, Customer Experience, was established in July 2018. This division became responsible for on-board and frontline services, the customer loyalty programme, ancillary revenue and product development. At the same time, digitalisation and data processing became a part of the division, as well as strategic planning and business development. This was an important step that had, by the end of the year, resulted in improved customer service and simplified processes and project management.

Restructuring to further emphasise aviation

Further changes were made to Icelandair Group's organisational structure in February 2019 to sharpen the focus further on the Company's flight operations. Now the Company is divided into eight divisions which consist of four core business divisions and four supporting functions. Three out of four core business divisions focus on maximising the potential and creating value from the Group's international route network. These are: Sales and Customer Experience, Operations and Air Freight and Logistics. The fourth, Aircraft Leasing and Consulting, uses Icelandair Group's expertise, experience and operating resources to provide charter and consulting services to airline operators around the world. The four supporting functions are Finance, People and Culture, Digital Development and Information Technology, and Fleet and Network.

The Managing Directors of the above-mentioned divisions form Icelandair Group's Executive Management, in addition to the Company's President and CEO. As a result of these changes, a decision was made to start preparing the sales process of Iceland Travel, in addition to Icelandair Hotels which have been in sales process for a few months. The Company's other subsidiaries, Air Iceland Connect and VITA, will become part of the Company's core operations.

Organisational Structure Icelandair Group



International Flight Operations

Icelandair operates a well-established route network between Northern Europe and North America. The route network is based on Iceland's advantageous geographic position making it an ideal central point for an extensive international hub-and-spoke network, connecting the two continents with 48 destinations and 527 connection options. Icelandair is the leading airline for travel to and from Iceland in addition to providing an exciting alternative for passengers across the North Atlantic. With over 80 years of experience, our mission is to operate a high-quality airline and to maintain a reliable standard of excellent service to our customers.

Operations in 2018

Icelandair's flight schedule for 2018 was the largest in the Company's history, growing by 7% from 2017. The number of passengers in 2018 was just over 4.1 million, a 2% increase from the previous year. Six new destinations were added to the route network: Dallas, Cleveland, Kansas City, Baltimore and San Francisco in the United States and Dublin in Ireland. Also, the frequency of flights to various existing destinations in North America and Europe was increased.

In 2018, Icelandair's fleet was combined of 26 Boeing 757 aircraft and four Boeing 767 aircraft. In addition, Icelandair received three new Boeing 737 MAX 8 aircraft in 2018. The new aircraft fits well into Icelandair's route network, increasing flexibility and reducing fuel consumption and carbon footprint. The number of weekly departures from Keflavik International Airport was 348 during the summer's high season.

After introducing a new Economy Light options in 2017, Icelandair introduced three new cabin options in 2018; Economy Flex, Saga Premium and Saga Premium Flex. With more cabin options, Icelandair has increased the focus on ancillary revenues.

Two new flight simulators, for Boeing 767 and Boeing 737 MAX aircraft, were added to the existing Boeing 757 simulator at the training facility in Iceland. The training facility is now well utilised around the clock all year round, for Icelandair and other airlines.

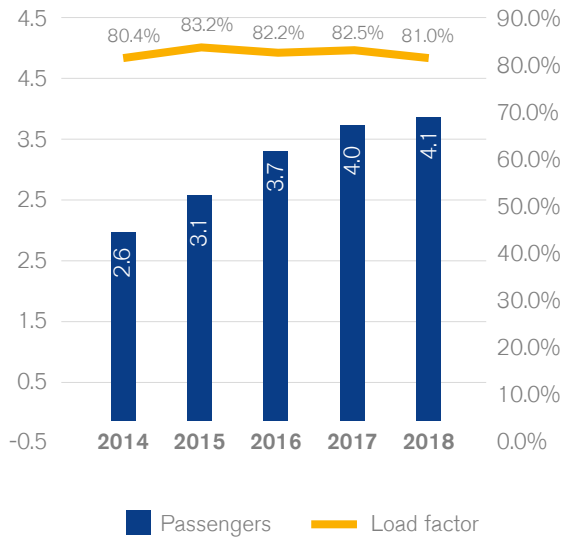
Addition to the route network

Icelandair's route network in 2019 is set to expand by 10% over last year's schedule. The number of passengers this year is projected at 4.6 million, up by five hundred thousand from the previous year. The route network will comprise 23 European destinations and 21 North American destinations.

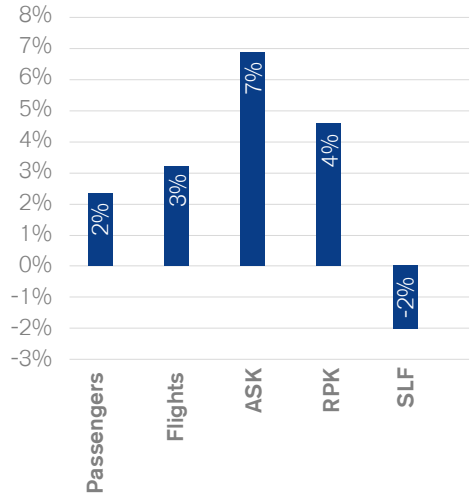
The heart of the Icelandair route network is the 24-hour hub at Keflavik Airport. In the morning Icelandair's aircraft take off for all the destinations in the east. They reach Europe at around midday and start the return flights early in the afternoon. Because of the two-hour time difference between Iceland and most of Europe, the fleet is typically back in Keflavik in mid-afternoon, Icelandic time. The North America operation begins toward late afternoon and the fleet arrives in the US and Canada in the early evening and returns to Keflavik at the dawn of the next day, just in time to depart again for Europe.

In 2019, Icelandair will offer increased availability with a second connection bank in the route network during high season, alongside the current connection bank. It includes departures to Europe in the latter part of the morning, arriving in Keflavik later in the afternoon. From there, the flights will depart to North

Number of passengers (millions) and load factor



Traffic Data Icelandair
change in % 2018 vs. 2017



International Flight Operations, continued:

America around dinner time, arriving at the end of the day. With this arrangement, Icelandair will make better use of the existing fleet, especially the aircraft flying to and from longer destinations, such as Denver, Seattle, Anchorage, etc. Until now, these aircraft have stood overnight at these locations. This measure will also include better utilisation of flight crews as well as increase customer options.

Icelandair will receive six new Boeing 737 MAX aircraft during the year of 2019. The 737 MAX is fuel efficient and offers further options for adding increased availability to the current route network. Icelandair will introduce Dusseldorf in Germany this spring as a new destination. Furthermore, a supply of flights to selected destinations will be significantly increased with the implementation of the second connection bank. For example, to Paris, Berlin, Frankfurt, Munich, Amsterdam, Copenhagen, Toronto, along with other destinations. In addition, there will be a better balance between supply to North America and Europe.

As Icelandair adds new destinations and increases frequency in North America or Europe, and the number of connecting options increases, the Company can diversify its passenger mix, thereby reducing risk and strengthening the hub in Keflavik International Airport.

Three passenger markets

Icelandair's route network serves three independent and distinct passenger markets: the Icelandic domestic market, the tourist market with Iceland as a destination and the international market between Europe and North America. Serving these three markets enables Icelandair to offer a higher flight frequency and a greater variety of destinations than the markets to and from Iceland alone would allow. Of the three markets, the "via" market is the largest and has been the main driving force of the growth of the route network in recent years. Since 2010, the proportion of "via" passengers has grown from 38% to 51% of the total passenger numbers in 2018. The market "to" Iceland accounts for 36% of Icelandair's operation and "from" Iceland 13%. The United States is Icelandair's largest single destination country, while its European network focuses mainly on Scandinavia and Northern Europe, with the United Kingdom as the Company's second largest destination country.

A fleet of Boeing 737s, 757s and 767s

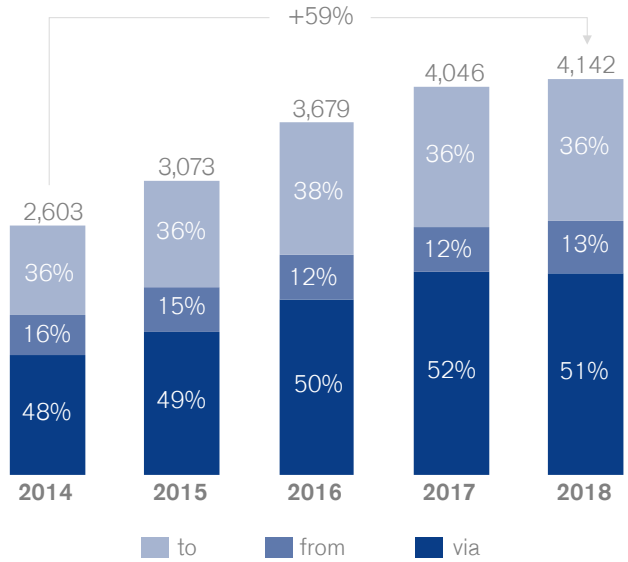
In 2019, 36 aircraft will be operated by Icelandair. The Company has ordered sixteen Boeing 737 MAX 8 and 737 MAX 9 aircraft, with an option to buy an additional eight aircraft. The order involves nine 737 MAX 8 aircraft, with a seating capacity of 160 passengers, and seven 737 MAX 9 aircraft, with a seating capacity of 178 passengers.

As previously mentioned, Icelandair received three new 737 Boeing MAX 8 in 2018 and delivery of six aircraft is scheduled for 2019, both MAX 8 and MAX 9. A mixed fleet of Boeing 767, Boeing 757 and Boeing 737 MAX aircraft fit well into Icelandair's route network, as destinations in Europe and North America are within reach of all aircraft. The fleet is equipped with personal in-flight entertainment systems and Icelandair offers on-board Wi-Fi connections on its routes across the North Atlantic.

Air freight and logistics

Icelandair's airfreight and logistics operation focuses on air freight services to and from Iceland by leveraging the passenger route network with scheduled air cargo flights to and from North America and Europe, operating two B757-200 cargo aircraft in addition to the passenger fleet. Carried freight measured in freight tonne kilometres (FTK) amounted to 125.8 million FTKs in 2018, a 7% increase from previous year. Fresh fish is the most essential product for the export part of the operation. The Icelandair route network places the Icelandic fishing industry in a unique position to distribute its fresh fish products to key markets, which in turn will continue to strengthen the market position of the cargo operation. The outlook for imports is good for 2019 and in line with the favourable economic conditions in Iceland.

Passenger mix in % 2014-2018



Air Iceland Connect

Icelandair Group's regional carrier, Air Iceland Connect, offers domestic flights to three destinations in Iceland and regional flights to four destinations in Greenland.

Air Iceland Connect aims to inspire customers to experience adventures by visiting remote North-Atlantic destinations.

The Company's focus is on offering efficient and reliable air transport to enhance quality of life. Dependable regional flight services also enable business undertakings and public agencies requiring travels to operate in a more efficient manner. Co-operation with other airlines enables interregional connections, both domestically in Iceland and to other North-Atlantic destinations.

Challenging year behind

A number of factors negatively affected Air Iceland Connect's performance in 2018. Following the decision of the UK to leave the European Union the passenger market in the UK has weakened considerably leading to a decision to cease Air Iceland Connect's operation to Aberdeen and Belfast in May 2018. In addition, the tourism market to Iceland changed significantly during the year with traditional markets from Europe dropping by double digit figures with the effect that demand for domestic and Greenland flights decreased. With 80% of the domestic passengers being Icelanders, the status of the Icelandic economy has a tremendous effect on demand for flights. Uncertainty around union negotiations affected the status of the economy, particularly in the latter half of the year.

Air Iceland Connect's direct flights from Keflavik to Akureyri begun on a year-round basis in February 2017. With emphasis on tourism over the winter time, the schedule has now been adjusted to operate only during the months of October through May.

AIR ICELAND CONNECT IN 2018

300,000 passengers

230 employees

8,000 flights

19,000 children as passengers

181 million available seat kilometres

Air Iceland Connect, continued:

Fleet

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

The deployment of three Q200s with their 37 seats and three Q400s with their 76 seats, all introduced in 2016, preserves the company's flexibility to meet differences in market demand. At the same time, focusing on a single aircraft manufacturer contributes to the streamlining and efficiency within the operations, in addition to the economic benefit of being able to offer the same training for all cockpit crews.

Outlook

With the Icelandic economy slowing down and some key tourism markets being challenged, the outlook for the coming year is moderate. Adjusting the production according to market conditions is key to achieve sustainability of the operations. The proposal prepared by the Icelandic Ministry of Transport to support air travel for the local population in remote regions in Iceland seems to have got some positive feedback, which, if implemented, can have a positive effect on the demand for Air Iceland Connect's services going forward.

Although mining and oil explorations in Greenland are currently at a low, the demand for Greenland as a tourist destination in the long run is growing, and revenues on routes to and from Greenland are expected to increase in 2019. Air Iceland Connect's long-term focus on the tourist market to Greenland will be further extended as the demand for travel to Greenland continues to grow in both existing and new markets. With new and extended airports in Greenland, scheduled to open in 2023, the accessibility to Greenland will be improved. This will provide Air Iceland Connect with opportunities for both passenger and cargo operation between Iceland and Greenland.

Loftleidir Icelandic

Icelandair Group offers aircraft leasing and consulting services to international passenger airlines and tour operators under the Loftleidir Icelandic brand.

Launched as a marketing vehicle for the Group's international Aircraft, Crew, Maintenance and Insurance (ACMI) and charter market services, Loftleidir Icelandic has narrowed its focus to leverage its expertise as a capacity solution provider, concentrating mainly on Aircraft and Maintenance (AM) projects and consulting services. The company operated six B757 200s, two B767 300s, one B737 800s and one B737 700 aircraft at the end of 2018.

Highlights in 2018

As in recent years, the ACMI market in 2018 continued to show strong demand with very limited supply, especially over the high season. As before, the strongest demand was in the narrow body market, especially for A320s and B737 NGs. While the wide body market had less demand the serious delays from the OEM's meant that most of the available wide bodies were leased out over the high season in the ACMI market.

In 2018, Loftleidir took an important step in becoming the most recognised player in the VIP market segment on a truly worldwide scale. In addition to operating on behalf of Abercrombie & Kent and Lakani in the US, Loftleidir operated its first charters on behalf of Captains Choice out of Australia and thereby, for the first time, operating VIP charters on a year-round basis. Loftleidir Icelandic secured two new contracts in 2018, adding two new customers to its portfolio; Hapaq Lloyd in Germany and National Geographic in the US. This growth in the VIP segment will mean that Loftleidir Icelandic will be operating two B757 VIP aircraft on a full-time basis over the next three to five years.

Loftleidir extended two of its contracts with Air Niugini, in addition to purchasing one of the B767, already on lease with

Air Niugini, which was due to expire at the end of year 2018. In addition, Loftleidir added two B757 aircraft to support its expanded operation for Cabo Verde Airlines.

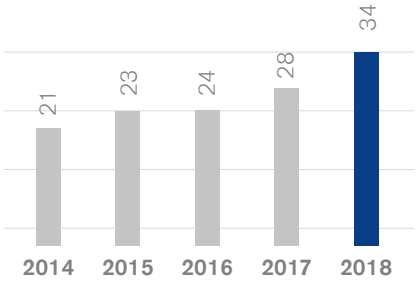
Market outlook for 2019

The market outlook for the aircraft leasing market in 2019 can be characterised by uncertainty and volatility. Increased number of airlines have struggled and gone out of business which in return has meant more short-term availability of aircraft in the dry lease market, especially on the narrow body side. The projections are that this trend will continue alongside consolidations, which historically have brought new opportunities for Loftleidir. The OEM's struggle to deliver their products, both on the aircraft side as well as the engine side is expected to continue in 2019 and will certainly affect the leasing market as well.

As before, Loftleidir Icelandic will be focusing on the AM product in its sales and marketing efforts, especially the B737NG type, while maintaining its marketing efforts in the VIP, ACMI, and Full Charter markets. In addition, increased emphasis will be put into Icelandair Group's aircraft management and consulting activities, which include network development, revenue accounting, ticket sales and marketing activities. Finally, aircraft end of service activities such as teardown and part sales will be added to Loftleidir Icelandic's activities.

Capacity solutions

Number of sold block hours (thousands)



Icelandair Hotels

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

Authentic Icelandic experience

The vision of the Group's hotel operations is to create an authentic Icelandic experience for visiting tourists. The focus is on leveraging Iceland's unique qualities as a tourist destination, to add value to Iceland as a destination and enhance its opportunities of appealing to a versatile target group, all year around. Although guests using Icelandair Group's hotels come from all over the world, the principal targeted markets are linked to the Group's international route network. The last year's increase in the number of flights on existing routes and new North American and European gateways has provided ample opportunities for growth for the hotels. Marketing efforts involving Icelandair Hotels in 2019 will focus on further enhancing existing and prospective new gateways.

The brand portfolio of Icelandair Hotels has never been more extensive, but the company now operates hotels all around the country under five different hotel brands. The chain of Icelandair Hotels consists of eight quality hotels, all at key locations in and outside of Reykjavik. One franchise hotel left the chain by the end of 2018, Icelandair Hotel Klaustur. The company opened a new hotel by Lake Myvatn in July and has plans of further expansions in the area in the near future. Edda Hotels operates 10 summer hotels, offering a diverse choice of simpler hotel lodgings at key locations around the country. The Hilton Reykjavik Nordica is a high-quality hotel that sets the standard for competitors to follow. The Canopy Reykjavik by Hilton is the first of its kind in a new hotel chain by Hilton Worldwide which opened in July 2016. The Canopy as well as its inhouse restaurant, Geiri Smart, have received outstanding reviews from day one, but the hotel has been nominated as the best hotel in Iceland for 2019 by Tripadvisor.

Alda Hotel joined the Icelandair Hotels in April 2018. Alda is an 88-room boutique hotel, ideally located on Laugavegur shopping street, and very popular among individual travellers visiting the city. The hotel is a welcome addition to the company's portfolio, as it fits well with its emphasis on adding number of keys with good access to direct online business. The Reykjavik Konsulat hotel is another welcome addition of Icelandair Hotels, but the hotel opened in March 2018. The Konsulat is a 50-room upper scale hotel, renowned for its rich storytelling, concept and design. The hotel belongs to a unique, growing collection of now 65 individual hotels all over the world, called Curio Collection by Hilton.

At Icelandair Hotels, the company's success builds on the combination of a professional team of hospitality talent, solid operation and processes, innovative approach to business in combination with the multiple brand options at hand, and constant focus on international trends in travel, design and services. The hotels aim to create a safe and innovative working

environment, with strong company culture and operations that have a positive impact on our local society and culture.

The hotel's business environment is a dynamic one, but the end target remains the same, and that is to create a valuable long-term investment for shareholders in balance with the destination and our natural resources.

The dust has settled

The immense growth in visitors to Iceland has seen tourism flourishing in the last few years. This time of growth has been used wisely to increase the choice of services provided, and for improving the level of quality. Icelandair Hotels have been instrumental in this process, taking a lead in the strategic build-up of an exciting, authentic service product offering that caters to the needs of more wide-ranging target groups than ever before.

As predicted, however, changes in the air marked the local tourism industry in 2018, while last year's extensive annual growth of 20-30% in number of visitors, decreased to 4.5%. Several negative impacts affected end results of Icelandair Hotels in 2018. Both the opening of the Icelandair Hotel Myvatn and the Reykjavik Konsulat suffered severe delays, causing a loss of revenue for the company. Strong ISK also had a negative impact

Icelandair Hotels, continued:

on the revenue, spending and length of stay. The countryside suffered a decrease during high season, as most traffic was restricted to shorter trips in and around the capital area and the south shore. Furthermore, a national salary increases of 3-5% had an impact on the company's costs.

Challenges of cost increase and negative impact of strong ISK during 2018 have been met with a clear focus on streamlining of processes and lean management. Effective revenue management is already in place, and in strong cooperation with Hilton Worldwide, price adjustment in accordance to demand plays a vital role in maximising the occupancy at each given time. F&B service offerings have also been adjusted to leaner wallets, but emphasis on local culinary experiences is still in place in order to maximise inhouse spending of foreign visitors in already well occupied properties.

Icelandair Hotels aims to continue automating the predictable so that there will be room to personalise the exceptional. Hence a focus on automation of booking processes, digitalisation of old-fashioned check-in and outs, as well as concierge services. At the same time, emphasis is put on the training of all front-line employees in order to further improve the service level intact with new higher end branded hotels. Likewise, a clear focus on training cross selling skills is in place, so that the company's own restaurants as well as other own hotels will always be highlighted to the company's customers.

As a part of the year's streamlining efforts, the total number of employees was reduced by 7% between 2017 and 2018. Out of the total 698 FTE's in 2018, 70 belong to the three new hotels which were added at different times of the year.

Outlook 2019 – Still room to grow

The company's biggest undertaking in 2019 will be the continuing development of the new Curio hotel. At an unparalleled location within a restricted zone of downtown Reykjavik, a new 145-165 key property is in the making. The hotel is currently at a design stage but with all plans approved and a planned opening date in Q4 2020. This will be accomplished if no further delays will impact the progress, but the site has already suffered local scrutiny and negative press, causing delays from initial plans. Icelandair Hotels puts emphasis on handling the ongoing local debate about the site with utmost respect for conflicting views.

By Austurvollur, Icelandair Hotels intend to create a versatile venue for international guests intrigued by ever changing international hot topics. The hotel concept promises a new, different take on what the company has already accomplished in its recent developments, granting the true authentic Icelandic experience with emphasis on local art and ever-changing events within the city.

Several future expansion possibilities are at hand at this crucial key location for the years to come.

Icelandair Hotels foresee gaining economic of scale when opening the Parliament and that occupancy will increase accordingly. Several new properties are confirmed in the pipe lines of both Reykjavik and countryside, yet forecasts of future growth still indicate that there is still room for additional keys. Icelandair Hotels remains the first refusal point for new developments.

Even though the tremendous increase of the last few years is expected to continue slowing down in 2019, it is forecasted that numbers will start picking up again already in 2020. A moderate growth of 3-6% is estimated for the next 10 years, providing opportunities to even out seasonality, pricing and service offerings all year round, all around the country. A healthy and more stable growth rate will allow the relatively young tourism industry to mature and focus on improving operational performance under a more stable macro-economic environment.

Icelandair Hotels, continued:

Reykjavik has become a well-known product, but there is still room for further growth in the countryside during all seasons. Consequently, Icelandair Hotels has a clear focus on marketing regional areas and the local infrastructure of services, so that the annual Occupancy (OCC) and Average Daily Rate (ADR) of the countryside hotels may be further improved. At the same time, it remains a challenge to further improve the difference in ADR between summer and winter, both in countryside and city. Improved, all year around access to the countryside and joint marketing efforts remain the key to evening out seasonality and the imbalance between the city and countryside hotels.

Icelandair Hotels have used the time of last year's increase wisely, by focusing on deliberate growth. New, innovative hotel brands have been strategically added to the company's portfolio, and well thought out key locations secured. Rather than focus on big increase in number of keys at a similar price level, the new hotels cater to a different, higher paying clientele, and thus allowing Icelandair Hotels to further improve its range of service offerings, pricing structure and end results accordingly. The new Icelandair Hotels have become a true benchmark for hotel services in Iceland, and renowned trend setters not just locally but also among Hilton Worldwide extensive global net of hotels.

Icelandair Hotels have acted as a positive force in the development of new neighbourhoods both in Reykjavik and countryside. It is the only hotel company which has been awarded for its sustainable efforts, education of employees and emphasis on the use of the Icelandic language. The firm is well prepared to outperform in times of inevitable decline of demand. The future success is secured with strategic locations, high quality services and streamlined, automated processes.

Iceland Travel

Iceland Travel is one of the major travel companies in Iceland, offering a diverse product portfolio and top-quality services aimed at creating unique experiences for travellers visiting Iceland. The core business consists of servicing leisure travellers through travel partners around the world and through direct online sales to consumers. Other segments include services relating to incentives, conferences, cruise ships as well as servicing luxury travel under the Nine Worlds brand.

Challenging year behind us

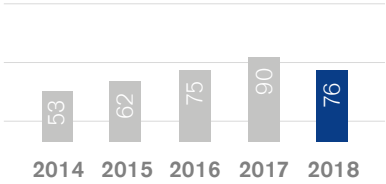
Last year was characterised by considerable drop in leisure sales during high season. This drop can be attributed to weakened competitive position due to a strong ISK at the start of the year, accompanied with high prices from service providers, and increased competition from other destinations in the Nordic region. In response to this, Iceland Travel had to lay off employees along with other austerity measures. These measures were accompanied with improved utilisation of our digital infrastructure, which has improved productivity and helped with finishing the year on a positive note.

Last year, Iceland Travel made changes to its organisational structure from a regional focus to a more product-oriented focus. These changes are aimed to improve processes and response time as well as improve measurement of unit costs.

Outlook for 2019

The year 2019 is expected to be similar in size to previous year regarding revenue and passengers. Market conditions improved slightly towards the end of last year with depreciation of ISK along with lower and/or more stable price from service providers, although response time of some sales channels can be slow at times. Changes made to the organisational structure, along with continuous development of digital solutions, will further strengthen our processes and productivity in 2019. A new customer portal was introduced in Q1 and increased functionality in development. Further innovations on our digital roadmap are aimed at improving automation and supplier communications.

Number of tourists with flights to Iceland through Iceland Travel (thousands)



VITA

VITA offers a variety of leisure tours to Icelanders travelling abroad through high-quality services supplied at competitive prices.

VITA takes advantage of opportunities that arise through the company's partnership with Icelandair, thereby offering a secure and attractive option for Icelanders seeking services and assistance for organised groups and individual tours, such as vacation tours, golf and ski trips and city breaks. VITA also offers specialised business solutions in partnership with Carlson Wagonlit Travel, serving large companies, institutions and small businesses alike.

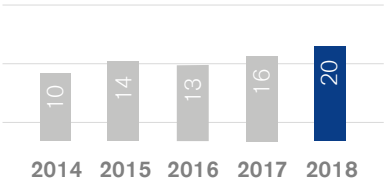
Ten-year anniversary

VITA celebrated its 10 years anniversary in 2018. The year was the biggest yet in the company with 20% capacity increase from previous year and EBITDA up 7% while occupancy was on average above 90%. Market conditions were favourable with a strong ISK and high purchasing power and willingness to travel. Improvements on the online booking process with seat only options and seat plan functionality aimed at improving ancillary revenues have been well received.

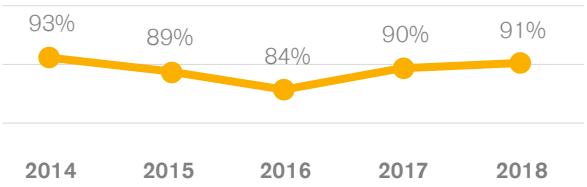
Outlook for 2019

In 2019 VITA aims to increase capacity by 37%. As of January 2019, bookings were up 46% compared to previous year. Alicante and Tenerife will remain the main destinations with 58% of capacity. Digital developments will be focused on improving the customer journey and offer online check-in.

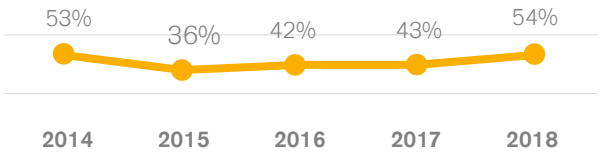
Number of passengers in charters (thousands)



Load factor in charters



Online sales ratio



FINANCIAL REVIEW

We drive results

With 4,600 employees around the world, more than 50 aircraft and more than 3,000 shareholders, we are a vibrant company guided by accountability and profitability. We emphasise teamwork and the sharing of information and values. The contribution of every employee matters to us, and they are well rewarded for it.

Shareholder Information

Since December 2006 Icelandair Group's shares have been listed on NASDAQ OMX under the symbol ICEAIR. Icelandair's share price stood at ISK 9.58 at the end of 2018. Shareholders were paid a dividend amounting to 0.15 US cents per share.

Share capital

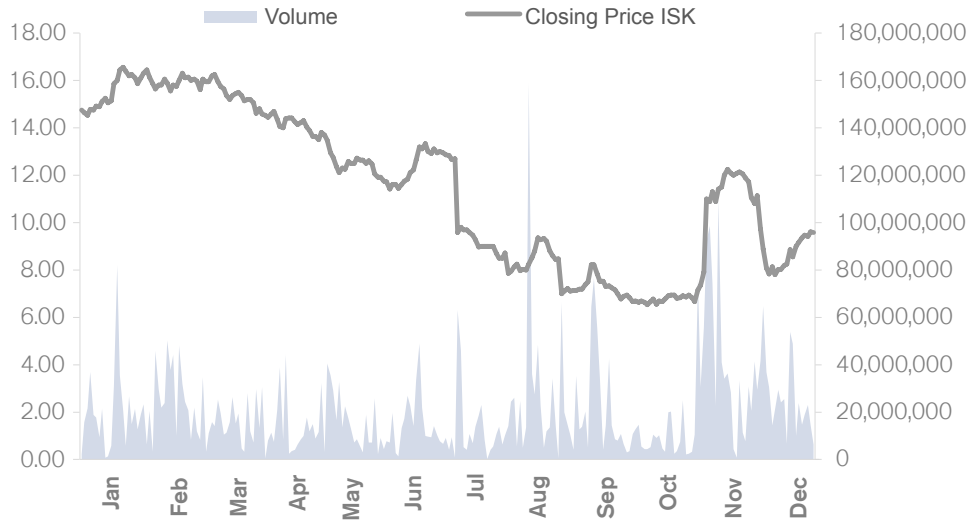
Icelandair Group's share capital as at 31 December 2018 amounted to ISK 5,000 million in nominal value. All shares are of the same class and hold equal rights; each share has a nominal value of ISK 1 and carries one vote. Shareholders are entitled to dividends as declared from time to time. The Company held own shares in the amount of ISK 187.3 million at year end 2018 (2017: ISK 139.5 million). During the year, the Company purchased 47.9 million shares for ISK 750 million, according to a share purchase programme authorised at the Company's Annual General Meeting. Icelandair Group is planning an equity issuance of up to ISK 625 million in nominal value in the first half of 2019, as announced to the Stock Exchange on 30 November and 19 December 2018.

Purchase of own shares

According to an authorisation granted at the Annual General Meeting of Icelandair Group hf. on 3 March 2017, the Board of Icelandair Group was authorised to execute a share repurchase programme where up to 10% of the Company's shares would be purchased within a period of 18 months. At the beginning of 2018, the Company owned 139,460,000 of its own shares, or 2.79% of the total share capital. A net total of 47,879,347 shares, corresponding to 0.96% of the total share capital, were bought in the first quarter of 2018, leaving a remainder of outstanding shares at 4,812,660,653 at year end 2018.

Share performance

Icelandair Group's shares stood at ISK 14.74 at the beginning of 2018. The shares reached a high of ISK 16.55 on 22 January 2018. Over the year Icelandair Group's share price decreased by 35.0%. Taking the dividend payment for the year into account, shareholders' return was negative by 34.0% in 2018.



Shareholder Information, continued:

Icelandair Group share price and trading volume in 2018:

All amounts in ISK	2018	2017	2016	2015	2014
Market capitalisation million	47,900	73,550	115,500	177,000	107,000
Share price at year end	9.58	14.71	23.10	35.40	21.40
Highest closing price	16.55	23.53	38.90	35.40	21.40
Lowest closing price	6.53	13.13	22.95	20.95	16.45
No. of issued shares million	5,000	5,000	5,000	5,000	5,000
No. of outstanding shares million	4,813	4,861	4,975	4,975	4,975
Weighted average no. of outstanding shares million	4,822	4,887	4,975	4,975	4,975

Share liquidity

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

Shares in Icelandair Group were traded 7,204 times in 2018 (2017: 5,589 times) for a total market value of ISK 57.2 billion (ISK 75.9 billion in 2017). The volume of trading in the shares averaged ISK 230.8 million per day, and the average number of shares traded was 20.3 million. Icelandair Group's market capitalisation at the end of 2018 was ISK 47.9 billion.

Key ratios

Icelandair Group reported net shareholder loss of USD 55.6 million in 2018, corresponding to –1.16 US cents per share. The Company's total equity at year end was USD 471.4 million.

	2018	2017	2016	2015	2014
Earnings per share in US Cent	–1.2	0.8	1.8	2.2	1.3
Intrinsic value of share capital	12.0	15.0	14.0	11.2	9.0
P/E ratio	–7.1	18.4	11.4	12.1	12.6
P/B ratio	0.8	3.1	1.6	2.4	2.4
Number of shareholders	3,016	2,394	2,560	2,387	2,099

Shareholder Information, continued:

Shareholders

At the end of 2018 the number of shareholders was 3,016, as compared to 2,394 at the beginning of the year. 0.4% of the total shareholder base held 63.8% of the shares in the Company.

Number of shares	Shareholders	%	Shares	%
1–100,000	2,101	69.6%	57,360,392	1.1%
100,001–1,000,000	742	24.6%	240,018,434	4.8%
1,000,001–10,000,000	129	4.3%	347,227,038	6.9%
10,000,001–100,000,000	34	1.1%	1,165,806,302	23.3%
100,000,001 +	11	0.4%	3,189,587,834	63.8%
Total	**3,017**	**100.0%**	**5,000,000,000**	**100.0%**

10 Largest shareholders 31 December 2018:

Name	No. Shares	Shares in %
The Pension Fund of Commerce	694,361	13.89
Stefnir - Icelandic Professional Investors Fund	592,212	11.84
The Pension Fund for State Employees, division A and B	488,613	9.77
Gildi Pension Fund	393,761	7.88
Birta Pension Fund	369,158	7.38
Stapi Pension Fund	211,350	4.23
Frjalsi Pension Fund	152,555	3.05
Kvika Bank - Nominee Account	100,238	2.00
Landsbréf - Úrvalsbréf - Icelandic Professional Investors Fund	96,311	1.93
Brú - Lífeyrissjóður starfsmanna sveitarfélaga	96,137	1.92
10 largest shareholders	3,194,696	63.89
Other shareholders	1,617,965	32.36
Treasury shares	187,339	3.75
Total	**5,000,000,000**	**100.00**

Dividend and dividend policy

Icelandair Group's goal is to pay 20–40% of each year's net profit in dividends. Final annual dividend payments will be based on the financial position of the Company, operating capital requirements and market conditions. Icelandair Group's Board of Directors proposes that no dividends will be paid out to shareholders for the year 2018.

Investor relations

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

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

Financial calendar

- Q1 2019 – week 18, 2019
- Q2 2019 – week 31, 2019
- Q3 2019 – week 44, 2019
- Q4 2019 – week 06, 2020
- AGM – week 11, 2020

Performance in 2018

The year 2018 was a difficult operational year, due to strong competition, low average airfares, and high input cost, mainly due to fuel and carbon price hikes and higher salary costs. Net loss amounted to USD 55.6 million, as compared to net profit of USD 37.5 million in 2017. Total operating income was USD 1.5 billion, up by 7% between years.

Transport figures

Passengers on international flights were 4.1 million in 2017, up by 2% from the preceding year. The Company has never transported as many passengers in a single year. The passenger load factor over the year was at 81.0% compared to 82.7% in 2017. The North Atlantic market was the Company's largest market, accounting for 51% of the total number of passengers in 2018. The greatest increase in passenger numbers was in the domestic market from Iceland, 16%.

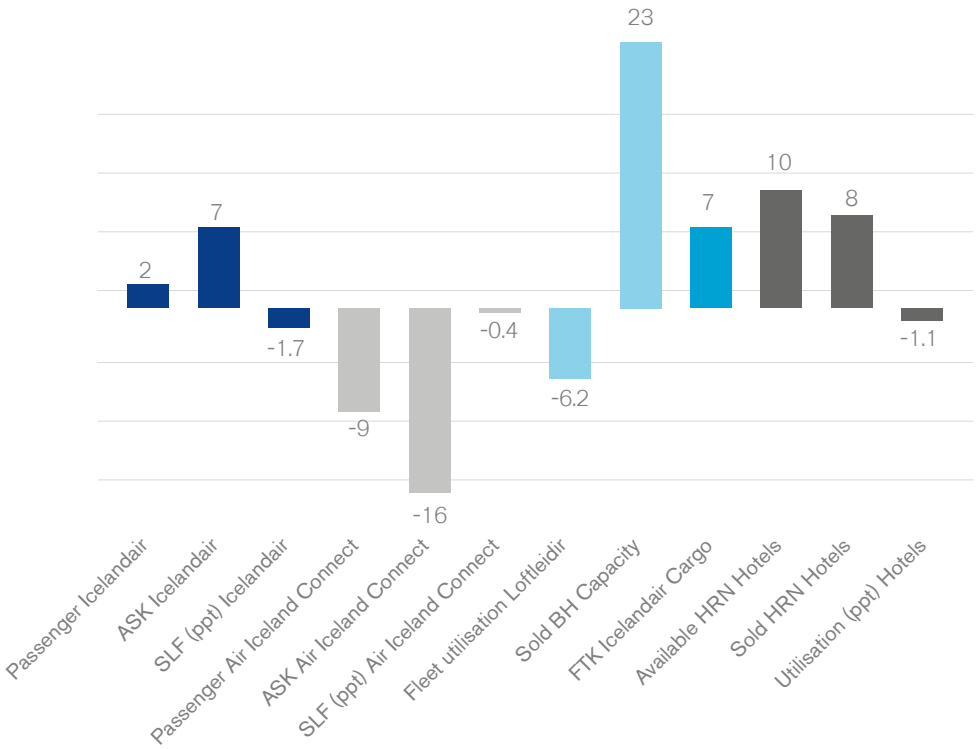
The total number of passengers on domestic and regional flights was 319 thousand, decreasing by 9%. The capacity measured in available seat kilometres (ASK) decreased by 16% between years. The main reason was that flights to Belfast, Aberdeen and between Keflavik and Akureyri stopped in mid-May. Sold block hours on charter flights increased by 23% between years, and transported cargo by 7% from the preceding year. The number of available hotel nights increased by 10%. Hotel room occupancy in the Company's hotels in 2018 was 80.1%, as compared to 81.2% in the record year of 2017.

INTERNATIONAL FLIGHTS		2018	2017	% Chg.
Number of passengers	Million	4,142	4,053	2%
Seat load factor (SLF)	%	81.0	82.7	-1.7 ppt
Available seat KM (ASK)	Million	16,240	15,245	7%
Revenue passenger kilometres (RPK)	Million	13,154	12,607	4%
Stage length (KM)		3,208	3,073	4%
REGIONAL AND GREENLAND FLIGHTS				
Number of passengers	Thousand	319	349	-9%
Load factor	%	65.4	65.9	-0.4 ppt
Available seat KM (ASK)	Million	181	215	-16%
CHARTER FLIGHTS				
Fleet utilisation	%	91.9	98.1	-6.2 ppt
Sold block hours	Number	33,670	27,460	23%
CARGO				
Freight tonne KM (FTK)	Thousand	125,758	117,055	7%
HOTELS				
Available hotel room nights	Number	407,994	371,289	10%
Sold hotel room nights	Number	326,686	301,302	8%
Occupancy of hotel rooms	%	80.1	81.2	-1.1 ppt

Performance in 2018, continued:

Traffic figures

Year-on-year change in %

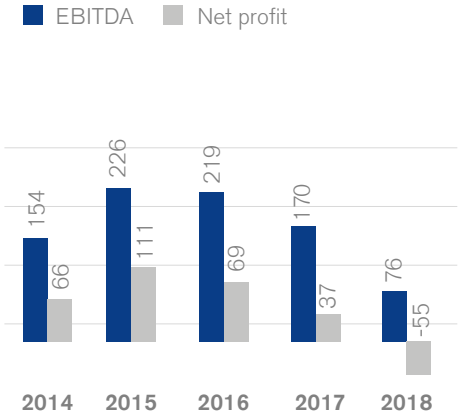


Earnings

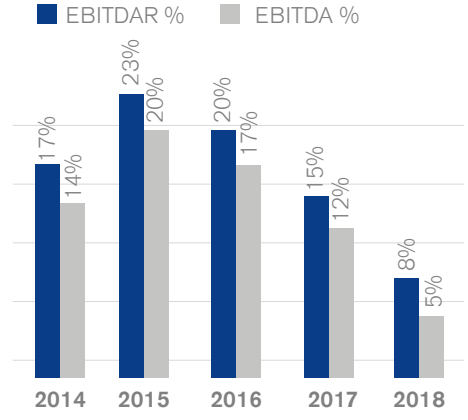
Difficult operating year

Net loss amounted to USD 55.6 million in 2018 compared to a profit of USD 37.5 million in 2017. EBITDA amounted to USD 76.5 million, down from USD 170.1 million in 2017. The results were affected by low airfares in the operating markets, higher input costs including high fuel and carbon prices, and high irregular operations costs during the high season. In addition, the structural changes that were made within the Company's sales and marketing department in the summer of 2017 were not implemented well enough. Furthermore, changes in the Company's route network that were made at the beginning of the year resulted in an imbalance between European and North American flights. Negative one-time-impact on EBITDA in relation to those latter factors is estimated at USD 50–80 million.

USD thousand	2018	2017	Chg.
EBITDAR	126,893	207,765	-80,872
EBITDA	76,479	170,076	-93,597
EBIT	-56,968	49,645	-106,613
EBT	-67,810	48,642	-116,452
Net loss / profit	-55,570	37,538	-248%
EBITDAR %	8.4%	14.7%	-6.3 ppt
EBITDA %	5.1%	12.0%	-6.9 ppt



EBITDA and Net profit/loss in USD million 2014–2018



EBITDAR % and EBITDA % 2014–2018

Performance in 2018, continued:

Income

Operating income amounted to USD 1,510.5 million in 2018, up by 7% from 2017.

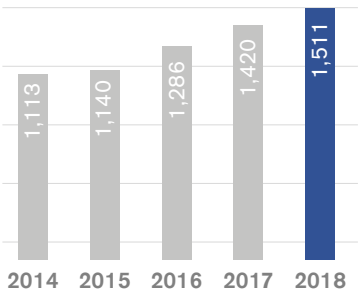
USD thousand	2018	2017	Change	% Change	% of rev. '18
Transport revenue:	1,093,314	1,050,101	43,213	4%	72%
Passengers	1,034,956	993,756	41,200	4%	69%
Cargo and mail	58,358	56,345	2,013	4%	4%
Aircraft and aircrew lease	120,113	87,701	32,412	37%	8%
Other operating revenue	297,091	280,185	16,906	6%	20%
Total	**1,510,518**	**1,417,987**	**92,531**	**7%**	**100%**

Transport revenue up by 4%

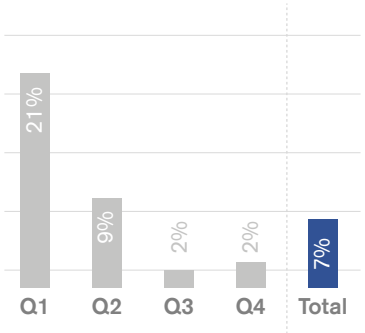
Transport revenue totalled USD 1,093.3 million, up by 4% between years. Of this figure, passenger revenues amounted to USD 947.5 million. Passenger revenues increased in all markets in the route network, with the greatest increase in the home market from Iceland. Passenger-related ancillary revenue increased significantly over the year as the Company focused on increasing this revenue. This revenue came to USD 87.5 million, as compared to USD 52.1 million last year.

Aircraft and aircrew lease increased by 37% between years

Revenue from aircraft and aircrew lease increased from USD 87.7 million in 2007 to USD 120.1 million in 2018 due to increased scope of the charter business. Other revenue totalled USD 297.1 million in 2018, up by USD 16.9 million from the preceding year. Of that figure, the increase in sale in airports and hotels amounted to USD 17.2 million, together with gain on sale of operating assets in the amount of USD 14.8 million, account for the largest share. Revenue from tourism decreased between years due to changes in demand.



Total income in USD million 2014–2018



Change in total income per quarter 2014 vs. 2018

Expenses

Operating expenses amounted to USD 1,434.0 million in 2018, as compared to USD 1,247.9 million in 2017, an increase of 15% between years.

USD thousand	2018	2017	Change	% Change	% of exp. '18
Salaries and other personnel expenses	515,872	445,162	70,710	16%	36%
Aircraft fuel	298,771	235,358	63,413	27%	21%
Aircraft lease	36,532	21,757	14,775	68%	3%
Aircraft maintenance expenses	80,923	76,140	4,783	6%	6%
Aircraft handling, landing and communication	136,443	122,757	13,686	11%	10%
Other operating expenses	365,498	346,737	18,761	5%	25%
Total	**1,434,039**	**1,247,911**	**186,128**	**15%**	**100%**

Salaries and personnel expenses increased by 16% between years

Salaries and other personnel expenses amounted to USD 515.9 million, increasing by USD 70.7 million, or 16%, from 2017. The reasons for the increase are the expanded scope of the Company's business, contractual wage increases, and the strengthening of the ISK against the USD over the comparison period, as most of the Company's wage costs are in ISK.

Carbon emission allowances increased substantially

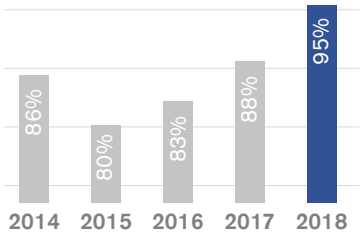
Fuel cost totalled USD 298.8 million in 2018, up by USD 63.4 million from 2017. Fuel cost as a percentage of total expenses was 21%, as compared to 19% in the preceding year. The average world market price of fuel increased by 30%, up to an average of USD 685/tonne in 2018. Icelandair Group's reporting price, taking fuel hedging into account, increased by 23%. The market price of carbon emission allowances increased substantially in the course of the year, from EUR 8.3 to 24.6 per carbon tonne.

Performance in 2018, continued:

Other operating expenses totalled 365.5 million
Other operating expenses increased by USD 18.8 million between years, or 5%. The main reason is the Company's expanded scope of business. Expenses related to customer services amounted to USD 65.8 million and increased by 17%, mainly due to irregular operations during high season. The aim in 2019 is to decrease this cost significantly. Tourist expenses totalled USD 84.1 million, decreasing by 8% between years due to reduced purchased services in tourism owing to changes in demand. This is reflected in the reduced income from tourism.

Depreciation and amortisation amounted to USD 133.4 million
Total depreciation of operating assets amounted to USD 129.8 million in 2018, as compared to USD 118.1 million in 2017. Amortisation of intangible assets totalled USD 3.7 million, up by USD 1.3 million from 2017. No impairments were made in 2018.

Interest expenses increases, and currency exchange gain decreases
Net finance expenses totalled USD 12.6 million in 2018, as compared to USD 1.6 million in 2017. The interest expenses amounted to USD 21.2 million in 2018, as compared to USD 15.7 million in 2017. Interest income totalled USD 2.9 million, down from USD 3.8 million in the preceding year. The currency exchange gain resulting from the position of financial assets and liabilities at the end of the year totalled USD 5.7 million, as compared to USD 10.3 million in 2017.



Total expenses as % of total income 2014–2018

Financial Position

Icelandair Group's financial position is strong. Assets at year-end amounted to USD 1,464.1 million, up by 3% from the beginning of the year. Capital expenditures totalled USD 331.4 million in 2018. Net interest-bearing liabilities amounted to USD 116.3 million, and the equity ratio at year end was 32%.

Balance sheet

Assets and liabilities pertaining to the hotel operation shown as assets held for sale

Icelandair Group's balance sheet totalled USD 1,464 million at year end 2018. Non-current assets decreased by USD 65.2 million, and current assets increased by USD 105,488 million. The main reason for the deviation is a shift from operating assets in non-current assets to assets held for sale in current assets as the Company decided to divest itself of its investments in tourism. The Icelandair Hotels divestment process began in November 2018 and is still ongoing. In the Consolidated Statement of Financial Position, the assets and liabilities pertaining to this segment are shown as assets held for sale.

Equity ratio 32% at year end 2018

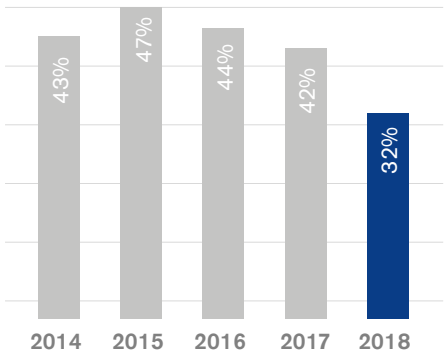
Equity amounted to USD 471.4 million as at 31 December 2018, down by USD 125.2 million from the beginning of the year. The largest part of the decrease is due to the negative comprehensive loss of USD 110.4 million. The net loss is thereof 55.6 million. The rest of the comprehensive loss are currency translation differences, cash flow hedges and net loss on hedge of investment net of tax. Dividend payments amounted to USD 7.3 million, which is equivalent to 0.15 US cents per share. Purchase of own shares in 2018 amounted to USD 7.5 million. The equity ratio was 32%, as compared to 42% in 2017. Share capital at year end amounted to ISK 5,000 million in nominal value. The Company held own shares in the nominal amount of ISK 187.3 million at year end 2018 (2017: ISK 139.5 million). During the year the Company purchased 47.9 million shares according to a share purchase programme authorised by the Company's Annual General Meeting.

USD thousands	2018	2017	2016	2015	2014
Result*	-110,427	43,477	138,650	109,419	37,967
Net loss / profit for the year	-55,570	37,538	89,068	111,223	66,499
Equity	471,379	596,545	568,213	456,531	365,055
Equity ratio	32%	42%	44%	47%	43%

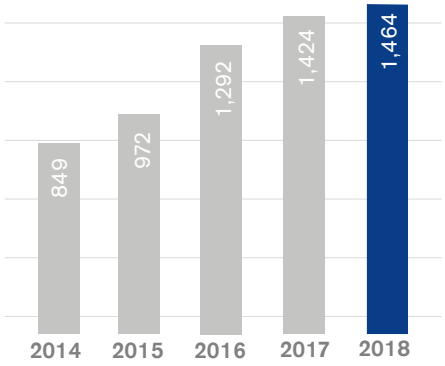
* Comprehensive income

Interest-bearing debt amounting to USD 415.8 million at 31 DECEMBER 2018

Non-current liabilities amounted to USD 194.9 million at year end 2018. Of that figure, secured bank loans amounted to USD 160.2 million, up by USD 97.9 million, and unsecured bonds totalled USD 212.7 million. The bondholders voted late December in favour of certain amendments to the terms and conditions of the bonds. The unsecured bonds are therefore shown among current loans and borrowings at year end. Current liabilities totalled USD 797.8 million at the end of December 2018 compared to USD 468.9 million at the beginning of the year 2018. Loans and borrowings amounted to 268.3 million of that figure, increasing by USD 259.0 million because of the unsecured bonds mentioned above. Derivatives used for hedging amounted to USD 39.7 million up from USD 1.4 million. Liabilities held for sale amounted to USD 52.2 million. Deferred income decreased by USD 11.2 million to USD 214.8 million, and trade and other payables decreased by USD 9.4 million to USD 222.8 million.



Equity ratio



Total assets in USD million

Financial Position, continued:

Interest-bearing liabilities amounted to USD 415.8 million, as compared to USD 289.5 million at the beginning of the year. Payments on long-term debts amounted to USD 18.8 million over the year. Cash and marketable securities amounted to USD 299.5 million at the end of the year. Icelandair's net interest-bearing debt amounted to 116.3 million USD at the end of 2018:

Calculation of net interest-bearing debt:

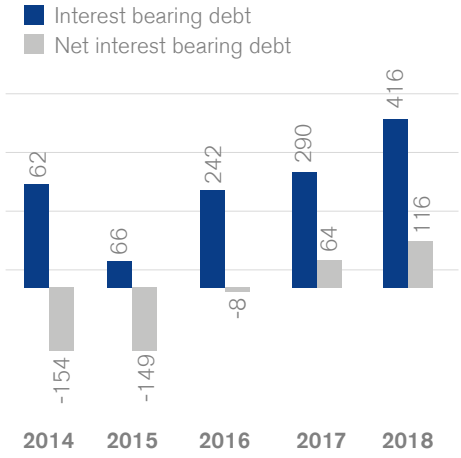
USD thousand	31.12.18	31.12.17	Change
Loans and borrowings non-current	147,513	280,254	-132,741
Loans and borrowings current	268,288	9,287	259,001
Short term investments	0	4,087	-4,087
Cash and cash equivalents	299,460	221,191	78,269
Net interest-bearing debt	**116,341**	**64,263**	**52,078**

CASH FLOW AND INVESTMENTS

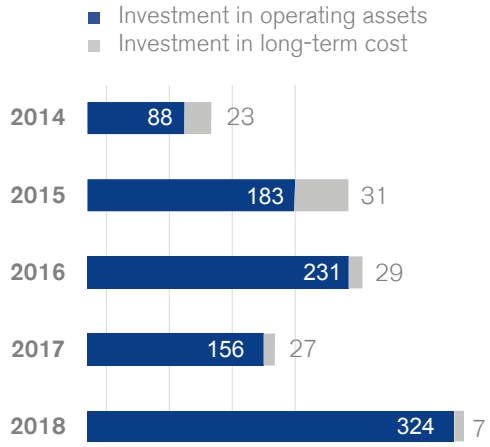
USD thousand	2018	2017	Change
Net cash from operating activities	61,553	205,603	-144,050
Net cash used in investing activities	-129,933	-228,419	98,486
Net cash from financing activities	149,336	14,554	134,782
Increase / decrease in cash and cash equivalents	80,956	-8,262	89,218
Cash and cash equivalents at 31 December	**299,460**	**221,191**	**78,269**

Cash provided by operating activities USD 61.6 million
Cash flow from operating activities decreased by USD 144.1 million and came to USD 61.6 million. Net cash used in investing activities amounted to USD 129.9 million. Net cash from financing activities amounted to USD 149.3 million in 2018. Cash and cash equivalents at year end amounted to USD 299.5 million, as compared to USD 221.2 million in 2017.

Total investments in 2018 USD 331.4 million
Investments in operating assets amounted to USD 324.1 million. Of this figure, investment in aircraft and aircraft components totalled USD 190.0 million, while investment in engine overhauls on own aircraft totalled USD 82.2 million over the year. Other investments amounted to USD 51.9 million, including investments in a flight simulator, an aircraft hangar at Keflavik Airport and the Company's hotel business. Investments in long-term expenses amounted to USD 4.6 million. Investment in intangible assets, mainly IT investments, amounted to USD 2.7 million.



Interest bearing and net interest bearing debt in USD million 2014-2018



Total investment in USD million 2014-2018

Financial Position, continued:

Fleet

At the end of 2018 Icelandair Group's fleet comprised 51 aircraft, of which 42 were owned by the Company and 9 were leased. Of the Company's own aircraft, 34 are free of liens in the balance sheet. The table below provides an overview of the Company's fleet:

Type	Icelandair	Cargo	Loftleidir	Air Iceland Connect	Group fleet 31.12.18	Group fleet 31.12.17	Of which own	Of which leased	Ch. as of 31.12.17
B757-200	24	2	5		31	29	27	4	2
B757-300	2				2	1	2		1
B737 MAX 8	3				3	0	2	1	3
B767-300	4		2		6	6	5	1	0
B737-700			1		1	1		1	0
B737-800			2		2	3		2	-1
Bombardier Q200				3	3	3	3		0
Bombardier Q400				3	3	3	3		0
Total	**33**	**2**	**10**	**6**	**51**	**46**	**42**	**9**	**5**

The Company made in 2012 an order for sixteen B737 MAX 8 and B737 MAX 9 aircraft, with an option to buy an additional eight aircraft. The commitment resulting from the confirmed orders, according to Boeing's list prices at the date of the contract, amounted to USD 1.6 billion. The Company received acceptable discounts which, due to confidentiality agreements, cannot be disclosed. The order was for nine B737 MAX 8 aircraft, with a seating capacity of 160 passengers, and seven B737 MAX 9 aircraft, with a seating capacity of 178 passengers in Icelandair's configuration.

The B737 MAX aircraft are a new and improved version of the current B737. They are fitted with new and more efficient engines, which will reduce fuel consumption by 27% per seat in comparison with the B757–200 aircraft currently used on the Company's international routes.

In 2018 a delivery was taken of three of the B737 MAX 8 aircraft. Two of the aircraft were financed by Jolco financing and one aircraft by sale and leaseback. In 2019 six additional 737 MAX will be added to the fleet (three B737 MAX 8 and three B737 MAX 9). All those aircraft have been financed with sale and leaseback agreements, as well as one additional aircraft that will be delivered in 2020. The financing for the remaining six aircraft out of the 16 that have been ordered has not been completed. Pre-delivery payments of eleven aircraft which will be delivered in 2019-2020 have been financed.

B757 and B767 aircraft will continue in use, as they have proven well suited for the routes extending from Iceland to Europe and North America. The B737 MAX aircraft will enlarge the fleet and improve both flexibility and the potential for further growth. Their range will permit them to fly to destinations in North America and Europe, opening new possibilities for increased flight frequency and an increased number of destinations, particularly in the wintertime, which will even out the seasonal fluctuations in the Company's operations.

For comparison, Icelandair's B757–200 aircraft used in the Company's international route network seats 183, the B757–300 aircraft seats 225 passengers and the B767–300 aircraft seats 262.

Risk Management

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

Various macroeconomic, sector-specific, financial, and enterprise-related risks can impact Icelandair Group's operations. The Board of Directors is responsible for defining policy measures to reduce exposure to financial and enterprise risk. These measures outline the parameters and framework that need to be considered when managing risk, especially risk arising from price volatility and liquidity fluctuations. An internal Risk Management Committee, chaired by the CEO, endeavours to reduce risk exposure to the maximum feasible extent within the Board's policy limits. The main policy objectives determine the methods to be used to reduce costs and disadvantages arising from any instability and uncertainty in the Company's operating environment. The policy is reviewed on a regular basis and modified when improvements are needed.

Foreign currency risk

The Group seeks to reduce its foreign exchange exposure arising from its business dealings in diverse currencies through a policy of matching receipts and payments in each individual currency to the extent possible. Any mismatch is dealt with using currency trades within the Group before turning to outside parties. Historically, the biggest currency mismatch has been a USD deficit, where the annual USD cash inflow falls short of the USD outflow, mainly due to investment, maintenance, fuel costs, and funding-related payments, which are to a large extent denominated in USD. This mismatch has since 2017 turned positive due to USD revenue growth and stronger USD inflows resulting from increased number of US destinations and US sales.

In recent years an ISK deficit has emerged and expanded from being trivial to becoming a significant and growing ISK shortfall since 2009. This trend stems from the revenue growth in foreign markets, whilst the consequential added costs of operations are mainly domestic and need to be covered by ISK. This shortage is financed by a surplus of European currencies, most importantly the EUR, Scandinavian currencies, and the CAD.

The Group follows a policy of hedging 50–80% of the net currency exposure 9–12 months forward. In addition to the impact on cash flow, risk exposure of this nature affects the Balance Sheet. The Risk Management Committee monitors on a monthly basis the net Balance Sheet currency mismatch and mitigates the exposure through short-term management of assets and loans to the extent feasible and within the scope of the cash flow objectives.

EUR/ISK exchange rate 2014–2018

Risk Management, continued:

Fuel price risk

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

Jet fuel price per tonne 2014–2018

Interest rate risk

The Group follows a policy of hedging 40–80% of the interest rate exposure of long-term financing with up to a five-year horizon. Currently, foreign loans are hedged against interest rate fluctuations using fixed-rate loan contracts or swap contracts, where the floating rate is exchanged for fixed interest rates. When evaluating the interest risk exposure and the optimal level of protection, account is taken of the Group's level of interest-bearing cash and marketable securities and various other offsetting economic factors.

Carbon price risk

Since the beginning of 2012, all airlines offering European destinations have been required to comply with the EU Emissions Trading Scheme (ETS), which commits them to raise their carbon permits in proportion to their emissions of carbon. In November 2012, the EU decided to offer airlines flying to and from European destinations an exemption from the Scheme with respect to international flights. Icelandair accepted this offer and its commitment was therefore reduced to covering internal European flights (i.e., "stop the clock"). Again, in April 2014, the EU extended this exemption and has therefore relieved airlines temporarily from the uncertainty of carbon exposures within this time frame. Carbon permit procurement is expected to be confined to European flights only until the end of 2020 at least. Emission permits are mainly purchased using spot and forward contracts, and carbon exposure is subject to the same scrutiny and risk management as jet fuel. Since 2012, the consequences of ETS compliance have been economically trivial in comparison with the magnitude of fuel cost volatility, and therefore the emission allowances have not been embedded into the fuel hedge strategies yet, but instead procured on a rolling 3–6 month basis

Risk Management, continued:

in proportion to fuel consumption. In 2018 carbon prices quadrupled and increased the cost of compliance materially. This turn of events will call for closer attention to this new and growing exposure by implementing systematic analysis and possible risk reducing actions into the Risk Management framework.

Liquidity risk

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

Credit risk

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

Industry-related risk factors

At Group and subsidiary levels, management monitors and assesses the airline industry's risk exposure, which has historically posed uncertainty, even in normal operating conditions. A part of the Company's culture stems from its long history, including a general recognition of the value of learning from past experience. Yet, in addition to the retrospective view, management systematically focuses attention on potential threats from a prospective viewpoint, as the environment is extremely cyclical. The Group operates and thrives in well-established and defined markets which, as such, can be regarded as valuable intangible assets that require attention. Icelandair's credibility and reputation are crucial for its market status and growth, but the markets are also sensitive to external factors, such as the macroeconomic elements governing aggregate demand. An economic downturn will usually reduce the general purchasing power of potential customers and thereby the demand for air travel. Airlines are prone to even greater vulnerability when it comes to other types of shocks that are more sudden and forceful. Abnormal weather conditions and volcanic eruptions in recent years have caused costly and unanticipated threats of disruptions. Terrorist incidents and pandemics are also examples of events that need to be

Six month USD libor 2014–2018

Risk Management, continued:

considered at all times. Factors that can be analysed and monitored with respect to reasonable risk of occurrence and impact call for close monitoring and readily available contingency plans. The ash cloud experience of Eyjafjallajokull glacier in 2010 and Grimsvotn in 2011, as well as the Holuhraun eruption in 2014, put the contingency planning and operational flexibility of Icelandair Group to the test. This experience benefits the Group now in light of the recent and future geological unrest in the glacier Bardarbunga and the volcanoes Katla and Hekla, which calls for constant monitoring and scenario analysis. The Company owes its adaptive potential and flexibility of operations chiefly to its capable human resources, contingency policies and economies of scale. The quality of the Company's responsive processes enables us to cope with other adverse circumstances and industry factors, such as seasonality, competition, insurance, and new taxes.

Operational risk

The Group distinguishes between industry-related risks and those which expose the subsidiaries at individual company level. Embedded in the Group's operations is a natural spread of business risk, not only in terms of market diversification, but also between the subsidiary business models themselves. This dispersion of interests has returned rewards during periods of economic turbulence. Methods of coping with threats of disruptions and disturbances are also decentralised when it comes to operational hazards. Again, the long and successful history of Icelandair Group and its companies is a valuable asset, which serves both as the foundation and the benchmark for many of the policies and contingency plans used across the Group. The Group's computer and communication systems are crucial for sales and market activities, but also for undisrupted internal operations. Equipment maintenance is needed to guarantee airworthiness. Third-party services may become bottlenecks in the production chain, whether in catering, ground, services or flight control. Human resources need to be managed, labour disputes resolved and work stoppages prevented. Wage negotiations are regular, and sometimes extensive, as a result of the number of different unions covering a large majority of the Company's workforce. Management constantly evaluates the risks involved and the potential consequences of individual events. Scenarios are projected, charted, and contemplated and action plans launched based on possible outcomes, where collaboration is maintained between the Group and its individual companies.

Enterprise risk management

Risk management needs access to a secure and steady flow of information about all enterprise-related risks at the Group level and thus requires centralised mapping and detailed registration of risk factors and their estimated inherent financial value and potential consequences. The Group's Risk Management Committee has focused on enterprise-related risk assessment in collaboration with Internal Audit and concentrated on aligning risk records across all subsidiaries to achieve consistency and compliance. The key objectives of enterprise risk management are to enhance motivation in risk analysis and improve risk awareness, standardise the quantification of risk, and establish the Company culture that is needed to promote everyday risk awareness and risk-reduction measures. Cash-flow stress testing is now performed with enterprise risk inputs by

Carbon price EUR/tonne 2014–2018

simulating events and scenarios induced by the factors defined in the risk registry. Although based on sensitive and qualitative assumptions, this practice has the merit of shedding light on the possible operational and financial consequences of external and internal disturbances. Annually, results are submitted to the Audit Committee for evaluation and support.

Outlook 2019

Icelandair Group is anticipating significantly better results in 2019 than in 2018. All cost items are under review by the Company, and a number of streamlining projects are underway, which should return improved results. Icelandair's flight schedule in 2019, as measured in available seat kilometres, is set to expand by 10% over last year's schedule and total number of passengers is projected at 4.7 million, up by 600 thousand between years.

Imbalance in the flight schedule between Europe and North America corrected

In the summer of 2019 it is estimated that 28 airlines will fly to and from Iceland to over 90 destinations in Europe and North America. The competition will also remain strong on the North Atlantic. Icelandair's flight schedule in 2019, as measured in available seat kilometres, is set to expand by 10% over last year's schedule. However, the total number of available seats will grow by 13% over the year, with the difference explained by the fact that available seats to and from Europe will be increased more than on routes to and from North America in order to correct the imbalance in availability that occurred in the summer of 2018. The increase in availability of seats to Europe will be 18%, but 3% to North America. Flights to Dallas and Baltimore will be discontinued. The total number of passengers is projected at 4.7 million, up by 0.6 million between years.

A new connection bank alongside the route network's current connection bank

As of May–September, flights will be available in a new connection bank alongside the route network's current connection bank. Flights will set off to Europe at around 11 am and to North America at around 8 pm. The new arrangement will result in an improved spread of arrivals and departures at Keflavik Airport, which will relieve pressure and improve the utilisation of the facilities that the Company has developed at the Airport. The arrangement will also enable the Company to grow in a sustainable manner in the coming years at Keflavik Airport.

Six new Boeing 737 MAX aircraft will be added to the fleet

Icelandair will have 36 aircraft in operation in 2019, three more than in 2018. Six new Boeing 737 MAX aircraft will be added to the fleet over the course of the year, while the number of B757–200 aircraft will be reduced by three. The number of Boeing 737 MAX aircraft will be up to nine in total, which will have a positive impact on fuel costs, as the fuel consumption of these aircraft is 27% lower than that of the Boeing 757 aircraft, and their carbon footprint is also smaller.

A difficult first quarter operations expected

Icelandair is anticipating difficult first quarter operations and somewhat worse financial results than in the first quarter of 2018. Average airfares have not increased between years, and the timing of Easter will have an impact on demand; in addition, training and other costs of introducing new aircraft will have a negative impact. Because of late changes in capacity, the utilisation of the Company's pilots will continue to be poor in the first quarter. The company will act to improve the utilisation in the winter of 2019–2020. With regard to high season in the third quarter, the trend is for passengers to book their flights closer to departure times than before, with the result that the uncertainty in the income projection is greater than before.

Outlook 2019, continued:

Aim to reduce irruption cost and increased focus on ancillary revenue
The cost to the Company of unpunctuality and disruptions in flight schedules amounted to approximately USD 45 million in 2018. The aim of the Company is to reduce this cost by at least about 40% in 2019 through improved punctuality, changes in the route network, and infrastructure reinforcements. The current trend in on time performance indicates that the Company is on a correct course toward its objective. The Company has also set itself the objective of substantially increasing its ancillary revenue to continue the fourth-quarter trend in 2018 between years into 2019. Investments have been made in training and staff increases to follow up on this trend.

New organisational structure
Changes have been made to Icelandair Group's organisational structure to further sharpen the focus on the Company's core business, flight operations. The changes will simplify the operations and increase efficiencies, for example in the finance division. This will make the Company better equipped to adapt to the constantly changing operating environment and take advantage of future opportunities. Increased emphasis on digitisation, development of the fleet and route network, as well as air freight and the leasing business, will also strengthen the competitive advantage.

Prospects in charter flight operations favourable
Loftleidir Icelandic's operations are showing success. An agreement has been reached on extending the charter of two aircraft that were scheduled for return in 2018, and the prospects for new assignments are favourable. Continued success is foreseen for the Company's VITA travel agency, which specialises in holiday trips for Icelanders abroad. The results of Air Iceland Connect were unacceptable in 2018 and the company's operations are now undergoing a thorough review.

Investments in tourism divested
In line with its sharper focus on aviation, the Board of Icelandair Group has decided to divest the Company of its investments in tourism. The Icelandair Hotels divestment process that started in November 2018 is still ongoing. About a dozen offers were received by the first deadline for offers, which was shortly before Christmas. Work is now continuing on the proposed divestment, and a decision on the matter is anticipated toward the close of the first quarter 2019. The Board of Directors has also decided to embark on a divestment process of Iceland Travel and thereby concentrate on aviation and related activities.

Financial position strong
The Company's balance sheet is strong, with the equity ratio at 32% and cash amounting to USD 300 million at year end. Financing of pre-delivery payments on 11 Boeing MAX aircraft that are scheduled for delivery to the Company in 2019 and 2020 has been finalised. The Company has also negotiated sale and leaseback arrangements for seven Boeing 737 MAX aircraft that will be delivered in 2019–2020. The Company's strategy of maintaining financial strength has always rested on the reasoning that the operating environment of air carriers is highly subject to fluctuations. Icelandair Group has shown that with its flexibility and financial strength it is well positioned to weather fluctuations in its operating environment.

GOVERNANCE

We build on expertise

We emphasise consistency and reliability, but warm and friendly service is really what we are all about. For 80 years we have developed experience and expertise in every area of flight and tourism operations. This is our primary source of strength. We seek to attract talented and qualified employees who can help us meet our future challenges and create a culture of equality, respect and team spirit.

Corporate Governance

The framework

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

The Company complies in all main respects to the rules mentioned above. The Company however does not yet have a Nomination Committee but the Board of Directors has proposed to the Annual General Meeting that such a committee will be established. No government organisation has found the Company to be in breach with any rule or regulation regarding corporate governance.

In 2012 The Iceland Chamber of Commerce, the Confederation for Icelandic Employers, and Nasdaq OMX Iceland hf. granted the Company a recognition for "Exemplary in corporate governance". The aim of 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 the 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 10 meetings in 2018.

Audit Committee:

Asthildur Margret Otharsdottir, Chairman
Gudmundur Hafsteinsson
Heidrun Jonsdottir

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, which was amended on 5 January 2011 and 18 November 2016. 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. The Compensation Committee meets on average four times a year.

Compensation Committee

Ulfar Steindorsson, Chairman
Omar Benediktsson

Corporate Governance

Board of Directors

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

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

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

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

The Board of Directors elects a Chairman and Deputy Chairman from its members, and otherwise allocates its obligations among its members as needed. The Chairman calls Board meetings. A meeting must also be held if requested by a member of the Board of Directors or the President and CEO. Meetings of the Board are valid if attended by a majority of its members. However, important decisions shall not be taken unless all members of the Board have had an opportunity to discuss the matter, if possible. The outcome of issues is decided by force of vote, and in the event of an equality of votes, the issue is regarded as rejected. The President and CEO attends meetings of the Board of Directors, even if he or she is not a member of the Board, and has the right to participate in discussions and submit proposals unless otherwise decided by the Board in individual cases. A book of minutes is kept of proceedings at meetings and must be signed by participants in the meeting. A Board member who disagrees with a decision made by the Board 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 or she 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, which were amended on 10 August 2012 and 9 February 2018. 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, for example, evaluation of the strengths and weaknesses of the Board's work and practices and takes into consideration the work components that 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 19 times during the year and all Board Members attended almost all meetings. All the members of the Board of Directors are independent from the Company, except Asthildur Margret Otharsdottir. All Board members were independent of the Company's major shareholders in 2018.

The Board of Directors

Ulfar Steindorsson

Chairman

Ulfar Steindorsson is CEO and Chairman of Toyota in Iceland ehf. and Ju ehf. He was CEO of Primex ehf. in Siglufjordur from 2002 to 2004 and CEO of the New Business Venture Fund from 1999 to 2002. Ulfar is Chairman of the Board of Eignarhaldsfelagid Bifreidar ehf., Bifreidainnflutningur ehf., Bilautleigan ehf., Okkar bilaleiga ehf., and TK bilar ehf. He is Board member of Toyota in Iceland ehf., Krokssslod ehf., TMH Iceland ehf., AB 257 ehf., UK fjarfestingar ehf., Johan Ronning hf., S. Gudjonsson ehf., Skorri ehf., and My Car ehf. Ulfar holds a Cand. Oecon. degree from the University of Iceland and an MBA from Virginia Commonwealth University. He joined the Board on 15 September 2010.

Omar Benediktsson

Deputy Chairman

Omar Benediktsson is CEO of Farice ehf. He is a Board Member of Landsnet hf. and Husafell Resort ehf. Omar has held various positions in the tourism and aviation industry in the past 30 years, for example at Island Tours, Islandsflug, Air Atlanta and SmartLynx airlines. Omar holds a Cand. Oecon. degree from the University of Iceland. He joined the Board on 3 March 2017.

Asthildur Margret Otharsdottir

Board Member

Asthildur Otharsdottir is an independent consultant and sits on a number of Boards. She is Chairman of the Board of Directors of Marel hf. and Frumtak Ventures. She is a member of the Council of the University of Iceland and the Court of Arbitration at the Icelandic Chamber of Commerce. She has prior business experience as Global Director of Corporate Development at Ossur hf. from 2006 to 2010, as a Senior Account Manager at Kaupthing Bank from 2004 to 2006, and Management Consultant at Accenture from 1996 to 2000. Asthildur holds an MBA degree from the Rotterdam School of Management, Erasmus University, and a Cand. Oecon. degree from the University of Iceland. She joined the Board on 23 March 2012.

Gudmundur Hafsteinsson

Board Member

Gudmundur Hafsteinsson leads product development for Google Assistant at Google. He joined Google in 2014 subsequent to the merger of Google and Emu, a chat-based virtual assistant start-up he founded in 2012. Prior to the founding of Emu, he was VP Product at Siri, and stayed on after the acquisition by Apple through the launch of Siri on iPhone 4S. Prior to Siri/Apple, Gudmundur was a Senior Product Manager at Google, where he managed the initial launches of Google Maps for mobiles and Google Voice Search. Gudmundur holds an MBA degree from MIT and a BSc. degree in Electrical and Computer Engineering from the University of Iceland. He joined the Board on 8 March 2018.

Heidrun Jonsdottir

Board Member

Heidrun Jonsdottir is an attorney. She is a member of the Board of Directors at Islandsbanki and the Vice Chairman of the Icelandic Bar Association. Heidrun is the former Chairman of the Board of Directors at Gildi Pension Fund, Nordlenska and Islensk Verdbref. She is a former member of the Board of Siminn hf. and Istak. Heidrun was the Public Relations Officer of Landssiminn hf. from 2001 to 2003, Managing Director and Partner at Lex Legal Services from 2003 to 2005. From 2006 until 2012 she was Vice President of legal affairs and public relations at Hf. Eimskipafelag Islands. Heidrun has a law degree from the University of Iceland, is a District Court Attorney and has finished an Advanced Management Program from IESE Business School in Barcelona. She joined the Board on 8 March 2018.

The Executive Management

Bogi Nils Bogason

President and CEO Icelandair Group

Bogi Nils Bogason was appointed President and CEO of Icelandair Group in December 2018 after having served as CFO since 2008 and interim President and CEO from August 2018. He was CFO of Askar Capital from January 2007 until he joined Icelandair Group and CFO of Icelandic Group from 2004 to 2006. Bogi Nils served as an auditor and partner at KPMG in Iceland during the years 1993–2004. Bogi Nils holds a Cand. Oecon. degree in Business from the University of Iceland and became licensed as a Chartered Accountant in 1998.

Birna Osk Einarsdottir

Chief Sales and Customer Experience Officer

Birna Osk Einarsdottir was appointed Chief Sales and Customer Experience Officer in February 2019 after having served as Chief Customer Experience Officer and Chief Business Development and Strategy Officer since she joined Icelandair Group in 2018. She served as Executive Vice-President of Marketing and Business Development for Landsvirkjun from 2017 to 2018. Prior to that, she was Executive Director at the IT company Siminn from 2011, most recently as Head of Sales and Services. Birna Osk joined Siminn in 2001 and worked in various other roles such as in public relations, HR, as the Head of the Company's Project Management Office and Marketing Manager. Birna has a BSc. degree in Business Administration from the University of Reykjavik and an MSc. degree in Management and Strategic Planning from the University of Iceland. She has also completed the Advanced Management Programme (AMP) at IESE Business School in Barcelona.

Jens Thordarson

Chief Operating Officer

Jens Thordarson was appointed Chief Operating Officer in January 2018 after having served as VP Technical Operations at Icelandair since October 2011. He has worked at the Company since 2006, first as an assistant to the Managing Director of ITS, a subsidiary of Icelandair. After that he was Director of Finance and Resources at Icelandair's Technical Division from 2007 to 2010 before he became Head of the Materials and Procurement department. Jens is an Industrial Engineer and holds an M.Sc. degree from the University of Iceland.

Gunnar Mar Sigurfinnsson

Managing Director Air Freight and Logistics

Gunnar Mar Sigurfinnsson has served as Managing Director of Air Freight and Logistics (Icelandair Cargo) since 2008. From mid-year 2018 to February 2019 he also served as Chief Commercial Officer at Icelandair Group alongside his role at Icelandair Cargo. He was SVP of Sales and Marketing at Icelandair from 2005 to 2008 and General Manager of Germany, Netherlands and the Central Europe regions from 2001 to 2005. Gunnar Mar was Director of Sales in Germany from 1997 to 2000. Prior to that, he worked at Flugleidir Domestic as Sales and Marketing Manager until 1997, after having worked at that Company in various roles since 1986. Gunnar Mar holds a BSc. degree in Business Administration from the University of Iceland.

Arni Hermannsson

Managing Director of Aircraft Leasing and Consulting

Arni Hermannsson was appointed Managing Director of Loftleidir Icelandic in January 2018 after having served as Chief Financial Officer of the Company since 2002. Prior to that he was Chief Financial Officer of the Icelandic technology companies ANZA and Alit. He holds a Cand. Oecon. degree in Business Administration from the University of Iceland.

The Executive Management

Eva Soley Gudbjornsdottir
Chief Financial Officer
Eva Soley Gudbjornsdottir was appointed Chief Financial Officer of Icelandair Group in February 2019. She worked as Managing Director of Finance and Operations at Advania in Iceland from 2015 and then as Managing Director of Service and Operations of the Company from May 2018. Prior to that she was Vice President in Corporate Finance at Ossur, focusing on Investor Relations and Strategic Projects. Eva Soley has also worked as an independent consultant and investor but started her career within the financial services industry and worked at Kaupthing bank for many years. Eva Soley holds a MSc. degree in Financial Engineering and a BSc. degree in Engineering Management Systems, with a minor in Economics from Columbia University in New York.

Elisabet Helgadottir
Chief Human Resources Officer
Elisabet Helgadottir was appointed Chief Human Resources Officer in January 2018. She worked in Human Resource Management at Islandsbanki starting in 2007 and as Head of Career Development for the last five years. Her tasks at Islandsbanki included supervision of all staff education and training, management training, executive coaching, and performance management. From 2000 to 2007 she worked for Capacent Gallup on research and consultancy. Elisabet holds a BA degree in Psychology at the University of Iceland and a Human Resource Management degree from the EADA Business School in Barcelona.

Tomas Ingason
Chief Information Officer
Tomas Ingason was appointed Chief Information Officer of a new division, Digital Development and Information Technology in February 2019. He was Chief Commercial Officer of WOW air in 2018 and Director of Rapid Digitisation at Arion Bank between 2016 and 2018. Tomas was Chief Business Development Officer of WOW air in 2014. Prior to that he was Management Consultant at Bain & Company in Copenhagen and served as Director of Revenue Management and Pricing at Icelandair for several years. Tomas holds an MBA degree from MIT Sloan School of Management in Boston, MSc. degree of Engineering in Logistics and Supply Chain Management and a BSc. degree in Industrial Engineering from the University of Iceland.

Ivar S. Kristinsson
Managing Director of Airco and Fleet Management
Ivar S. Kristinsson has served as Managing Director of Icelandair's Fleet since May 2018 after having been with the Company since 2010 as Director of Resource Management. Prior to that, he was Director in Operations at Promens from 2006 to 2008 and Project Manager at Icelandair from 2000 to 2005. Ivar holds an MSc. degree in Industrial Engineering from University of Iceland and an MBA in Corporate Finance from University of North Carolina, Chapel Hill.

Changes in the Executive Management in 2018

Bjorgolfur Johannsson, who had served as President and CEO of Icelandair Group since 2008, resigned from the Company in August 2018. Gudmundur Oskarsson was Chief Commercial Officer until July 2018. Magnea Thorey Hjalmarsdottir, Managing Director of Icelandair Hotels, was part of the Executive Management until February 2019. Jens Bjarnason was also part of the Executive Management, as Managing Director of Corporate Affairs until February 2019. He is now CEO of Cabo Verde Airlines, of which Loftleidir Cabo Verde, a subsidiary of Loftleidir Icelandic, is a majority shareholder.

RESPONSIBILITY

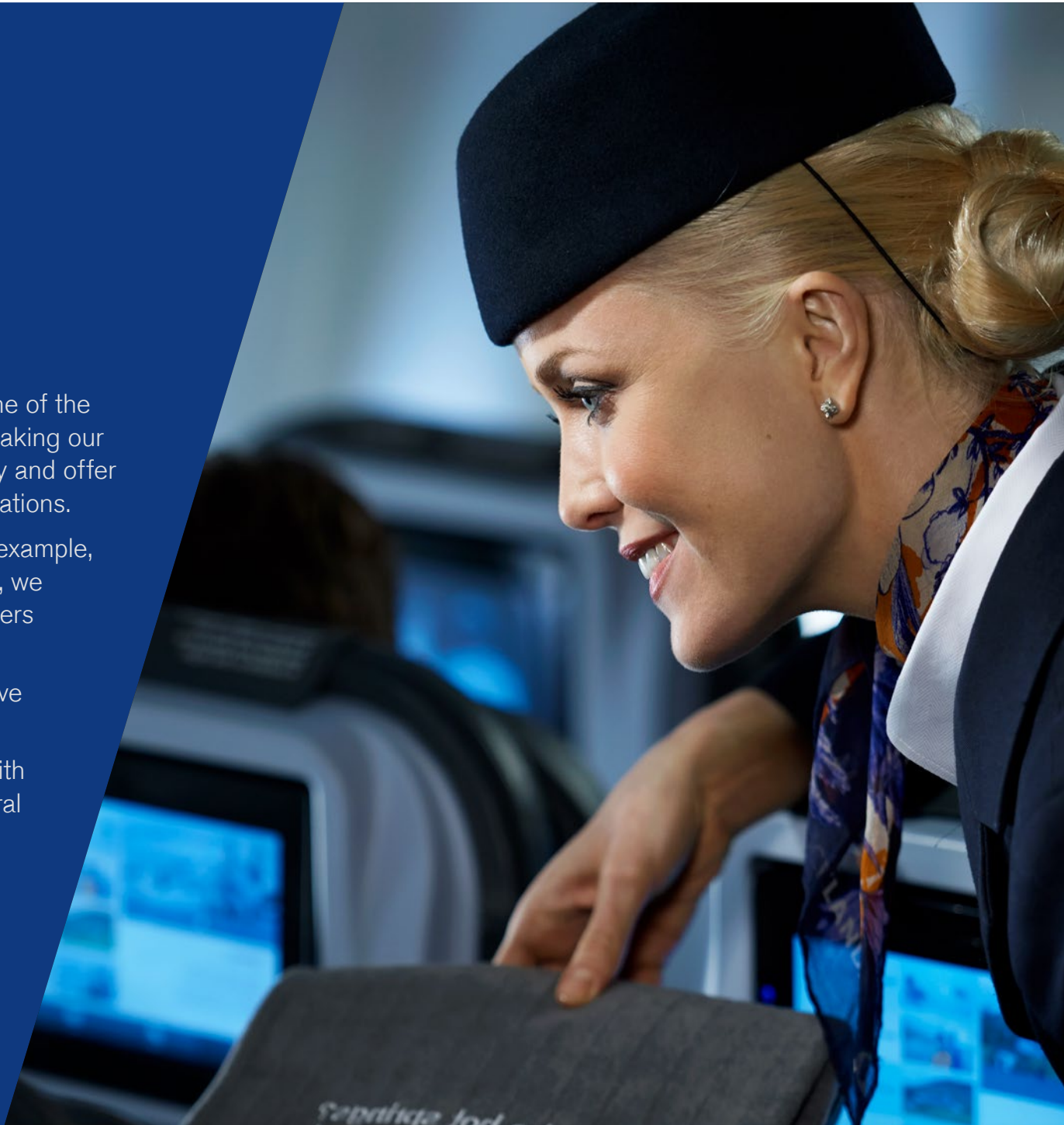
We care

For more than 80 years we have been a cornerstone of the Icelandic travel industry, economy and community, taking our social responsibility seriously. We celebrate diversity and offer equal opportunity and pay in every field of our operations.

Naturally, safety is a matter close to our heart. For example, in addition to standard on-board safety instructions, we make it our mission to inform international passengers about safety on their travels in Iceland.

We care about our planet and continue to take active steps towards minimising our carbon footprint.

Last but not least, contributing to the community with charity work and sponsorship of sporting and cultural events has always been important to us.



Corporate Social Responsibility

Environmental, Social and Governance Reporting

Icelandair Group recognises its responsibility to establish a sustainable business model, build a diverse workforce, and devise a strategy to reduce its long-term environmental impact. Icelandair Group makes every effort to contribute by creating value and meeting the needs of its customers, as well as having a positive impact on the Icelandic community. Icelandair Group's sustainability policy is directly linked to the Company's business strategy.

This is the first time Icelandair Group reports in accordance with the Environmental, Social and Governance Reporting Guide for the Nordic and Baltic Markets issued by Nasdaq. These guidelines are based on recommendations issued by the United Nations in 2015, the Sustainable Stock Exchange Initiative, and a working group at the World Federation of Exchange.

Business model

Icelandair Group operates in the international airline and tourism sectors with Iceland as the focal point of its international flight operations. Icelandair Group's core business is built on Icelandair's route network and on marketing Iceland as a year-round destination. In addition to its international flight operations, Icelandair Group has investments in the aviation industry and within the Icelandic tourism industry.

Sustainable value creation for the Company's shareholders and other stakeholders lies at the heart of Icelandair Group's business model. It consists of three operating pillars that support the Company's vision – the growth of Icelandic tourism, the growth of connecting VIA traffic, and a combination of flexibility and experience.

Stakeholder analysis

Icelandair Group focuses on creating sustainable value for its stakeholders by integrating a wide range of corporate social responsibility efforts into its business model. The four CSR focus areas that the Company has identified are:

Employees and Governance
Exemplary corporate governance and commitment to our employees with extensive programmes for human resource development.

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

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

Icelandair Group in the community

Icelandair Group is proud of its role in the Icelandic community and continues to seek new opportunities to expand its ties to society at large. A strong part of the Company's culture for years has been to support a wide variety of community activities. The main focus has been on supporting Icelandic sports, Icelandic arts and culture, the Icelandic tourist industry, and the Special Children Travel Fund.

The Icelandic Tourism Fund

Icelandair Group is a leading shareholder of the Icelandic Tourism Fund, an investment fund focused on new projects that increase the diversity of Icelandic tourism and strengthen its infrastructure. A key focus is on all-year-round projects that provide additional recreational options for tourists and make better use of the existing infrastructure, in particular over the winter season.

The Special Children Travel Fund

The main objective of Icelandair's Special Children Travel Fund, established in 2003, is to help children suffering from long-term illnesses or other difficult circumstances to travel with their families. The fund is supported both directly by Icelandair and through the generous donations of its customers. In 2018, 40 children and their families received travel grants from the fund to go on their "dream journey".

ICE-SAR – Icelandic Search and Rescue operation

Icelandair Group has since December 2014 been one of the main sponsors of ICE-SAR, the Icelandic Search and Rescue operation. The Company's objective is to provide support to enable the organisation to engage in efficient accident prevention and rescue efforts and to enhance the safety of tourists travelling in Iceland. The purpose of the co-operation is to represent an important factor in promoting safer tourism by various means.

In addition to these projects, Icelandair Group supports various cultural projects, such as the Reykjavik Arts Festival, Icelandic Music Experiments and Iceland Airwaves. Furthermore, Icelandair Group supports a variety of sports organisations, such as the National Olympic and Sports Association of Iceland, the Iceland Sports Association for the Disabled, in addition to the Icelandic associations of handball, football, basketball, and golf.

Environmental Accounting

Icelandair Group is an environmentally-conscious company aiming to set the standard high for safe and responsible aviation, and it is dedicated to minimising the environmental impact of its operations. The Company recognises the influence that air travel has on the environment by addressing its responsibilities to reduce emissions, conserve natural resources, as well as optimise the use of sustainable energy and recyclable materials.

The Company's Environmental Management System encompasses all activities within Icelandair Group and is certified in accordance with ISO 14001. In addition, Icelandair operations follow the IATA Environmental Assessment programme. Icelandair Group is one of few airlines to be certified in accordance to ISO 14001 throughout all its operations.

Sustainable business growth requires the Company to address its environmental impact, both globally and locally. As part of this effort, Icelandair Group participates in the work of various environmental groups, such as IATA, Airlines for Europe (A4E) and the Environmental Committee of the Icelandic Travel Industry Association. Icelandair Group participates in the incentive project of Responsible Tourism in Iceland along with over 300 companies, with the purpose of maintaining Iceland's status as an optimal future destination for tourists by supporting sustainability for future generations.

Direct and Indirect GHG Emissions (E1)

Icelandair Group has grown tremendously over the past years. The increase in the number of passengers and amount of cargo, the constant growth of the route network, as well as the expansion of the Company's fleet are all factors that affect and increase the total emissions from the Company. In addition, the Company's emissions also include ground facilities, offices, vehicles and maintenance areas.

Icelandair Group's objective is to reduce emissions, conserve natural resources and optimise the use of sustainable energy and recyclable materials.

Scope 1 emissions are direct emissions from owned or controlled sources which are mostly emissions from flights.

		2017	2018
Scope 1	tCO2e	1,037,164	1,065,536

Carbon Intensity (E2)

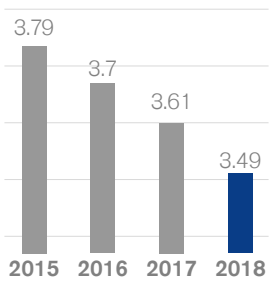
To counteract the increased emissions, Icelandair Group is constantly pursuing improvements within its operations, both on the ground and in the air. The Company's goal is to maximise the use of renewable energy in all aspects of its operations where it is possible to use alternatives, and actively observe progress in the development of alternative aviation fuels.

Despite the increase of total emissions that goes in line with the growth of the Company over the years, the fuel consumption per passenger and cargo transport has been decreasing.

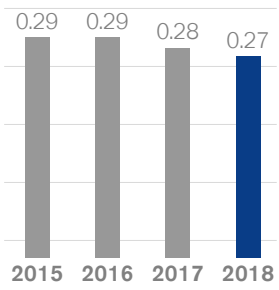
A steady decrease in fuel consumption is measured in passenger kilometres and operational tonne kilometres. In other words, Icelandair Group is reducing its fuel usage transporting passengers and cargo over a given distance.

In 2018, fuel burn per 100-revenue passenger kilometres (RPK) was reduced by 3.32% compared to 2017, and fuel burn per operational tonne kilometres (OTK) was reduced by 3.26%. These reductions are a result of various measures taken to improve aircraft fuel efficiency.

		2017	2018
Carbon intensity per unit of revenue	tCO2e/mUSD	730	705
Fuel burn per 100 revenue passenger kilometres	l/100RPK	3.61	3.49
Fuel burn per operational tonne kilometre	l/OTK	0.276	0.267



Fuel burn per 100 revenue passenger kilometres (RPK)



Fuel burn per operational tonne kilometre

Environmental Accounting, continued:

Direct and Indirect Energy Consumption (E3), Energy Intensity (E4), Primary Energy Source (E5), and Renewable Energy Intensity (E6)

Most of Icelandair Group's energy consumption is from the use of fossil aviation fuel, which has been gradually increasing in line with the expansion of the Company's airline operations.

On the other hand, all other energy consumption is from renewable energy sources. That is, all the water, both hot and cold, used in domestic operations, offices and hotels, is from renewable energy sources. Also, all the electricity used at Icelandair Group comes from a renewable source and is 100% hydroelectric.

		2017	2018
Total energy consumption	kWh	4,817,220,040	5,064,962,249
Of which energy from fossil fuel	kWh	4,802,223,116	5,005,477,277
Of which energy from electricity	kWh	14,996,923	15,200,464
Of which energy from hot water	kWh	NA	44,284,508
Energy Intensity per FTEe	kWh/FTEe	1.130.007	1,099,644
Share of renewable energy	%	NA	1.17%
Primary Energy Source		Fossil fuel	Fossil fuel

Water Management (E7)

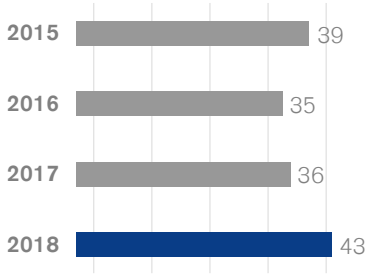
All domestic water usage and consumption is from renewable energy sources.

Waste Management (E8)

Icelandair Group's goal is to minimise waste and increase recycling in all operations where restrictions by laws and regulations do not restrict waste separation. The geographical location of operations and the legal environment must be considered as in some cases these factors may restrict waste separation.

Icelandair Group has initiated various projects to improve waste recycling within the Company with good success.

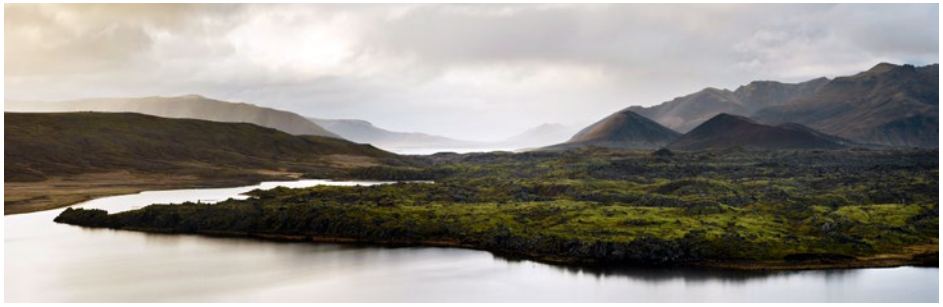
		2017	2018
Total amount of waste generated annually	kg	2,130,463	1,535,410
Of which sorted waste	%	36%	43%



Percentage of recycled waste

Environmental Accounting, continued:

Environmental Policy (E9)



Icelandair Group Environmental Policy

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

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

Icelandair Group is committed to minimising its impact on the environment by continuously improving the Company's environmental performance, by using sustainable materials and disposing of them in a responsible way, by conducting business with environmentally friendly suppliers and by adhering to environmental protection principles.

We recognise that even though our subsidiaries operations can differ, we share important principles.

In addition to compliance with applicable laws and regulations, we show our continuing commitment by

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

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

	2017	2018
Does the company have Environmental Management System	Yes	Yes
Is environmental policy in place	Yes	Yes

Environmental Impact (E10)

To achieve the objectives of Icelandair Group's Environmental Policy, an Environmental Management System has been implemented in all companies and subsidiaries of Icelandair Group.

Icelandair Group's Environmental Policy describes the Company's approaches to protecting and preserving the environment. All the Company's employees are responsible for complying with the policy. The management teams at all the Company's subsidiaries and entities have adopted guidelines and procedures to comply with the Policy.

As an integrated part of the Environmental Management System, risk assessments have been carried out on a regular basis and appropriate actions have been initiated.

As a part of being an environmentally certified company, a procedure is in place for a biannual review and monitoring of all domestic applicable laws and regulations in relation to possible environmental impacts of the Company's activities.

No incident has occurred in which the Company's environmental liability or responsibility has been in question.

Social Accounting

Social Accounting

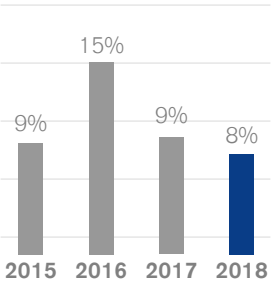
Engaged and skilled employees are the foundation of Icelandair Group's quality service, satisfied customers, positive image, and good financial performance. Their flexibility and dedication have been instrumental in a constantly evolving business environment.

Icelandair Group seeks to attract talented and qualified employees who can help the Company meet future challenges while at the same time fitting into the existing corporate culture. Equality, respect and team spirit are the pillars of the corporate culture at Icelandair Group.

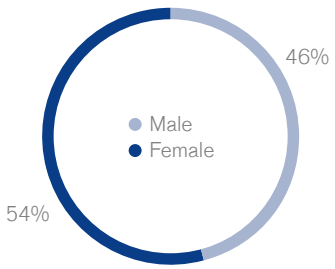
Icelandair Group has grown at a very robust pace in recent years, resulting in a 10.4% growth in the number of employees on average on a yearly basis. The gender ratio in 2018 within Icelandair Group was close to equal.

		2017	2018
Icelandair	FTEs	2,143	3,260
IGS	FTEs	779	
Icelandair Cargo	FTEs	56	80
Icelandair Shared Services (Fjarvakur)	FTEs	127	137
Air Iceland Connect	FTEs	232	233
Loftleidir Icelandic	FTEs	10	11
VITA	FTEs	25	30
Icelandair Hotels	FTEs	677	673
Iceland Travel	FTEs	197	168
Icelandair Group	FTEs	17	14
Total	FTEs	4,263	4,606

* IGS is included in Icelandair in 2018



Average growth of 10.4%



Gender ratio

CEO remuneration (S1)

The salary and benefits for the Company's President and CEO are decided by the Board of Director's 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 to serve the long-term interests of shareholders.

	2017	2018
CEO remuneration as share of average salary	7.21%	6.85%

Gender Pay Ratio (S2)

The Icelandic government passed a bill of law (amendments to the Gender Equality Act No. 10/2008) on 1 June 2017, requiring that women and men working for the same employer shall be paid equal wages and enjoy equal terms of employment for the same jobs or jobs of equal value. The amendment requires companies and institutions employing 25 or more workers, on annual basis, to obtain equal pay certification of their equal pay system and the implementation thereof. In accordance to the legislation, certification shall meet the requirements of the Standard ÍST 85, The Equal Pay Standard.

In 2018 Icelandair, Icelandair Cargo and Icelandair Hotels have all achieved a certification according to the ÍST 85 standard from a third-party auditor. Other companies will achieve the certification in 2019.

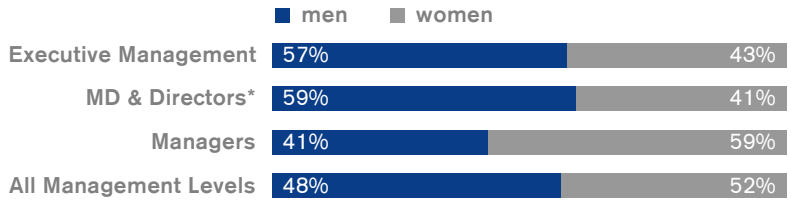
		2018
Gender pay ratio	* Basic earnings	1.22% in favour of men
Gender pay ratio	* Regular earnings	2.2% in favour of men

* Icelandair, Icelandair Cargo, Icelandair Hotels

Social Accounting, continued:

Gender Diversity (S4)

Icelandair Group's HR strategy emphasises equality, non-discrimination and embraces diversity.



* Managing Directors which are not a part of the Executive Management

Non-Discrimination Policy (S6)

Icelandair Group makes sure that its employees are given equal opportunities to further their careers. Equal rights are a part of the Equal Rights Policy and the Equal Rights Plan that have been approved by the Executive Management.

Injury Rate (S7), Global Health and Safety Policy (S8)

Icelandair Group provides its employees access to professional development and training. Icelandair Group upholds safety and security standards and has detailed action plans in place designed to achieve the Company's goals. Mandatory training is carried out for all employees working in a risk environment and occupational health and safety policy is a natural part of new employee training.

Icelandair Group makes every effort to improve the wellbeing of its employees, maintaining an attractive, yet challenging and demanding workplace, and enabling them to flourish and achieve their highest potential. A comprehensive Health and Attendance Policy has been put forward and, alongside its introduction, various health lectures and other initiatives have been offered to place a further emphasis on employee's health and wellbeing.

		2018
Health Indicator	Average no. of sick days per FTE	9.2

Icelandair Group aids its employees with grants of various types, such as sports grant and a transportation grant. This is in accordance with the Health and Attendance Policy to encourage employees to exercise and to make use of environmentally friendly and healthy transportation methods to and from work.

In addition, the Company offers employees regular health assessments, flu shots, and aid with regards to their working environment.

Human Rights Policy (S10)

Icelandair Group respects human rights, as set out in the UN Universal Declaration of Human Rights and requires all its employees to treat others with trust, dignity, respect, fairness and equity. All cabin crew have been trained in relation to human trafficking awareness and preventive actions.

Importance is placed on ensuring that employees respect the equal rights policy and conduct themselves within its spirit. All discrimination, such as on the basis of gender, age, origin, religion, operating field, opinions or position in other respects, is not permitted.

Human Rights Violations (S11)

Early 2018, Icelandair Group sharpened its policy and actions against bullying, and sexual- and gender-related harassment and violence. The policy and its related actions include clear procedures and preventive measures. Information on the policy can be accessed on the Company's intranet, together with a plan of action that details the options available to employees who feel victimised. All managers received appropriate training and open lectures were held for all employees to attend.

Board – Diversity (S12)

Following an amendment to the laws on public limited companies (No. 2/1995) and private limited companies (No. 138/1994), companies that have over 50 employees are obligated to have both women and men on their company Boards and if the Board members are more than three, the percentage of women or men cannot be under 40%.

	2017	2018
Total number of members	5	5
Of which women	40%	40%
Of which men	60%	60%
Of which independent Board members	80%	80%

Governance Accounting

Board – Separation of Powers (G1)

The President and CEO of Icelandair Group does not sit on the Company's Board of Directors and does not lead Board Committees. However, the President and CEO shall attend Board meetings, unless otherwise decided by the Board in certain instances. According to Article 70 (1) of the Icelandic Act on Public Limited Companies, a company's CEO cannot act as its Chairman of the Board.

	2017	2018
Is the CEO the Chairman of the Board	No	No
Does the CEO lead Committees	No	No
Does the CEO sit on the Board	No	No

Board – Transparent Practices (G2)

The Board's practices, actions and outcomes on certain matters are not made public unless such publication is required under the Act on Securities Transactions or Nasdaq's rules for issuers of financial securities. The Board practices are according to the Chamber of Commerce Guidelines on Corporate Governance.

Fair Labour Practices (G4)

The majority of the employees at Icelandair Group are members of a union. The Company makes employment contracts with all employees which references all rights and obligations in accordance with the collective wage agreement with Trade Unions and the Confederation of Icelandic Enterprises. Icelandair Group also follows the Icelandic Labour Law.

	2018
Percentage of employees in unions	98%

Supplier Code of Conduct (G5)

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

The Company respects fair labour practices. Contractors, sub-contractors or work agencies working for Icelandair Group shall ensure that wages, wage-related obligations and safety in the workplace all comply with applicable laws as well as Icelandair Group's standards.

Ethics – Code of Conduct (G6)

On 25 May 2009, the Board of Directors approved a Code of Ethics, which was amended on 5 January 2011 and 18 November 2016. The Code of Ethics is accessible to all Icelandair Group's employees through the Company's intranet, MyWork.

Anti-Bribery / Anti-Corruption (G7)

Icelandair Group conducts all its business in an honest and ethical manner and the integrity of each and every member of staff serves to maintain the good reputation and trust of the Company. All persons, representing or performing services for or on behalf of Icelandair Group must comply with applicable anti-bribery and anti-corruption legislation and policies, and Icelandair Group's Code of Conduct.

Tax Transparency (G8)

Icelandair Group prepares and publishes country by country tax reports. The Company calculates its tax contribution on a regular basis.

Sustainability Report (G9)

This is the first sustainability report of Icelandair Group made with reference to Nasdaq's ESG Reporting Guide for Nordic & Baltic Markets, issued in March 2017. These guidelines are based on guidance from the United Nations´ Sustainable Stock Exchange Initiative and The World Federation of Exchange. The report should include all information to fulfil the Icelandic law (3/2006, 66. gr. d.) on non-financial reporting, as amended with reference to EU directive 2013/34 in year 2016.

ACCOUNTS

We welcome you aboard

A pioneer and a leading force in our nation's aviation history, we are proud to be an Icelandic airline. We have strong roots in our culture and magnificent nature, and allow them to inspire us in every aspect of our operations and brand design. As an example, we have dedicated our aircraft to various aspects of Iceland's natural phenomena, including volcanoes, glaciers and the northern lights.

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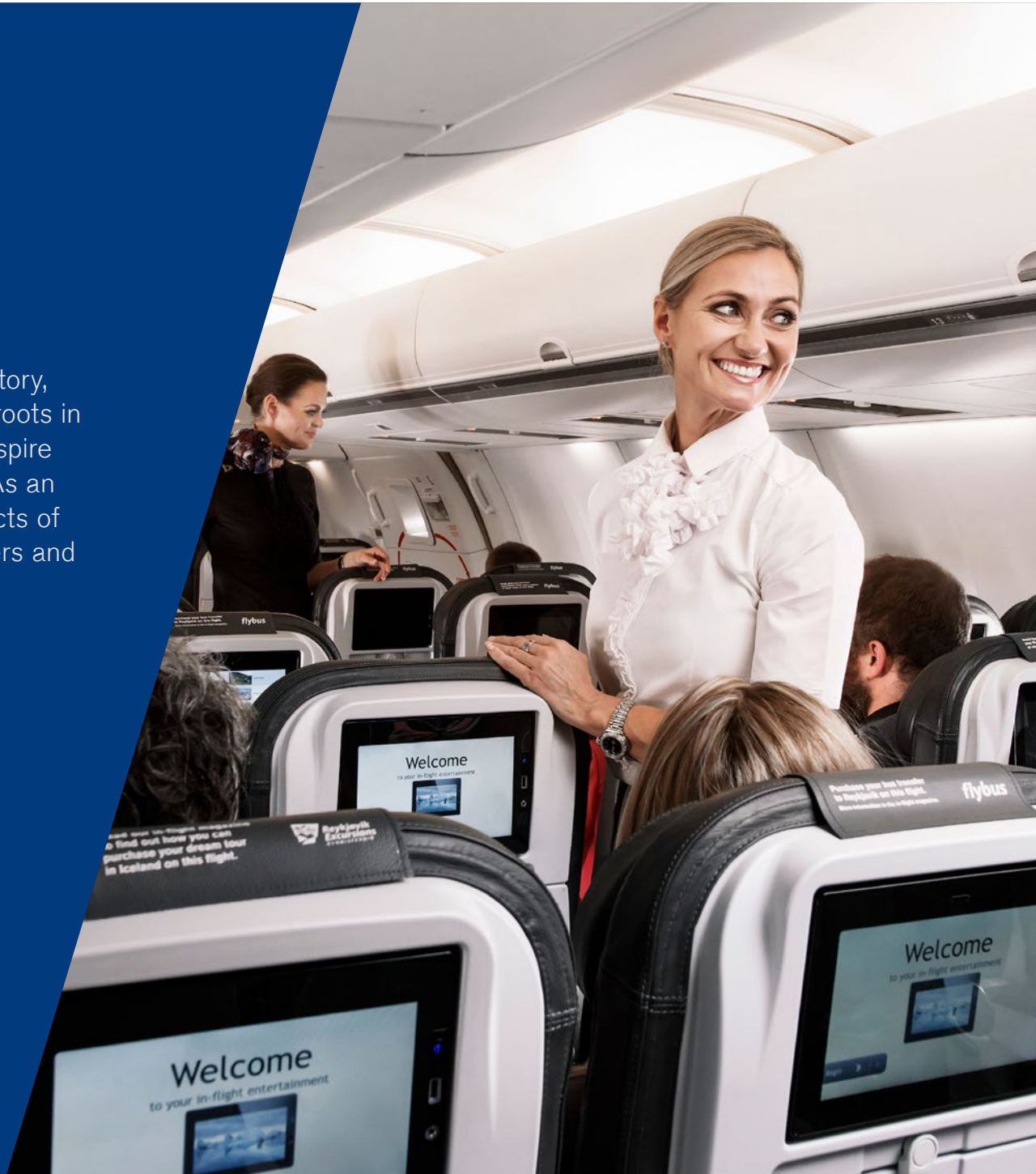


Endorsement and Statement by the Board of Directors and the CEO

Operations in the year 2018

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

Loss for the year 2018 amounted to USD 55.6 million and total comprehensive loss amounted to USD 110.4 million, according to the consolidated statement of comprehensive income. Total equity at year end 2018 amounted to USD 471.4 million, including share capital of USD 39.1 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.

During the year, management committed to selling its hotel operation following a strategic decision to place greater focus on the Group's key competencies, i.e., the airline industry.

The Board of Directors proposes no dividend payment to shareholders in 2019 for the year 2018.

At the Icelandair Group shareholders' meeting on 30 November 2018, a proposal was passed to grant the Company's Board of Directors authorisation to increase share capital by up to ISK 625 million in nominal value. The Board of Directors has decided to organise a single offering of shares in nominal value of up to ISK 625 million. The offering will solely be for holders of pre-emptive rights to shares in the Company and is estimated to take place before the end of April 2019. Prior to the offering, a full prospectus will be published. The Board of Directors will determine the size, share price, conditions of payment, and other terms of the offering.

The objective of the share capital increase is to further solidify Icelandair Group's financial position, preparing the Company for further growth and making it capable of seizing opportunities that may present themselves in the current operational climate where Icelandair Group will be supplied with six new Boeing MAX aircraft in 2019.

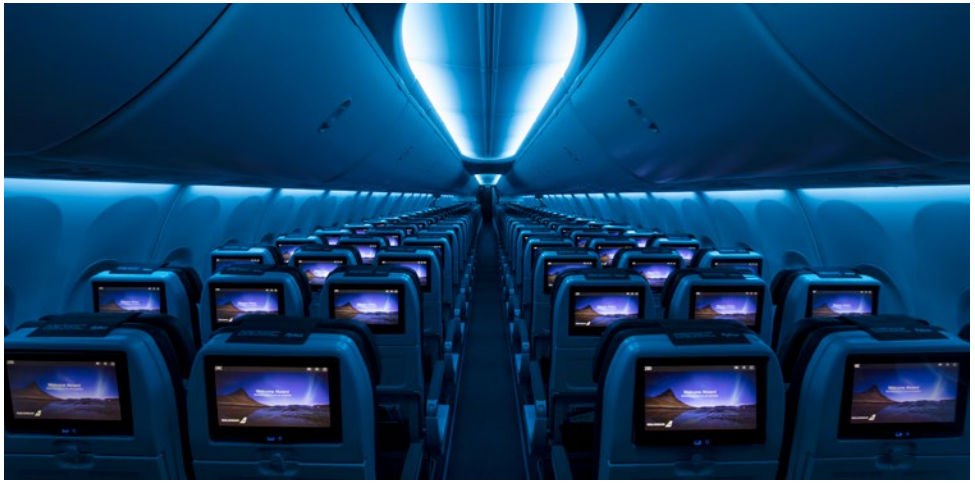
Endorsement and Statement by the Board of Directors and the CEO, continued:

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 187.3 million. The share capital is divided into shares of ISK 1 each with equal rights within a single class of shares listed on the Icelandic Stock Exchange (Nasdaq OMX Iceland). Companies can acquire and hold up to 10% of the nominal value of treasury shares according to the Icelandic Companies Act. During the year the Company purchased 47.9 million shares for USD 7.5 million according to a share purchase programme authorised at the Company's Annual General Meeting.

The Company's Board of Directors comprises five members: two women and three men. The gender ratio is thus in accordance with Laws requiring companies with over 50 employees to ensure that the Board has representation from both genders and each gender is at least 40% when there are more than three Board members. The Board members are 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 seven 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.

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



The number of shareholders at year end 2018 was 3,016, an increase of 623 during the year. At year end 2018 the 10 largest shareholders were:

Name	Shares in ISK thousand	Shares in %
Lífeyrissjóður verslunarmanna	694,361	13.89
Stefnir Sjóðir	592,212	11.84
Samstæður teljast einn aðili 3. mgr. 65.gr.		
Lífeyrissjóður starfsmanna ríkisins A deild og B deild	488,613	9.77
Gildi – lífeyrissjóður	393,761	7.88
Birta lífeyrissjóður	369,158	7.38
Stapi lífeyrissjóður	211,350	4.23
Frjálsi lífeyrissjóðurinn	152,555	3.05
Kvika Banki – Safnreikningur	100,238	2.00
Landsbréf – Úrvalsbréf	96,311	1.93
Brú – Lífeyrissjóður starfsmanna sveitarfélaga	96,137	1.92
	3,194,696	63.89
Other shareholders	1,617,965	32.36
Treasury shares	187,339	3.75
	5,000,000	**100.00**

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

Corporate Governance

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

The framework for Corporate 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.

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

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

Non-Financial Reporting

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

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

Statement by the Board of Directors and the CEO

The consolidated financial statements for the year ending 31 December 2018 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and additional Icelandic disclosure requirements for financial statements of listed companies.

According to our best knowledge it is our opinion that the annual consolidated financial statements give a true and fair view of the consolidated financial performance of the Group for the year 2018, its assets, liabilities and consolidated financial position as at 31 December 2018 and its consolidated cash flows for the year 2018.

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 2018 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the consolidated financial statements be approved at the annual general meeting of Icelandair Group hf.

Reykjavik, 7 February 2019.

Board of Directors
Úlfar Steindórsson, Chairman of the Board
Ásthildur Margrét Otharsdóttir
Guðmundur Hafsteinsson
Heiðrún Jónsdóttir
Ómar Benediktsson

CEO
Bogi Nils Bogason

Independent Auditors' Report

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

Report on the audit of the Consolidated Financial Statements

Opinion
We have audited the consolidated financial statements of Icelandair Group hf. "the Group", which comprise the consolidated statement of financial position as at 31 December 2018, the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2018 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and additional disclosure requirements for listed companies in Iceland.

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), together with the ethical requirements that are relevant to our audit of consolidated financial statements in Iceland, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters
Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit responded to the key audit matter
Timing and accuracy of revenue recognition of passenger income *Reference is made to note 8 "Operating income" and 32 "Deferred income".* Passenger ticket sale is presented as deferred income in the consolidated statement of financial position until transportation has been provided, and at that time the sale is recognised as revenue. A large volume of transactions flows through various computer systems from the date of sale until revenue is recognised in the consolidated statement of profit or loss. The recording process is complex, which gives rise to an inherent risk of error in determining the amount and timing of the revenue recognition. Timing and accuracy in the registration of passenger income is therefore one of the key audit matters of our audit of the consolidated financial statements.	Our audit procedures were designed to challenge the accuracy of the revenue recognition. These procedures include testing of controls over the Group's systems which govern the passenger ticket sale. We used the service of our IT specialists to test selected appropriate controls such as access control, change management control, and automated controls of the revenue systems. We also tested non-automated controls. The purpose of the testing was to assess if the design of the controls was likely to ensure the accuracy and timing of the revenue recognition of passenger income and to test operating effectiveness of selected controls. We analysed passenger revenue and used external and internal information to set expectations which were compared to recognised revenue. We used substantive testing, including a reconciliation between systems and testing of selected journal entries posted to revenue accounts, and we tested the inclusion of revenue transactions in the appropriate period by testing selected flights before and after the reporting date.

Independent Auditors' Report, continued:

Key audit matter	How our audit responded to the key audit matter
Expected recoverable amount of intangible assets and goodwill *Reference is made to note 17 "Intangible assets and goodwill" and 43o "Impairment".* The carrying value of goodwill amounted to USD 140.4 million and other intangible assets of USD 37.2 million at year end 2018 as specified in note 17. The carrying value of intangible assets has been allocated to the applicable cash-generating units within the Group. Management is required to perform an impairment test annually on goodwill and other intangible assets with indefinite useful lives. The purpose of an impairment test is to determine if goodwill and other intangible assets can be recovered through future cash flows. The recoverable amounts of individual cash-generating units are determined by discounting the expected future cash flows generated from the continuing use of the units. The expected recoverable amount of intangible assets is one of the key audit matters due to the significance to the Group's consolidated statement of financial position, and due to inherent uncertainty involved in forecasting and discounting future cash flows which are the basis of the assessment of the recoverability of the intangible assets.	We used the service of our valuation specialists to assess the valuation models and assumptions used by management in their calculations of expected recoverable amount of each cash-generating unit. We assessed management assumptions by comparing them to both internal and external industry information. **Our procedures included among others:** ▪ Management forecasts for each cash-generating unit for the explicit period were compared to forecasts presented to the Board, historic revenue amounts, growth rates, and historic industry statistics. Forecasts from prior periods were also compared to actual results to test its accuracy. ▪ Assessing the reasonableness of management forecasts of the long-term growth rate. ▪ Assessing the reasonableness of management forecasts for changes in margins, new investments, utilisation, and changes in pricing. ▪ Assessing the reasonableness of the discount rates applied by comparing them to current finance cost and market conditions for the cash-generating units. ▪ Review of information in the notes to the financial statements to confirm that all information required by applicable accounting policies was provided.

Other information

The Board of Directors and CEO are responsible for the other information. The other information comprises the information included in the annual report, but does not include the consolidated financial statements nor our auditors' report thereon. Our opinion on the consolidated financial statements does not cover the other information, and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. The annual report is not available at our reporting date but is expected to be made available to us after that date.

Independent Auditors' Report, continued:

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

The Board of Directors and CEO are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS as adopted by the European Union and additional disclosure requirements for listed companies in Iceland, financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditors' Responsibilities for the audit of the Consolidated Financial Statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

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

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

Independent Auditors' Report, continued:

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

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

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

Report on other legal and regulatory requirements

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

The engagement partner on the audit resulting in this independent auditors' report is Auður Þórisdóttir.

Reykjavik, 7 February 2019.

KPMG ehf.

Auður Þórisdóttir
Hjördís Ýr Ólafsdóttir

Consolidated Statement of Profit or Loss and Other Comprehensive Income for the Year 2018

	Notes	2018	2017 *Restated
Operating income			
Transport revenue	8	1,093,314	1,050,101
Aircraft and aircrew lease		120,113	87,701
Other operating revenue	8	297,091	280,185
		1,510,518	**1,417,987**
Operating expenses			
Salaries and other personnel expenses		515,872	445,162
Aviation expenses		552,669	456,012
Other operating expenses		365,498	346,737
	9	**1,434,039**	**1,247,911**
Operating profit before depreciation and amortisation (EBITDA)		76,479	170,076
Depreciation and amortisation	11	(133,447)	(120,431)
Operating (loss) profit (EBIT)		**(56,968)**	**49,645**
Finance income		8,578	14,083
Finance costs		(21,172)	(15,678)
Net finance costs	12	**(12,594)**	**(1,595)**
Share of profit of associates	19	**1,752**	**592**
(Loss) profit before tax		**(67,810)**	**48,642**
Income tax	22	12,240	(11,104)
(Loss) profit for the year		**(55,570)**	**37,538**

	Notes	2018	2017 *Restated
Other comprehensive (loss) income			
Items that are or may be reclassified to profit or loss			
Currency translation differences		(6,745)	8,448
Cash flow hedges – effective portion of changes in fair value, net of tax		(40,339)	(2,509)
Net loss on hedge of investment, net of tax		(7,773)	0
Other comprehensive (loss) income for the year		**(54,857)**	**5,939**
Total comprehensive (loss) income for the year		**(110,427)**	**43,477**
Owners of the Company		(55,815)	37,438
Non-controlling interests		245	100
(Loss) profit for the year		**(55,570)**	**37,538**
Total Comprehensive (loss) income attributable to:			
Owners of the Company		(110,606)	42,526
Non-controlling interests		179	951
Total comprehensive (loss) income for the year		**(110,427)**	**43,477**
(Loss) earnings per share			
Basic (loss) earnings per share in US cent per share	28	(1.16)	0.75
Diluted (loss) earnings per share in US cent per share	28	(1.16)	0.75

*See note 5

The notes on pages 69–110 are an integral part of these consolidated financial statements.

Consolidated Statement of Financial Position as at 31 December 2018

	Notes	2018	2017 *Restated
Assets			
Operating assets	13–16	673,420	652,705
Intangible assets and goodwill	17–18	177,568	180,422
Investments in associates	19	26,134	29,629
Deferred cost	20	91	0
Receivables and deposits	21	17,365	97,030
Non-current assets		894,578	959,786
Inventories	23	25,951	26,801
Derivatives used for hedging	34	666	18,450
Trade and other receivables	24	118,298	186,027
Assets held for sale	7	125,169	7,500
Short-term investments	25	0	4,087
Cash and cash equivalents	26	299,460	221,191
Current assets		569,544	464,056
Total assets		**1,464,122**	**1,423,842**

	Notes	2018	2017 *Restated
Equity			
Share capital		39,053	39,532
Share premium		133,513	140,519
Reserves		26,262	127,407
Retained earnings		271,034	287,749
Equity attributable to equity holders of the Company	27	469,862	595,207
Non-controlling interests		1,517	1,338
Total equity		471,379	596,545
Liabilities			
Loans and borrowings	29	147,513	280,254
Payables	30	14,554	17,239
Deferred tax liabilities	22	32,868	60,885
Non-current liabilities		194,935	358,378
Loans and borrowings	29	268,288	9,287
Derivatives used for hedging	34	39,660	1,383
Liabilities held for sale	7	52,244	0
Trade and other payables	31	222,766	232,188
Deferred income	32	214,850	226,061
Current liabilities		797,808	468,919
Total liabilities		992,743	827,297
Total equity and liabilities		**1,464,122**	**1,423,842**

*See note 5

The notes on pages 69–110 are an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Equity for the Year 2018

	Attributable to the equity holders of the Company						
2017	**Share capital**	**Share premium**	**Reserves**	**Retained earnings**	**Total**	**Non-controlling interest**	**Total equity**
Balance at 1 January 2017	40,576	154,705	114,849	257,696	567,826	387	568,213
Impact of IFRS 15 implementation				5,129	5,129		5,129
Restated Balance at 1 January 2017	**40,576**	**154,705**	**114,849**	**262,825**	**572,955**	**387**	**573,342**
Purchase of treasury shares	(1,044)	(14,186)			(15,230)		(15,230)
Total comprehensive income			5,207	37,319	42,526	951	43,477
Profit of subsidiaries and associates in excess of dividend received			7,351	(7,351)			
Dividend (0.54 USD cent per share)				(5,044)	(5,044)		(5,044)
Balance at 31 December 2017	**39,532**	**140,519**	**127,407**	**287,749**	**595,207**	**1,338**	**596,545**

2018	**Share capital**	**Share premium**	**Reserves**	**Retained earnings**	**Total**	**Non-controlling interest**	**Total equity**
Balance at 1 January 2018	39,532	140,519	127,407	282,739	590,197	1,338	591,535
Impact of IFRS 15 implementation				5,010	5,010		5,010
Restated Balance at 1 January 2018	**39,532**	**140,519**	**127,407**	**287,749**	**595,207**	**1,338**	**596,545**
Purchase of treasury shares	(479)	(7,006)			(7,485)		(7,485)
Total comprehensive loss			(54,790)	(55,816)	(110,606)	179	(110,427)
Loss of subsidiaries and associates in excess of dividend received			(46,355)	46,355			
Dividend (0.15 USD cent per share)				(7,254)	(7,254)		(7,254)
Balance at 31 December 2018	**39,053**	**133,513**	**26,262**	**271,034**	**469,862**	**1,517**	**471,379**

Information on impact of IFRS 15 implementation is provided in note 5.
Information on changes in other reserves is provided in note 27.

Consolidated Statement of Cash Flows for the Year 2018

	Notes	2018	2017 *Restated
Cash flows from operating activities			
(Loss) profit for the year		(55,570)	37,538
Adjustments for:			
Depreciation and amortisation	11	133,447	120,431
Expensed deferred cost		9,991	10,051
Net finance costs		12,594	1,595
(Gain) loss on sale of operating assets		(4,767)	264
Gain on sale of investments		(710)	0
Share in profit of associates		(1,752)	(592)
Tax expense		(12,240)	11,104
		80,993	**180,391**
Changes in:			
Inventories, decrease (increase)		850	(2,838)
Trade and other receivables, (increase) decrease		(8,577)	10,400
Trade and other payables, increase		29,077	15,816
Deferred income, (decrease) increase		(11,211)	25,225
Cash generated from operating activities		**10,139**	**48,603**
Interest received		2,642	3,354
Interest paid		(23,546)	(16,618)
Income taxes paid		(8,675)	(10,127)
Net cash from operating activities		**61,553**	**205,603**
Cash flows to investing activities			
Acquisition of operating assets	13	(263,900)	(149,213)
Proceeds from sale of operating assets		52,719	1,415
Acquisition of intangible assets	17	(2,749)	(5,661)
Deferred cost, change		(4,602)	(4,176)
Investment in subsidiaries and associates		0	(3,335)
Non-current receivables, change		88,546	(86,661)
Cash attributable to assets held for sale	7	(4,034)	0
Short-term investments, change		4,087	19,212
Net cash used in investing activities		**(129,933)**	**(228,419)**

	Notes	2018	2017 *Restated
Cash flows to financing activities			
Purchase of treasury shares	27	(7,485)	(15,230)
Dividend paid		(7,254)	(5,044)
Proceeds from loans and borrowings	29	143,424	45,384
Repayment of loans and borrowings	29	(18,783)	(10,556)
Short-term loans, change	29	39,434	0
Net cash from financing activities		**149,336**	**14,554**
Increase (decrease) in cash and cash equivalents		80,956	(8,262)
Effect of exchange rate fluctuations on cash held		(2,687)	2,564
Cash and cash equivalents at beginning of the year		221,191	226,889
Cash and cash equivalents at 31 December	**26**	**299,460**	**221,191**
Investment and financing without cash flow effect			
Acquisition of operating assets		(60,177)	(7,081)
Acquisition of intangible assets		(4,563)	0
Proceeds from sale of operating assets		1,237	0
Investment in subsidiaries and associates		4,573	0
Non-current receivables		52,506	0
Proceeds from loans and borrowings	29	6,424	7,081

*See note 5

The notes on pages 69–110 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 Reykjavíkurflugvöllur in Reykjavik, Iceland. The consolidated financial statements for the Company as at and for the year ended 31 December 2018 comprise the Company and its subsidiaries, together referred to as the "Group" and individually as "Group entities" and the Group's interests in associates. The Group primarily operates in the airline and tourism industry. The Company is listed on the Nasdaq OMX Iceland.

2. Basis of accounting

a. Statement of compliance

The Group's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and additional Icelandic disclosure requirements for consolidated financial statements of listed companies. They were authorised for issue by the Company's Board of Directors on 7 February 2019.

b. Basis of measurement

The consolidated financial statements are prepared on the historical cost basis, except that derivative financial instruments, part of deferred income and certain short-term investments are stated at their fair values. Details of the Group's accounting policies are included in note 43.

This is the first set of the Group's annual financial statements in which IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have been applied. Changes to significant accounting policies are described in note 5.

3. Functional and presentation currency

The Company's functional currency is US dollars (USD). These consolidated financial statements are presented in US dollars (USD), except for information in note 38 on salaries and benefits of management for their service to Group companies. Payments to management are denominated and presented in ISK. All financial information presented in USD has been rounded to the nearest thousand, unless otherwise indicated.

4. 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 2018 is included in the following notes:

Note 18 – measurement of the recoverable amounts of cash-generating units;

Note 32 – deferred income;

Note 34 – Financial instruments and values.

Measurement of fair values

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

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

Notes, continued:

4. continued:

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

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

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.

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

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

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

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

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

Note 25 – short-term investments;
Note 32 – deferred income;
Note 34 – derivatives;
Note 34 – non-derivative financial liabilities.

5. Changes in accounting policies

Except for the changes below, the Group has consistently applied the accounting policies to all periods presented in these consolidated financial statements.

IFRS 9 Financial Instruments

IFRS 9 "Financial Instruments" became effective as of 1 January 2018, and replaced IAS 39 "Financial Instruments: Recognition and Measurement". The standard's three main projects are classification and measurement, impairment, and hedge accounting. In 2017 Icelandair Group performed a review and an assessment of the effects on financial assets and liabilities.

The table below explains the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Group's financial assets and liabilities as at 1 January 2018. There is no impact of IFRS 9 on the financial reporting for The Group and therefore no adjustment is needed.

	Original classification under IAS 39	New classification under IFRS 9
Short-term investments	Held for trading	Mandatorily at FVTPL*
Receivables and deposits	Loans and receivables	Amortised cost

*FVTPL means fair value through profit or loss.

Notes, continued:

5. continued:

IFRS 15 Revenue from Contracts with Customers

The Group has adopted IFRS 15 Revenue from Contracts with Customer with a date of initial application of 1 January 2017. As a result, the Group has changed its accounting policy for revenue recognition as detailed below.

The Group applied IFRS 15 retrospectively, with adjustments to all periods presented. The details and quantitative impact of the changes in accounting policies are disclosed below.

a. Service fees

Revenue for service fee was previously recognised when booking was made. Under IFRS 15, as there is only one performance obligation, revenue is recognised on the date of the flight.

b. Change fees

Revenue for change fee was previously recognised when the modification was made and the passenger charged. Under IFRS 15, while the change service may have economic value, it is highly interrelated with the service of providing the flight, and is not considered a distinct service. Change fee revenue is therefore recognised at the date of the flight.

c. Package tours

Revenue for sold package tours was previously recognised at the first day of travel. Under IFRS 15, the total consideration in the service contracts is allocated to all services based on their stand-alone selling prices and revenue recognised as performance obligations are satisfied over time.

d. Commission, credit card fees and booking fees

The Group previously recognised commission fees, credit card fees and booking fees as selling expenses when they incurred. Under IFRS 15, the Group capitalises these fees as costs of obtaining a contract when they are incremental, and if they are expected to be recovered, it amortises them consistently with the pattern of revenue for the related contract.

e. Impacts on consolidated financial statements

(i) Consolidated Statement of Financial Position

The following table shows the change to the line items of the 31 December 2017 consolidated statement of financial position by the adoption of IFRS 15.

	31.12.2017 Original	Adjustment IFRS 15	31.12.2017 Restated
Assets			
Current assets:			
Trade and other receivables	177,275	8,752	186,027
Current assets	455,304	8,752	464,056
Total assets	**1,415,090**	**8,752**	**1,423,842**
Equity and liabilities			
Equity:			
Retained earnings	282,739	5,010	287,749
Total equity	**591,535**	**5,010**	**596,545**
Non-current liabilities:			
Deferred tax liabilities	59,633	1,252	60,885
Total non-current liabilities	**357,126**	**1,252**	**358,378**
Current liabilities:			
Deferred income	223,571	2,490	226,061
Total current liabilities	**466,429**	**2,490**	**468,919**
Total equity and liabilities	**1,415,090**	**8,752**	**1,423,842**

Notes, continued:

5. continued:

(ii) Consolidated Statement of Comprehensive Income

The following table shows the change to the line items of the consolidated statement of comprehensive income during the year 2017 by adopting IFRS 15.

	2017 Original	Adjustment IFRS 15	2017 Restated
Operating income			
Transport revenue	1,033,268	16,833	1,050,101
Other operating revenue	298,559	(18,374)	280,185
Total operating income	1,419,528	(1,541)	1,417,987
Operating expenses			
Other operating expenses	348,129	(1,392)	346,737
Total operating expenses	1,249,303	(1,392)	1,247,911
Operating profit before depreciation and amortisation (EBITDA)	170,225	(149)	170,076
Profit before income tax	48,791	(149)	48,642
Income tax	(11,134)	30	(11,104)
Profit for the year	**37,657**	**(119)**	**37,538**

(iii) Consolidated Statement of Cash Flows

The following table shows the change to the line items of the consolidated statement of cash flows during the year 2017 by adopting IFRS 15

	2017 Original	Adjustment IFRS 15	2017 Restated
Cash flows from operating activities			
Profit for the period	37,657	(119)	37,538
Tax expense	11,134	(30)	11,104
Trade and other receivables, increase	11,792	(1,392)	10,400
Deferred income, increase	23,684	1,541	25,225

(iv) Impact of adopting IFRS 15 on the Group's Consolidated Statement of Comprehensive Income as at 31 December 2018

The following table shows the impact by the adoption of IFRS 15 on the consolidated statement of comprehensive income for the year 2018:

	Amounts without adoption of IFRS 15	Adjustment IFRS 15	2018 As reported
Operating income			
Transport revenue	1,092,610	704	1,093,314
Total operating income	1,509,814	704	1,510,518
Operating expenses			
Other operating expenses	368,889	(3,391)	365,498
Total operating expenses	1,437,430	(3,391)	1,434,039
Operating profit before depreciation and amortisation (EBITDA)	72,384	4,095	76,479
Loss before income tax	(71,905)	4,095	(67,810)
Income tax	13,059	(819)	12,240
Loss for the year	**(58,846)**	**3,276**	**(55,570)**

Notes, continued:

6. Operating segments

Segment information is presented in the consolidated financial statements in respect of the Group's business segments, which are the primary basis of segment reporting. The business segment reporting format reflects the Group's management and internal reporting structure and is divided into three segments: International Flight Operations, Aviation Investments, and Tourism Investments.

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.

International Flight Operations

The International Flight Operations are based on the hub-and-spoke concept between Europe and North America via Iceland, leveraging Iceland's geographical position. This strategy of combining passengers visiting and departing Iceland, with passengers travelling across the Atlantic (via Iceland) has allowed Icelandair to grow and expand its route network over the past years. In 2018 Icelandair's international route networking connected 23 Cities in North America with 26 Cities in Europe and thereby offering connectivity between 670 city pairs within the network. The network is an invaluable asset for the Icelandic Tourism offering direct flights to Iceland from around 50 cities. Icelanders and businesses also utilise the network and make use of the frequent and diverse connections to Europe and North America.

The network is important for the export and import industries in Iceland, wherein Icelandair Cargo utilises the network and own freighters to offer reliable, frequent, and quick transport of cargo.

Aviation Investments

There are three subsidiaries within the Aviation Investment segment. Loftleidir Icelandic, the leasing arm of the group, Air Iceland Connect, the domestic airline and VITA an outgoing tour operator. They have access to the systems, vast experience, and knowhow within Icelandair and the International Flight Operations, bringing economy of scale to the whole operations.

Tourism Investments

There are two subsidiaries within the Tourism Investments, Icelandair Hotels and Iceland Travel. Icelandair Hotels offers quality hotels both in Reykjavik and around the countryside. Iceland Travel is the largest incoming tour operator in Iceland. Both companies utilise Icelandair's international route network on a whole-year basis.

In a strategic review it was concluded that more focus should be put on aviation and airline operations and less on Tourism. The Company has initiated a process to sell its hotel operations. The process is ongoing and is supposed to be concluded in the first half of the year 2019.

Geographic information

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

Revenues	2018	2017
North America	40%	39%
Iceland	22%	22%
West Continental Europe	14%	14%
Scandinavia	7%	7%
United Kingdom	6%	7%
Other	11%	11%
Total revenues	**100%**	**100%**

Notes, continued:

6. continued:

Information on reportable segments

2018	International flight operations	Aviation investment	Tourism investment	Total
External revenue	1,108,637	196,502	205,379	1,510,518
Inter-segment revenue	95,091	7,509	10,345	112,945
Segment revenue	**1,203,728**	**204,011**	**215,724**	**1,623,463**
Segment EBITDAR*	55,013	47,017	24,863	126,893
Operating lease expenses	(12,397)	(23,987)	(14,030)	(50,414)
Segment EBITDA	**42,616**	**23,030**	**10,833**	**76,479**
Finance income	8,267	1,523	2,256	12,046
Finance costs	(20,690)	(2,405)	(1,545)	(24,640)
Depreciation and amortisation	(115,666)	(11,127)	(6,654)	(133,447)
Share of profit of equity accounted investees	**1,648**	**0**	**104**	**1,752**
Reportable segment (loss) profit before tax	**(83,825)**	**11,021**	**4,994**	**(67,810)**
Reportable segment assets	1,889,791	119,652	61,584	2,071,027
Investment in associates	25,980	154	1,055	27,189
Capital expenditure	293,151	29,160	13,680	335,991
Reportable segment liabilities	1,239,285	96,079	44,092	1,379,456

2017 restated**	International flight operations	Aviation investment	Tourism investment	Total
External revenue	1,052,820	161,790	203,377	1,417,987
Inter-segment revenue	187,924	8,972	15,308	212,204
Segment revenue	**1,240,744**	**170,762**	**218,685**	**1,630,191**
Segment EBITDAR*	146,898	39,018	21,849	207,765
Operating lease expenses	(9,414)	(16,031)	(12,244)	(37,689)
Segment EBITDA	**137,484**	**22,987**	**9,605**	**170,076**
Finance income	18,300	309	619	19,228
Finance costs	(12,041)	(7,295)	(1,487)	(20,823)
Depreciation and amortisation	(104,085)	(10,600)	(5,746)	(120,431)
Share of profit of equity accounted investees	**287**	**0**	**305**	**592**
Reportable segment profit before tax	**39,945**	**5,401**	**3,296**	**48,642**
Reportable segment assets	1,849,459	115,968	62,417	2,027,844
Investment in associates	28,368	173	1,088	29,629
Capital expenditure	142,660	15,215	8,256	166,131
Reportable segment liabilities	928,105	92,754	46,328	1,067,187

*EBITDAR means EBITDA before operating lease expenses.

**See note 5

Notes, continued:

6. continued:

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

	2018	2017 restated**
Revenue		
Total revenue for reportable segments	1,623,463	1,630,191
Elimination of inter-segment revenue	(112,945)	(212,204)
Consolidated revenue	**1,510,518**	**1,417,987**
Profit or loss		
Total profit of reportable segments	(67,810)	48,642
Consolidated continuing profit before tax	**(67,810)**	**48,642**
Assets		
Total assets for reportable segments	2,071,027	2,027,844
Investments in associates	27,189	29,629
Elimination of inter-segment assets	(634,094)	(633,631)
Consolidated total assets	**1,464,122**	**1,423,842**
Liabilities		
Total liabilities for reportable segments	1,379,456	1,067,187
Elimination of inter-segment liabilities	(386,713)	(239,890)
Consolidated total liabilities	**992,743**	**827,297**

Other material items	Reportable segment totals	Adjustments	Consoli-dated totals
2018			
Segment EBITDAR	126,893		126,893
Segment EBITDA	76,479		76,479
Finance income	12,046	(3,468)	8,578
Finance costs	(24,640)	3,468	(21,172)
Depreciation and amortisation	(133,447)		(133,447)
Share of profit of associates	1,752		1,752
Capital expenditure	335,991		335,991
2017			
Segment EBITDAR	207,765		207,765
Segment EBITDA	170,076		170,076
Finance income	19,228	(5,145)	14,083
Finance costs	(20,823)	5,145	(15,678)
Depreciation and amortisation	(120,431)		(120,431)
Share of profit of associates	592		592
Capital expenditure	166,131		166,131

**See note 5

Notes, continued:

7. Assets held for sale

Management has committed to a plan to sell its hotel operation following a strategic decision to place greater focus on the Group's key competencies, i.e., the airline industry.

As the hotel operation is deemed being immaterial on the consolidated statement of comprehensive income, it is included and not shown separately as discontinued operations. In the consolidated statement of financial position, assets and liabilities of this segment are stated as held for sale. Comparative amounts have not been re-presented. The impact on the consolidated financial statements as a whole is presented below.

a.Impacts on consolidated financial statements

(i) Comprehensive income for the hotel operation

	2018	2017
Revenue	117,030	105,411
Elimination of inter-segment revenue	(15,328)	(19,782)
External revenue	**101,702**	**85,629**
Expenses	(114,051)	(102,324)
Elimination of expenses of inter-segment sales	15,328	19,782
External expenses	**(98,723)**	**(82,542)**
Profit from operating activities	2,979	3,087
Income tax	(575)	(558)
Profit from hotel operations, net of tax	**2,404**	**2,529**
Basic profit per share in US cent per share	0.05	0.05
Diluted profit per share in US cent per share	0.05	0.05

(ii) Cash flows from (used) in hotel operation

	2018	2017
Net cash from operating activities	11,506	9,006
Net cash used in investing activities	(25,367)	(12,912)
Net cash from financing activities	13,651	7,782
Net cash flows for the period	**(210)**	**3,876**

(iii) Effect of possible disposal on the financial position of the Group

The assets and liabilities of the hotel operation are presented as held for sale in the consolidated statements of financial position at year end 2018. An aircraft that is not part of hotel operation was held for sale at year end 2017 and was sold in June 2018. The carrying amounts of the major classes of assets and liabilities were as follows:

	31.12.2018	31.12.2017
Operating assets	102,491	7,500
Intangible assets and goodwill	5,457	0
Investments in associates	1,055	0
Inventories	755	0
Trade and other receivables	11,377	0
Cash and cash equivalents	4,034	0
Deferred tax liabilities	(3,191)	0
Loans and borrowings	(35,644)	0
Trade and other payables	(8,683)	0
Deferred income	(4,726)	0
Net assets and liabilities	**72,925**	**7,500**

Notes, continued:

8. Operating income

Transport revenue is specified as follows:	2018	2017 Restated
Passengers	947,494	941,611
Passenger ancillary revenues	87,462	52,145
Cargo and mail	58,358	56,345
Total transport revenue	**1,093,314**	**1,050,101**

With the implementation of the new IFRS 15 revenue recognition standard, baggage fees, in-flight sales, excess legroom and Wi-Fi that are sold as a separate component are now included in passenger revenue but were before included in cargo and mail and sale at airports and hotels. Amounts from the prior year have been restated accordingly.

Other operating revenue is specified as follows:		
Sale at airports and hotels	104,590	87,389
Revenue from tourism	133,543	140,193
Aircraft and cargo handling services	24,014	21,072
Maintenance revenue	2,760	3,985
Gain on sale of operating assets	4,767	0
Other operating revenue	27,417	27,546
Total other operating revenue	**297,091**	**280,185**

9. Operating expenses

Salaries and other personnel expenses are specified as follows:

	2018	2017 Restated
Salaries	350,804	306,154
Contributions to pension funds	51,853	43,813
Other salary-related expenses	43,421	32,003
Other personnel expenses	69,794	63,192
Total salaries and other personnel expenses	**515,872**	**445,162**

	2018	2017 Restated
Average number of full year equivalents	4,606	4,263
Gender ratio for employees (male / female)	46 / 54	46 / 54

Aviation expenses are specified as follows:

Aircraft fuel	298,771	235,358
Aircraft lease	36,532	21,757
Aircraft handling, landing and communication	136,443	122,757
Aircraft maintenance expenses	80,923	76,140
Total aviation expenses	**552,669**	**456,012**

Other operating expenses are specified as follows:

Operating cost of real estates and fixtures	37,631	30,215
Communication	27,758	25,861
Advertising	29,353	30,033
Booking fees and commissions	64,365	61,189
Cost of goods sold	17,011	14,046
Customer services	65,770	56,317
Tourism expenses	84,025	91,203
Other operating expenses	39,585	37,873
Total other operating expenses	**365,498**	**346,737**

10. Auditors' fee

are specified as follows:	Group auditors 2018	Group auditors 2017	Other auditors 2018	Auditors' fee 2017
Audit	555	538	3	0
Other services	66	327	34	0
	621	**865**	**37**	**0**

Notes, continued:

11. Depreciation and amortisation

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

	2018	2017
Depreciation of operating assets, see note 13	129,792	118,059
Amortisation of intangible assets, see note 17	3,655	2,372
Depreciation and amortisation recognised in profit or loss	**133,447**	**120,431**

12. Finance income and finance costs

Finance income and finance costs are specified as follows:

	2018	2017
Interest income on cash and cash equivalents	1,620	1,548
Interest income on corporate debt securities – at amortised cost	557	1,056
Interest income on corporate debt securities – at fair value through profit or loss	0	952
Other interest income	714	207
Net currency exchange gain	5,687	10,320
Finance income total	**8,578**	**14,083**
Interest expense on loans and borrowings	19,143	14,971
Other interest expenses	2,029	707
Finance costs total	**21,172**	**15,678**
Net finance costs	**(12,594)**	**(1,595)**

13. Operating assets

Operating assets are specified as follows:

Cost	Aircraft and flight equipment	Buildings	Other property and equipment	Total
Balance at 1 January 2017	644,105	128,843	82,331	855,279
Additions	90,733	32,908	32,653	156,294
Sales and disposals	(68,520)	0	(2,581)	(71,101)
Reclassification	0	479	(479)	0
Effects of movements in exchange rates	549	11,561	5,903	18,013
Balance at 31 December 2017	**666,867**	**173,791**	**117,827**	**958,485**
Additions	272,407	25,434	26,236	324,077
Sales and disposals	(138,236)	(584)	(6,719)	(145,539)
Reclassification	(977)	0	0	(977)
Assets classified as held for sale	0	(82,949)	(42,474)	(125,423)
Effects of movements in exchange rates	(921)	(19,388)	(6,136)	(26,445)
Balance at 31 December 2018	**799,140**	**96,304**	**88,734**	**984,178**
Depreciation and impairment losses				
Balance at 1 January 2017	206,830	14,132	31,702	252,664
Depreciation	103,297	4,008	10,754	118,059
Sales and disposals	(66,516)	0	(2,677)	(69,193)
Effects of movements in exchange rates	119	1,486	2,645	4,250
Balance at 31 December 2017	**243,730**	**19,626**	**42,424**	**305,780**
Depreciation	111,654	5,538	12,600	129,792
Sales and disposals	(89,038)	(539)	(6,695)	(96,272)
Assets classified as held for sale	0	(4,873)	(18,060)	(22,933)
Effects of movements in exchange rates	(191)	(2,572)	(2,846)	(5,609)
Balance at 31 December 2018	**266,155**	**17,180**	**27,423**	**310,758**
Carrying amounts				
At 1 January 2017	**437,275**	**114,711**	**50,629**	**602,615**
At 31 December 2017	**423,137**	**154,165**	**75,403**	**652,705**
At 31 December 2018	**532,985**	**79,124**	**61,311**	**673,420**
Depreciation ratios	4–20%	2–6%	5–33%	

Notes, continued:

13. continued:

Acquisition of operating assets in 2018 amounted to USD 324.1 million. (2017: USD 156.3 million). Included are two Boeing 737 MAX 8 aircraft, two Boeing 757 aircraft, one Boeing 767 aircraft, overhaul of own engines and aircraft spare parts in the amount of USD 272.4 million (2017: USD 60.8 million).

14. 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 203.1 million at year end 2018 (2017: USD 65.8 million). The Group owns 42 aircraft, of which 40 are unencumbered, including 35 Boeing 757 and 5 Boeing 767.

15. 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 amounts	
	2018	2017	2018	2017
Boeing – 36 / 31 aircraft	771,700	585,000	440,285	334,689
Other aircraft	60,075	66,466	43,148	43,660
Flight equipment	67,862	67,025	49,552	44,788
Total aircraft and flight equipment	**899,637**	**718,491**	**532,985**	**423,137**

16. Insurance value of buildings and other operating assets

The principal buildings owned by the Group are the following:

2018	Maintenance hangars	Hotels / staff apartm.	Office buildings	Other buildings	Under construction	Total
Official assessment value	32,773	10,155	25,314	12,262	177	80,681
Insurance value	65,649	14,030	52,299	23,194	7,018	162,190
Carrying amounts	31,152	6,163	24,197	12,225	5,387	79,124
Square metres	31,814	5,690	19,736	11,808	6,108	75,156
2017						
Official assessment value	41,153	34,668	28,238	15,557	2,747	122,363
Insurance value	77,077	65,537	50,429	24,225	15,359	232,627
Carrying amounts	32,504	73,555	23,531	13,128	11,447	154,165
Square metres	31,814	18,853	19,736	11,509	5,245	87,157

In 2018 hotel buildings both in operation and under construction were transferred to assets held for sale.

Insurance value of assets held for sale amounted to USD 58.5 million at year end. Official valuation of the same assets amounted to USD 30.6 million. The carrying amount at the same time was USD 77.4 million.

Official valuation of the Group's leased land for buildings at 31 December 2018 amounted to USD 16.5 million (2017: USD 18.2 million) and is not included in the consolidated statement of financial position.

Insurance value of the Group's other operating assets and equipment amounted to USD 66.9 million at year end 2018 (2017: USD 121.7 million). The carrying amount at the same time was USD 61.3 million (2017: USD 75.4 million).

Notes, continued:

17. Intangible assets and goodwill

Intangible assets and goodwill are specified as follows:

Cost	Goodwill	Trademarks and slots	Other intangibles	Total
Balance at 1 January 2017	150,448	35,990	5,017	191,455
Additions	0	0	5,661	5,661
Sales and disposals	0	0	(2,442)	(2,442)
Effects of movements in exchange rates	2,116	23	451	2,590
Balance at 31 December 2017	**152,564**	**36,013**	**8,687**	**197,264**
Additions	4,563	0	2,749	7,312
Sales and disposals	0	0	(2,017)	(2,017)
Assets classified as held for sale	(4,563)	0	(1,873)	(6,436)
Effects of movements in exchange rates	(731)	0	(558)	(1,289)
Balance at 31 December 2018	**151,833**	**36,013**	**6,988**	**194,834**

Amortisation and impairment losses	Goodwill	Trademarks and slots	Other intangibles	Total
Balance at 1 January 2017	11,431	2,605	2,715	16,751
Amortisation	0	0	2,372	2,372
Sales and disposals	0	0	(2,442)	(2,442)
Effects of movements in exchange rates	0	0	161	161
Balance at 31 December 2017	**11,431**	**2,605**	**2,806**	**16,842**
Amortisation	0	0	3,655	3,655
Sales and disposals	0	0	(2,017)	(2,017)
Assets classified as held for sale	0	0	(978)	(978)
Effects of movements in exchange rates	0	0	(236)	(236)
Balance at 31 December 2018	**11,431**	**2,605**	**3,230**	**17,266**

Carrying amounts	Goodwill	Trademarks and slots	Other intangibles	Total
At 1 January 2017	**139,017**	**33,385**	**2,302**	**174,704**
At 31 December 2017	**141,133**	**33,408**	**5,881**	**180,422**
At 31 December 2018	**140,402**	**33,408**	**3,758**	**177,568**

18. 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:

	2018	2017
Goodwill	140,402	141,133
Trademarks and airport slots	33,408	33,408
Total	**173,810**	**174,541**

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

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

	Goodwill		Trademarks and slots	
	2018	2017	2018	2017
International Flight Operations	82,647	83,280	23,893	23,893
Aviation Investments	55,728	55,728	9,515	9,515
Tourism Investments	2,027	2,125	0	0
Total goodwill	**140,402**	**141,133**	**33,408**	**33,408**

Notes, continued:

18. continued:

The recoverable amounts of cash-generating units were 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-year business plan. Cash flows were extrapolated for determining the residual value using a constant nominal growth rate that 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:

2018	International flight operations	Aviation investments	Tourism investments
Long-term growth rate	2.5–3.0%	2.5%	3.5%
Revenue growth:			
Weighted average 2018/2017	4.8%	32.8%	-14.9%
2019–2023 / 2018–2022	7.8%	3.4%	0.3%
Budgeted EBITDA growth	49.8%	1.2%	25.5%
WACC	10.0–15.1%	12.4%	8.9%
Debt leverage	10.2–45.3%	45.3%	25.0%
Interest rate for debt	4.3–6.8%	7.7%	2.0%

2017			
Long-term growth rate	2.5–4.0%	2.5%	4.0%
Revenue growth:			
Weighted average 2017/2016	10.9%	4.2%	26.8%
2018–2022 / 2017–2021	9.6%	6.7%	4.0%
Budgeted EBITDA growth	17.0%	-4.5%	48.5%
WACC	9.3–14.4%	11.6%	10.2%
Debt leverage	10.2–49.8%	49.8%	22.4%
Interest rate for debt	3.9–6.4%	7.5%	2.2%

The recoverable amounts of the cash-generating units were estimated to be higher than carrying amounts and no impairment was required. The estimated recoverable amount of the International flight operations unit exceeded its carrying amount by approximately USD 80 million (2017: 246 million). Management has identified that a reasonably possible change in two key assumptions could cause the carrying amount to exceed the recoverable amount. The discount rate would need to change by 0.6 percentage points and the long-term EBIDTA by 3.2% for the estimated recoverable amount to be equal to the carrying amount.

Notes, continued:

19. Investment in associates

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

		2018		2017	
	Ownership	Investment	Operating result	Investment	Operating result
Lindarvatn ehf.	50%	16,118	(37)	18,158	35
ITF 1 slhf.	29%	8,594	1,611	9,805	217
Other investments		1,422	178	1,666	340
Total investments in associates		**26,134**	**1,752**	**29,629**	**592**

Lindarvatn ehf. is the owner of a property at Thorvaldsensstræti and other properties located near Austurvollur that are being rebuilt as a hotel. In total the properties are 15,000 square metres, while the new hotel is expected to be 11,000 square metres.

ITF 1 slhf. is a fund managed by Landsbref. The Fund's purpose is to invest in Icelandic companies focusing on entertainment and experience for foreign tourists. Main focus is on whole-year projects that contribute to better utilisation of the infrastructure in the Icelandic Tourism industry.

20. Deferred cost

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

	2018	2017
Deferred cost	623	68
Current portion, classified as prepayments among receivables	(532)	(68)
Total deferred cost	**91**	**0**

Deferred cost will be expensed as follows:		
Expensed in 2018	532	68
Expensed in 2019	91	
Total deferred cost, including current maturities	**623**	**68**

21. 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.

Non-current receivables and deposits are specified as follows:	2018	2017
Loans, effective interest rate 6% / 6%	266	154
Security deposits	6,499	6,339
Prepayments on aircraft purchases (see disclosure 37)	15,729	143,644
	22,494	**150,137**
Current maturities	(5,129)	(53,107)
Non-current receivables and deposits total	**17,365**	**97,030**

Contractual repayments mature as follows:

Maturities in 2018	–	53,107
Maturities in 2019	5,129	72,588
Maturities in 2020	3,681	18,405
Maturities in 2021	7,988	2,617
Maturities in 2022	217	19
Maturities in 2023	899	465
Subsequent	4,580	2,936
Total non-current receivables and deposits, including current maturities	**22,494**	**150,137**

Non-current receivables and deposits denominated in currencies other than the functional currency comprise USD 1.4 million (2017: USD 1.5 million).

Notes, continued:

22. Income taxes

Amounts recognised in profit or loss	2018	2017
Current tax expense		
Current year	0	8,894
	0	8,894
Deferred tax expense		
Origination and reversal of temporary differences	(12,240)	2,210
Total tax expense recognised in profit or loss	**(12,240)**	**11,104**

Amounts recognised in other comprehensive income		
Effective portion of changes in fair value of cash flow hedge	(12,030)	(631)
Total tax recognised in other comprehensive income	**(12,030)**	**(631)**

Reconciliation of effective tax rate		2018		2017 Restated
(Loss) profit before tax		(67,810)		48,642
Income tax according to current tax rate	20.0%	(13,562)	20.0%	9,728
Non-deductible expenses	(0.9%)	637	1.1%	547
Other items	(1.0%)	685	1.7%	829
Effective tax rate	**18.1%**	**(12,240)**	**22.8%**	**11,104**

Recognised deferred tax liabilities Deferred tax liabilities are specified as follows:	2018	2017 Restated
Deferred tax liabilities 1 January	60,885	58,179
Impact of IFRS15 implementation	0	1,282
Deferred tax recognised in profit or loss	(12,240)	2,210
Income tax recognised in other comprehensive income	(12,030)	(631)
Exchange rate difference	(556)	(155)
Deferred tax liabilities transferred to assets held for sale	(3,191)	0
Deferred tax liabilities 31 December	**32,868**	**60,885**

Deferred tax liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2018	2017	2018	2017 Restated	2018	2017 Restated
Operating assets	0	0	(62,050)	(52,795)	(62,050)	(52,795)
Intangible assets	0	0	(277)	(679)	(277)	(679)
Derivatives	6,665	0	0	(3,468)	6,665	(3,468)
Trade receivables	0	0	(44)	(2,056)	(44)	(2,056)
	6,665	**0**	**(62,371)**	**(58,998)**	**(55,706)**	**(58,998)**
Tax loss carry-forwards	23,563	1,020	0	0	23,563	1,020
Other items		0	(725)	(2,907)	(725)	(2,907)
Deferred income tax	**30,228**	**1,020**	**(63,096)**	**(61,905)**	**(32,868)**	**(60,885)**

Notes, continued:

22. continued:

Movements in deferred tax balance during the year

2018	1 January	Recognised in profit or loss	Exchange rate difference	Recognised in other comprehensive income and equity	Transferred to asset held for sale	31 December
Operating assets	(52,795)	(13,309)	854	0	3,200	(62,050)
Intangible assets	(679)	214	188	0	0	(277)
Derivatives	(3,468)		3	10,130		6,665
Trade receivables	(3,308)	3,200	12	0	52	(44)
Tax loss carry-forwards	1,020	22,294	(448)	697	0	23,563
Other items	(1,655)	(159)	(53)	1,203	(61)	(725)
	(60,885)	**12,240**	**556**	**12,030**	**3,191**	**(32,868)**
2017 *restated						
Operating assets	(51,580)	(1,543)	328	0	0	(52,795)
Intangible assets	(955)	95	181	0	0	(679)
Derivatives	(4,103)	229	(225)	631	0	(3,468)
Trade receivables	(2,150)	(1,149)	(9)	0	0	(3,308)
Tax loss carry-forwards	895	97	28	0	0	1,020
Other items	(1,568)	61	(148)	0	0	(1,655)
	(59,461)	**(2,210)**	**155**	**631**	**0**	**(60,885)**

23. Inventories

Inventories are specified as follows:

	2018	2017
Spare parts	19,546	18,767
Other inventories	6,405	8,034
Inventories total	**25,951**	**26,801**

24. Trade and other receivables

	2018	2017 Restated
Trade and other receivables are specified as follows:		
Trade receivables	69,243	100,972
Prepayments	30,036	15,140
Restricted cash	2,307	2,132
Current maturities of long long-term receivables	5,129	53,107
Other receivables	11,583	14,676
Trade and other receivables total	**118,298**	**186,027**

At year end trade receivables are presented net of an allowance for doubtful debts of USD 4.8 million (2017: USD 4.8 million).

Prepayment and prepaid expenses that relate to subsequent periods amounted to USD 30.0 million (2017: USD 15.1 million) at year end. The prepayments consist mainly of prepaid contractual obligations, insurance premiums, and software licenses and leases.

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

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

Notes, continued:

25. Short-term investments

Other investments at year end 2017 consist of short-term securities listed on stock exchanges in Iceland and fixed deposits. They are recognised at fair value at year end, based on market value. There are no other investments at year end 2018.

26. Cash and cash equivalents

Cash and cash equivalents are specified as follows:	2018	2017
Bank deposits	299,177	220,312
Cash on hand	283	879
Cash and cash equivalents total	**299,460**	**221,191**

27. Equity

Share capital

The Company's share capital amounts to ISK 5.0 billion according to its Articles of Association. Shareholders are entitled to receive dividend 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 187.3 million at year end 2018 (2017: ISK 139.5 million). During the year the Company purchased 47.9 million shares for USD 7.5 million according to a share purchase programme authorised at the Company's Annual General Meeting.

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 the Icelandic Companies Act, 25% of the nominal value of share capital must be held in reserve. The balance of the share premium account can be used to offset losses not covered by other reserves or to offset stock splits.

Reserves

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

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

According to the Icelandic Financial Statement Act, companies must retain in a separate equity account recognised share in profit of subsidiaries and associates in excess of dividend received or declared.

Reserves are specified as follows:

	Hedging reserve	Translation reserve	Reserve for profit share of affiliates	Total reserves
Balance 1 January 2017	16,423	34,524	63,902	114,849
Share in profit of subsidiaries and associates in excess of dividend received			7,351	7,351
Currency translation differences		7,716		7,716
Effective portion of changes in fair value of cash flow hedges, net of tax	(2,509)			(2,509)
Balance at 31 December 2017	**13,914**	**42,240**	**71,253**	**127,407**
Share in profit (loss) of subsidiaries and associates in excess of dividend received			(46,355)	(46,355)
Currency translation differences		(6,678)		(6,678)
Net loss on hedge of investment, net of tax	(7,773)			(7,773)
Effective portion of changes in fair value of cash flow hedges, net of tax	(40,339)			(40,339)
Balance at 31 December 2018	**(34,198)**	**35,562**	**24,898**	**26,262**

Dividend

Dividend amounting to USD 7.3 million was paid to shareholders in the year 2018 (2017: USD 5.0 million).

The Board of Directors proposes no dividend payment to shareholders in 2019 for the year 2018.

Notes, continued:

28. Earnings per share

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

	2018	2017
Basic (loss) earnings per share:		
(Loss) profit for the year attributable to equity holders of the parent company	(55,815)	37,438
Weighted average number of shares for the year	4,812,661	4,974,540
Basic (loss) earnings per share in US cent per share	(1.16)	0.75
Diluted (loss) earnings per share in US cent per share	(1.16)	0.75

29. Loans and borrowings

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

	Current interest bearing debt	Non-current interest bearing debt	Total
Total interest bearing debt 1 January 2017	35,385	206,997	242,382
Proceeds from loans and borrowings	3,448	42,436	45,884
Transaction cost of long-term loans and borrowings	0	(500)	(500)
Repayment of borrowings	0	(10,556)	(10,556)
Cash flows related to financing activities	**3,448**	**31,380**	**34,828**
Proceeds from loans and borrowings	0	7,081	7,081
Refinancing	(38,710)	38,710	0
Financing activities without cash flows	**(38,710)**	**45,791**	**7,081**
Indexation	0	159	159
Currency exchange difference	3,325	1,398	4,723
Expensed borrowing cost recognised in effective interests	0	368	368
Other liability related changes	**3,325**	**1,925**	**5,250**
Total interest bearing debt 1 January 2018	**3,448**	**286,093**	**289,541**
Proceeds from loans and borrowings	0	144,440	144,440
Transaction cost of long-term loans and borrowings	0	(1,016)	(1,016)
Repayment of borrowings	0	(18,783)	(18,783)
Cash flows related to financing activities	**0**	**124,641**	**124,641**
Proceeds from loans and borrowings	39,423	6,424	45,847
Loans on assets held for sale		(35,651)	(35,651)
Financing activities without cash flows	**39,423**	**(29,227)**	**10,196**
Indexation	0	225	225
Currency exchange difference	11	(9,304)	(9,293)
Expensed borrowing cost recognised in effective interests	0	491	491
Other liability related changes	**11**	**(8,588)**	**(8,577)**
Total interest bearing debt 31 December 2018	**42,882**	**372,919**	**415,801**

Notes, continued:

29. continued:

Loans and borrowings are specified as follows:	2018	2017
Non-current loans and borrowings:		
Secured bank loans	160,211	62,338
Unsecured bonds	212,708	223,755
Total loans and borrowings	**372,919**	**286,093**
Current maturities	(225,406)	(5,839)
Total non-current loans and borrowings	**147,513**	**280,254**
Current loans and borrowings:		
Current maturities of non-current liabilities	12,698	5,839
Unsecured bonds	212,708	0
Bank overdrafts and bank loans	42,882	3,448
Total current loans and borrowings	**268,288**	**9,287**
Total loans and borrowings	**415,801**	**289,541**

Terms and debt repayment schedule

	Currency	Nominal interest rates year end 2018	Year of maturity	Total remaining balance 2018	Total remaining balance 2017
Secured bank loans	USD	2.8%	2022–2028	49,035	12,202
Secured bank loans	EUR	0.1%	2026–2028	72,983	7,285
Secured bank loans	ISK	6.3%	2023–2036	38,193	41,146
Secured bank loans, indexed	ISK			0	1,706
Unsecured bond issue	USD	5.7%	2019	212,708	212,360
Unsecured bond issue, indexed	ISK			0	11,394
Secured bank loans – short-term	USD	6.2%	2019	30,022	3,448
Secured bank loans – short-term	ISK	7.5%	2019	12,860	0
Total interest bearing liabilities				**415,801**	**289,541**

Repayments of loans and borrowings are specified as follows:

	2018	2017
Repayments in 2018	–	9,287
Repayments in 2019	268,287	41,723
Repayments in 2020	12,809	27,015
Repayments in 2021	12,919	193,534
Repayments in 2022	16,674	7,573
Repayments in 2023	26,494	3,914
Subsequent repayments	78,618	6,495
Total loans and borrowings	**415,801**	**289,541**

The Company has issued two listed bond categories: ISIN N000107769982, amounting to USD 190 million and ISIN IS0000025427 amounting to USD 23.6 million. In late December the bondholders voted in favour of certain amendments to the terms and conditions of the bonds, which were identical for both bond categories. The amendments included that the Company would redeem one third (1/3) of the bonds, which was done on 15 January 2019 and amounted to USD 73 million including accrued interests. The Company may redeem all or only some of the outstanding on or before 30 June, and each bondholder has the right to request that all, or only some, of the bonds shall be repurchased between 30 June 2019 to (and including) 15 July 2019. Due to this situation, the bonds are categorised as short-term financing in the Company's balance sheet. The Company's cash and cash equivalents amounted to USD 300 million in year end 2018 and all of the Company's Q400, Boeing 757 and 767 aircraft were unencumbered at year end. Thus, the Company can refinance the bond categories, which is currently under review.

Notes, continued:

29. continued:

On 27 December 2018, Icelandair Group entered into a new financing facility with BOC Aviation regarding the financing of pre-delivery payments of the Boeing 737 MAX Aircraft on order from The Boeing Company, which will be delivered in 2019 and 2020. The final scheduled delivery date of the aircraft is in March 2020. The total amount of the financing facility is approximately USD 200 million but the Company's liquidity increased by USD 160 million due to the agreement, since Icelandair Group had already made the pre-delivery payments with its own funds.

In addition to the PDP facility, the parties agreed to a Sale and Leaseback of two Boeing 737 MAX aircraft, one of them to be delivered in 2019 and the second one in 2020. The lease period is 12 years but includes a purchase option 30 months into the lease period.

30. Non-current payables

Non-current payables correspond to accrued engine overhaul cost of leased aircraft and security deposits from lease contracts to be realised after 2019.

Non-current obligations are specified as follows:

	2018	2017
Non-current payables	27,406	24,289
Current portion, classified in trade and other payables	(12,852)	(7,050)
Total non-current payables	**14,554**	**17,239**

Non-current payables are scheduled to be repaid as follows:

Repayments in 2018	–	7,050
Repayments in 2019	12,852	2,728
Repayments in 2020	925	10,015
Repayments in 2021	3,712	4,353
Repayments in 2022	896	143
Repayments in 2023	4,264	0
Subsequent	4,757	0
Total non-current payables, including current maturities	**27,406**	**24,289**

31. Trade and other payables

Trade and other payables are specified as follows:

Trade payables	55,909	58,391
Current portion of engine overhauls and security deposits from lease contracts	12,852	7,050
Income tax payable	0	8,894
Other payables	154,005	157,853
Total trade and other payables	**222,766**	**232,188**

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

Notes, continued:

32. Deferred income

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

	2018	2017 Restated
Sold unused tickets	171,537	188,754
Frequent flyer points	19,165	19,124
Other prepayments	24,148	18,183
Total deferred income	**214,850**	**226,061**

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

33. Financial risk management

Overview

The Group has exposure to the following financial risks:

- credit risk
- liquidity risk
- market risk

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

Risk management framework

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

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

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

Notes, continued:

33. continued:

Credit risk

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

Exposure to credit risk

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

		Carrying amount	
	Note	2018	2017
Non-current receivables and deposits	21	17,365	97,030
Trade and other receivables	24	88,262	170,887
Short-term investments	25	0	4,087
Cash and cash equivalents	26	299,460	221,191
		405,087	**493,195**

Trade and other receivables

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

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

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

At year end 2018, the maximum exposure to credit risk for trade and other receivables by type of financial instrument was as follows:

	2018	2017 Restated
Credit cards	40,744	55,219
Trade receivables	28,499	45,753
	69,243	**100,972**
Prepayments on aircraft purchases	4,249	52,521
Other receivables	44,806	32,534
	118,298	**186,027**

Impairment losses

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

	Gross 2018	Allowance for Impairment 2018	Gross 2017	Allowance for Impairment 2017
Not past due	54,276	(157)	83,848	(1,065)
Past due 1–30 days	7876	(290)	10,035	(93)
Past due 31–120 days	5,537	(1,981)	7,073	(1,084)
Past due 121–365 days	3,309	(507)	2,284	(696)
More than one year	3,017	(1,837)	2,565	(1,895)
Total	**74,015**	**(4,772)**	**105,805**	**(4,833)**

Notes, continued:

33. continued:

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

	2018	2017
Balance at 1 January	4,833	5,151
Impairment loss allowance, increase	869	2,074
Amounts written off	(613)	(2,424)
Exchange rate difference	(15)	32
Impairment on assets held for sale transferred to assets held for sale	(302)	0
Balance at 31 December	**4,772**	**4,833**

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

The allowance account in respect of trade receivables is used to record impairment losses. If the Group believes that no recovery is possible the financial asset is written off directly.

Guarantees

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

Liquidity risk

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

Exposure to liquidity risk

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

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

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

31 December 2018	Carrying amount	Contractual cash flows	Within 12 months	1–2 years	2–5 years	More than 5 years
Non-derivative financial liabilities						
Unsecured bank loans	212,708	237,997	237,997	0	0	0
Secured loans	203,093	231,723	60,826	17,656	66,536	86,705
Payables and prepayments	237,320	237,320	222,766	925	8,872	4,757
	653,121	**707,040**	**521,589**	**18,581**	**75,408**	**91,462**
Derivative financial liabilities						
Commodity derivatives	33,491	34,139	31,784	2,355	0	0
Forward exchange contracts	3,946	2,518	2,518	0	0	0
– Outflow	(87,765)	(89,363)	(89,363)	0	0	0
– Inflow	91,712	91,882	91,882	0	0	0
Interest rate swaps	(832)	(858)	(648)	(24)	(177)	(9)
	36,605	**35,799**	**33,654**	**2,331**	**(177)**	**(9)**

Notes, continued:

33. continued:

31 December 2017	Carrying amount	Contractual cash flows	Within 12 months	1–2 years	2–5 years	More than 5 years
Non-derivative financial liabilities						
Unsecured bond issue	223,755	259,684	14,898	35,124	209,662	0
Secured loans	65,786	71,120	11,054	41,035	10,823	8,208
Payables and prepayments	249,427	249,427	232,188	2,728	14,511	0
	538,968	**580,231**	**258,140**	**78,887**	**234,996**	**8,208**
Derivative financial liabilities						
Commodity derivatives	17,969	18,163	17,767	396	0	0
Forward exchange contracts	(629)		1,964	1,964	0	0
– Outflow	(134,564)	(134,775)	(134,775)	0	0	0
– Inflow	133,935	136,739	136,739	0	0	0
Interest rate swaps	365	390	49	(3)	344	0
	17,705	**20,517**	**19,780**	**393**	**344**	**0**

Unused unsecured credit lines at year end 2018 amounted to USD 0 million (2017: USD 74.8 million).

As stated in note 29 the Company has categorised its listed bonds as short-term financing in the balance sheet. The Company can refinance the bond categories which is currently under review.

In addition to the liquidity exposure presented in the balance sheet, the Group is exposed to off balance sheet liabilities. Further information on these liabilities is provided in note 35 and 37.

Market risk

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

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

Carbon risk

The Group is exposed to carbon price risk. In terms of volume, carbon emission is a fixed proportion of the fuel consumption but the price volatility of carbon has been greater although the consequential cash flow has been trivial compared to that of fuel costs. Last year the price of carbon units tripled. In 2018 the estimated volumes which need to be submitted in according to the Group's compliance is 530,000 units of which 186,000 are covered by free allocation from the ETS. The volume for 2019 compliance is expected the same, leaving the exposure dependent on price developments. The end of year price was 24.64 EUR/t.

Fuel risk

The Group is exposed to fuel price risk. The Group's fuel price risk management strategy aims to provide the airline with protection against sudden and significant increases in oil prices while ensuring that the airline is not competitively disadvantaged in the event of a substantial fall in the price of fuel. The current Group strategy as reflected in the policy is to hedge between 40% and 60% of fuel consumption 12 months forward and up to 20% from 13–18 months forward. In implementing the strategy, the hedge programme allows for a number of derivatives with approved counterparties and within approved limits. At year end the 55% of an estimated 12 months exposure of 437,000 tonnes was hedged with swaps.

Notes, continued:

33. continued:

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	
	2018	2017	2018	2017
Increase in fuel prices by 10%	14,724	16,122	0	0
Decrease in fuel prices by 10%	(14,724)	(16,122)	0	0

Currency risk

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

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

Exposure to currency risk

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

2018	ISK	EUR	GBP	DKK	SEK	CAD
Receivables / payables, net	69,378	(2,687)	(5,150)	(778)	(178)	79
Cash and cash equivalents	10,263	15,604	5,376	1,768	6,118	3,340
Secured bank loans	(35,987)	(61,554)	0	0	0	0
Forward exchange contracts	89,256	(32,052)	(8,926)	(6,899)	(12,867)	(23,500)
Net statement of financial position exposure	**132,910**	**(80,689)**	**(8,700)**	**(5,909)**	**(6,927)**	**(20,081)**
Next 12 months forecast sales	274,856	243,087	40,939	25,670	26,894	79,162
Next 12 months forecast purchases	(618,089)	(161,891)	(27,405)	(10,430)	(3,472)	(15,739)
Capex thereof	(25,066)	(628)	(1,146)			
Net 12 months currency exposure	**(210,323)**	**507**	**4,834**	**9,331**	**16,495**	**43,342**

2017	ISK	EUR	GBP	DKK	SEK	CAD
Receivables / payables, net	49,103	(4,951)	(4,378)	(786)	183	1,869
Cash and cash equivalents	56,317	35,310	10,201	1,369	4,492	12,054
Secured bank loans	(11,394)	0	0	0	0	0
Forward exchange contracts	122,075	(16,866)	(27,085)	(16,116)	(23,198)	(38,245)
Net statement of financial position exposure	**216,101**	**13,493**	**(21,262)**	**(15,533)**	**(18,523)**	**(24,322)**
Next 12 months forecast sales	307,536	283,863	75,181	24,652	25,606	65,778
Next 12 months forecast purchases	(632,561)	(214,534)	(25,905)	(9,381)	(3,028)	(13,509)
Capex thereof	(46,234)					
Net 12 months currency exposure	**(108,924)**	**82,822**	**28,014**	**(262)**	**4,055**	**27,947**

Notes, continued:

33. continued:

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

	Average rate		Year end spot rate	
	2018	2017	2018	2017
ISK	0.0092	0.0093	0.0086	0.0096
EUR	1.18	1.13	1.14	1.20
GBP	1.33	1.29	1.28	1.35
CAD	0.77	0.77	0.73	0.80
DKK	0.16	0.15	0.15	0.16
SEK	0.12	0.12	0.11	0.12

Sensitivity analysis

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

2018	Directly in equity	Profit or loss	Total effect on equity
ISK	1,017	(3,492)	(2,475)
EUR	2,564	3,891	6,455
GBP	714	(18)	696
DKK	552	(79)	473
SEK	1,029	(475)	554
CAD	1,880	(274)	1,606
2017			
ISK	(9,766)	(7,522)	(17,288)
EUR	1,349	(2,429)	(1,079)
GBP	2,167	(466)	1,701
DKK	1,289	(47)	1,243
SEK	1,856	(374)	1,482
CAD	3,060	(1,114)	1,946

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

Interest rate risk

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

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

	Carrying amount	
	2018	2017
Fixed rate instruments		
Financial assets	0	4,087
Commodity derivatives and forward exchange contracts	(36,605)	17,705
Interest rate swaps	(99,796)	(50,000)
	(136,401)	**(28,208)**
Variable rate instruments		
Financial assets	299,177	220,312
Financial liabilities	(318,523)	(211,709)
	(19,346)	**8,603**

Notes, continued:

33. continued:

Fair value sensitivity analysis for fixed rate instruments

The Group designates derivatives for the purpose of fuel, currency and interest rate hedging as hedging instruments under a fair value hedge accounting model. As such, market rates affect the Mark to Market of the derivatives and the market value of fixed rate financial assets. In addition, interest rate changes affect the fixed rate instruments carrying amount through equity.

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

31 December 2018	100 bp increase	100 bp decrease
Commodity derivatives and forward exchange contracts	145	(148)
Interest rate swaps	3,115	(3,275)
Fair value sensitivity (net)	**3,261**	**(3,423)**

31 December 2017		
Fixed rate instruments	(80)	83
Commodity derivatives and forward exchange contracts	(70)	71
Interest rate swaps	(1,541)	1,499
Fair value sensitivity (net)	**(1,692)**	**1,653**

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.

31 December 2018	100 bp increase	100 bp decrease
Variable rate instruments	155	(155)
Cash flow sensitivity (net)	**155**	**(155)**

31 December 2017		
Variable rate instruments	69	(69)
Cash flow sensitivity (net)	**69**	**(69)**

Capital management

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

Dividend

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.

Notes, continued:

34. Financial instruments and fair values

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

	Carrying amount 2018	Fair value 2018	Carrying amount 2017	Fair value 2017
Derivatives used for hedging	(38,994)	(38,994)	17,067	17,067
Short-term investments	0	0	4,087	4,087
Unsecured bond issue	212,708	(221,058)	223,755	(246,238)
Secured loans	203,093	(198,171)	65,786	(68,504)
Total	**376,807**	**(458,223)**	**310,695**	**(293,588)**

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

31 December 2018	Level 1	Level 2	Level 3	Total
Financial assets				
Derivatives used for hedging		666		666
	0	**666**	**0**	**666**
Financial liabilities				
Unsecured bond issue			(221,058)	(221,058)
Secured loans			(198,171)	(198,171)
Derivatives used for hedging		(39,660)		(39,660)
	0	**(39,660)**	**(419,229)**	**(458,889)**

31 December 2017	Level 1	Level 2	Level 3	Total
Financial assets				
Derivatives used for hedging		18,450		18,450
Short-term investments	4,087			4,087
	4,087	**18,450**	**0**	**22,537**
Financial liabilities				
Unsecured bond issue			(246,238)	(246,238)
Secured loans			(68,504)	(68,504)
Derivatives used for hedging		(1,383)		(1,383)
	0	**(1,383)**	**(314,742)**	**(316,125)**

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

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

Notes, continued:

35. Off-balance sheet items

Leases as lessee

As a lessee the Group has in place operating leases for storage facilities, hotels, equipment, the longest until the year 2041. The Group has also in place operating leases for aircraft, the longest until the year 2027. The aircraft lease payments consist of regular lease payments excluding maintenance reserves. During the year USD 50.4 million was recognised as an expense in profit or loss in respect of operating leases (2017: USD 37.7 million). At year end 2018 the leases are payable as follows in nominal amounts for each year:

2018	Real estate	Aircraft	Other	Total
In the year 2019	20,471	37,027	8,270	65,768
In the year 2020	24,364	40,740	3,463	68,567
In the year 2021	26,327	37,640	2,985	66,952
In the year 2022	26,470	37,640	2,497	66,607
In the year 2023	26,552	36,389	2,436	65,377
Subsequent	315,167	129,693	30,662	475,522
Total	**439,351**	**319,129**	**50,313**	**808,793**

2017				
In the year 2018	18,363	19,745	10,371	48,479
In the year 2019	23,075	24,885	3,766	51,726
In the year 2020	22,886	25,568	3,951	52,405
In the year 2021	22,192	20,412	2,897	45,501
In the year 2022	21,833	18,882	3,046	43,761
Subsequent	249,072	80,851	40,419	370,342
Total	**357,421**	**190,343**	**64,450**	**612,214**

36. Leases as lessor

As a lessor the Group leases aircraft on wet, dry and various other terms, both on short and long-term leases. Lease income for the year amounted to USD 120.1 million (2017; USD 87.7 million). Contracted leases at year end were as follows:

	2018	2017
In the year 2018	–	76,750
In the year 2019	65,722	33,463
In the year 2020	53,975	29,119
In the year 2021	39,074	10,911
In the year 2022	25,876	502
In the year 2023	11,676	0
Subsequent	11,028	0
Total	**207,351**	**150,745**

37. Capital commitments

In 2013 Icelandair Group and Boeing signed an agreement for the purchase of sixteen 737 MAX 8 and 737 MAX 9 aircraft with an option to purchase additional eight aircraft. The delivery of the first three aircraft was in first half of 2018. The commitment for all sixteen aircraft was valued at USD 1.6 billion at Boeing list prices when the agreement was finalised. The Group received acceptable discounts that, due to confidentiality agreements, cannot be disclosed. Prepayments according to the agreement will be made over the construction period.

Two of the three aircraft delivered in 2018, were financed with a JOLCO financing structure (Japanese Operating Lease with a Call Option) and one was financed with a sale and leaseback. All six of the aircraft delivered in 2019 are financed through sale and leaseback agreements. A commitment has been made to finance one MAX aircraft in 2020 with a sale and leaseback. The lease obligation from the contract is included in note 35.

The delivery plan of the aircraft is as follows:	2019	2020	2021
Boeing 737 MAX 8	3	2	1
Boeing 737 MAX 9	3	3	1
Total	**6**	**5**	**2**

Notes, continued:

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

	2018 Salaries and benefits ISK	Number of shares held at year end 2018 in thousands	2017 Salaries and benefits ISK	Number of shares held at year end 2017 in thousands
Board of Directors				
Úlfar Steindórsson, Chairman of the Board	10,591	12,240	9,224	
Ásthildur Margrét Otharsdóttir	7,556		5,375	
Guðmundur Hafsteinsson	4,863			
Heiðrún Emilía Jónsdóttir	4,944	400		
Ómar Benediktsson	8,182		6,198	102,361
Georg Lúðvíksson, former Board member	926		4,074	
Katrín Olga Jóhannesdóttir, former Board member	1,815	13	7,183	13
Sigurður Helgason, former Chairman of the Board			1,528	14,000
Magnús Magnússon, former Board member			669	
Key employees				
Bogi Nils Bogason CEO of Icelandair Group hf.	59,383	1,750	53,900	1,750
Björgólfur Jóhannsson, former CEO of Icelandair Group hf.	68,799	300	67,066	1,900
Six/eight executives of Group companies	204,046	261	286,955	111
Shares held by management and directors includes shares held by companies controlled by them.				
Gender ratio for key employees (male / female)	57 / 43		90 / 10	

Transaction with associates
The Group purchased and sold services to associates for immaterial amounts in 2018 and 2017. At year end the Company had a receivable on it's associate Lindarvatn amounting to USD 1.6 million.

Transaction with shareholders
There are no shareholders with significant influence at year end 2018. Companies which members of the Board and key employees control have been identified as being twenty five. 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 which were immaterial in amounts both in 2018 and 2017.

Notes, continued:

39. Litigations and claims

The Icelandic Competition Authority (ICA) is investigating Icelandair's alleged predatory pricing in 2012–2013 which could be considered as a breach of Article 11 of the Icelandic Competition Act. If the investigation will conclude that Icelandair had a dominant position in the market, and abused its position by predatory pricing, the ICA could lay an administrative fine on Icelandair for the alleged breach of the Competition Act. The ICA's decision may be appealed to the Icelandic Competition Appeals Committee. The Company's management is of the opinion that Icelandair's pricing in 2012–2013 was fully compliant with the Competition Act.

40. Group entities

The Company held ten subsidiaries at year end 2018 which are all included in the consolidated financial statements. During the year Icelandair ehf. merged with IGS ehf. and ownership of Icelandair Cargo ehf. was transferred to Icelandair ehf. The remaining subsidiaries at year end are as follows:

	Ownership interest	
	2018	2017
International Flight Operations		
A320 ehf.	100%	100%
Fjárvakur – Icelandair Shared Services ehf.	100%	100%
IceCap Ltd., Guernsey	100%	100%
Iceeignir ehf.	100%	100%
Icelandair ehf.	100%	100%
Icelandair Cargo ehf.	–	100%
IGS ehf.	–	100%
Aviation investments		
Air Iceland ehf.	100%	100%
Feria ehf.	100%	100%
Loftleiðir – Icelandic ehf.	100%	100%
Tourism investments		
Iceland Travel ehf.	100%	100%
Icelandair Hotels ehf.	100%	100%

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

41. Other matters

Loftleidir Icelandic, a subsidiary of Icelandair Group, has, together with Icelandic investors, submitted a binding offer for a 51% of the shares in Cabo Verde Airlines on Cape Verde. Authorities in Cape Verde and Loftleidir Icelandic have been cooperating for some time. In August 2017, Loftleidir Icelandic signed a management agreement with the Cape Verde Government on restructuring Cabo Verde Airlines. The agreement also aimed to strengthen the international airport in Cape Verde, to develop the islands as a promising tourist destination and to build an international hub for connecting flights. Coinciding with the agreement, it was announced that the company was due to be privatised. Cabo Verde Airlines already has operating licenses to fly scheduled flights to Europe and the United States.

The purchase price is confidential but the acquisition would partly be paid for by the service already performed by Loftleidir Icelandic on the basis of the management contract. If the acquisition goes through, Loftleidir Iceland will hold 35% in Cabo Verde Airlines through a new company, Loftleidir Cabo Verde ehf. The acquisition does not have significant effect on Icelandair Group's financial statements, the shares will classified as an investment in an associated company.

Notes, continued:

42. Ratios

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

	2018	2017 *Restated
Current ratio	0.71	0.99
Equity ratio	0.32	0.42
Intrinsic value of share capital	12.07	15.09

43. Significant accounting policies

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

a. Basis of consolidation

(i) Subsidiaries

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

(ii) Investments in associates

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

(iii) Transactions eliminated on consolidation

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

b. Currency exchange

(i) Currency transactions

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

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

Notes, continued:

43. continued:

(ii) Subsidiaries with other functional currencies

Assets and liabilities of foreign operations and subsidiaries with functional currencies 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.

c. Operating income

(i) Transport revenue

Passenger ticket sales are recognised as revenue when 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 recognised as revenue two months after expected transport if not used. Revenue from mail and cargo transportation is recognised when transportation has been provided.

(ii) Customer loyalty programmes

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

(iii) Aircraft and aircrew lease

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

(iv) Other operating revenue

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

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

d. Employee benefits

(i) Short-term employee benefits

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

(ii) Defined contribution plans

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

Notes, continued:

43. continued:

e. 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.

f. Finance income and finance costs

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

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

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

g. Income tax

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

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

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

h. 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.

i. Operating assets

(i) Recognition and measurement

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

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

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

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

Notes, continued:

43. continued:

(ii) Aircraft and flight equipment

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

(iii) Subsequent expenditure

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

(iv) Depreciation

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

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

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

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

j. Intangible assets and goodwill

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

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

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

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

(ii) Other intangible assets

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

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

Notes, continued:

43. continued:

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.

k. Leased assets

Leases of operating assets that transfer to the Group substantially all of the risks and rewards of ownership are classified as finance leases. The leased assets are measured initially at an amount equal to the lower of their fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the assets are accounted for in accordance with the accounting policy applicable to that asset.

Assets held under other leases are classified as operating leases and are not recognised in the Group's statement of financial position.

l. Assets held for sale

Non-current assets, or disposal groups comprising assets and liabilities, are classified as held-for-sale if it is highly probable that they will be recovered primarily through sale rather than through continuing use.

Such assets, or disposal groups, are generally measured at the lower of their carrying amount and fair value less costs to sell. Any impairment loss on a disposal group is allocated first to goodwill, and then to the remaining assets and liabilities on a pro rata basis, except that no loss is allocated to inventories, financial assets or deferred tax assets which continue to be measured in accordance with the Group's other accounting policies. Impairment losses on initial classification as held-for-sale or held-for-distribution and subsequent gains and losses on remeasurement are recognised in profit or loss.

Once classified as held-for-sale, intangible assets and operating assets are no longer amortised or depreciated, and any equity-accounted investee is no longer equity accounted.

m. Financial instruments

(i) Non-derivative financial assets

Trade receivables and debt securities are initially recognised when they are originated. All other financial assets and financial liabilities are initially recognised when the Group becomes a party to the contractual provisions of the instrument.

A financial asset (unless it is a trade receivable without a significant financing component) or financial liability is initially measured at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue. A trade receivable without a significant financing component is initially measured at the transaction price.

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legally enforceable right to set off the amounts and it intends either to settle them 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 financial assets measured at amortised cost.

Notes, continued:

43. continued:

Financial assets at fair value through profit or loss
Financial assets that are held for trading or are managed and whose performance is evaluated on a fair value basis are measured at FVTPL. These assets are subsequently measured at fair value. Net gains and losses, including any interest or dividend income, are recognised in profit or loss.

Financial assets at fair value through profit or loss comprise marketable securities actively managed by the Group's treasury department to address short-term liquidity needs.

Financial assets measured at amortised cost
A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

These assets are subsequently measured at amortised cost using the effective interest method. The amortised cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognised in profit or loss. Any gain or loss on derecognition is recognised in profit or loss.

Financial assets measured at amortised cost comprise cash and cash equivalents and trade and other receivables.

Cash and cash equivalents comprise cash balances and call deposits with original maturities of three months or less.

(ii) Non-derivative financial liabilities
The Company initially recognises debt securities issued on the date that they are originated. All other financial liabilities are recognised initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire. The Group also derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different, in which case a new financial liability based on the modified terms is recognised at fair value.

The Company classifies non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortised cost using the effective interest method.

Financial liabilities other than derivatives comprise loans and borrowings and trade and other payables.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company 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.

(iv) Derivative financial instruments and hedge accounting
The Group holds derivative financial instruments to hedge its foreign currency, fuel price and interest rate risk exposures (see note 33). 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 generally recognised in profit or loss. The Group holds no trading derivatives.

Notes, continued:

43. continued:

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

Cash flow hedges

When a derivative is designated as a cash flow 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 accumulated 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 hedged future cash flows is no longer expected to occur, then the amounts that have been accumulated in the hedging reserve and the cost of hedging reserve are immediately reclassified to profit or loss.

Net investment hedges

When a non-derivative financial liability is designated as the hedging instrument in a hedge of a net investment in a foreign operation, the effective portion of foreign exchange gains and losses is recognised in other comprehensive income and presented in the translation reserve within equity. Any ineffective portion of the changes in the fair value of foreign exchange gains and losses on the non-derivative is recognised immediately in profit or loss. The amount recognised in other comprehensive income is reclassified to profit or loss as a reclassification adjustment on disposal of the foreign operation.

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.

n. Share capital

Ordinary shares

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

Repurchase and reissue of share capital

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

Notes, continued:

43. continued:

o. 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 that have occurred after the initial recognition of the asset, and that loss event had an impact on the estimated future cash flows of that asset which can be estimated reliably.

Objective evidence that financial assets are impaired includes:

Default or delinquency by a debtor;

Restructuring of an amount due to the Group on terms that the Group would not consider otherwise;

Indications that a debtor or issuer will enter bankruptcy;

Adverse changes in the payment status of borrowers or issuers;

The disappearance of an active market for a security because of financial difficulties; or

Observable data indicating that there is a measurable decrease in the expected cash flows from a group of financial assets.

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

(ii) Non-financial assets

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

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

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

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

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.

Notes, continued:

43. continued:

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.

p. 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 leases

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.

q. Deferred income

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

Icelandair's frequent flyer programme

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

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

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

r. Earnings per share

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

s. 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.

Notes, continued:

43. continued:

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.

44. Standards issued but not yet effective

A number of new standards are effective for annual periods beginning after 1 January 2019 and earlier application is permitted; however, the Group has not early adopted the new or amended standards in preparing these consolidated financial statements.

Of those standards that are not yet effective, IFRS 16 is expected to have a material impact on the Group's financial statements in the period of initial application.

a. IFRS 16 Leases

The Group is required to adopt IFRS 16 Leases from 1 January 2019. The Group has assessed the estimated impact that initial application of IFRS 16 will have on its consolidated financial statements, as described below. The actual impacts of adopting the standard on 1 January 2019 may change because:

- the new accounting policies are subject to change until the Group presents its first financial statements that include the date of initial application; and
- the Group has not made a final decision on a transition option due to the potential sale of Icelandair Hotels.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low-value items. Lessor accounting remains similar to the current standard – i.e., lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance, including IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases – Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

(i) Leases in which the Group is a lessee

The Group will recognise new assets and liabilities for its operating leases of aircraft, storage facilities, hotels, real estate and equipment (see note 35). The nature of expenses related to those leases will now change because the Group will recognise a depreciation charge for right-of-use assets and interest expense on lease liabilities.

Previously, the Group recognised operating lease expense on a straight-line basis over the term of the lease, and recognised assets and liabilities only to the extent that there was a timing difference between actual lease payments and the expense recognised.

No significant impact is expected for the Group's finance leases.

Based on the information currently available, the Group estimates that it will recognise additional lease liabilities in the region of USD 280 million as at 1 January 2019 (thereof Icelandair Hotels in the region of USD 188 million).

Notes, continued:

44. continued:

(ii) Leases in which the Group is a lessor

Under IFRS 16, a lessor continues to classify leases as either finance leases or operating leases and account for those two types of leases differently. However, IFRS 16 has changed and expanded the disclosures required, in particular regarding how a lessor manages the risks arising from its residual interest in leased assets.

Under IFRS 16, an intermediate lessor accounts for the head lease and the sublease as two separate contracts. The intermediate lessor is required to classify the sublease as a finance or operating lease by reference to the right-of-use asset arising from the head lease (and not by reference to the underlying asset as was the case under IAS 17).

Because of this change the Group will reclassify certain of its sublease agreements as finance leases. As required by IFRS 9, an allowance for expected credit losses will be recognised on the finance lease receivables. The leased assets will be derecognised and finance lease asset receivables recognised. This change in accounting will change the timing of recognition of the related revenue (recognised in finance income).

Based on the information currently available, the Group expects that it will reclassify three sub-lease as a finance lease, resulting in recognition of a finance lease receivable in the region of USD 19 million as at 1 January 2019.

(iii) Transition

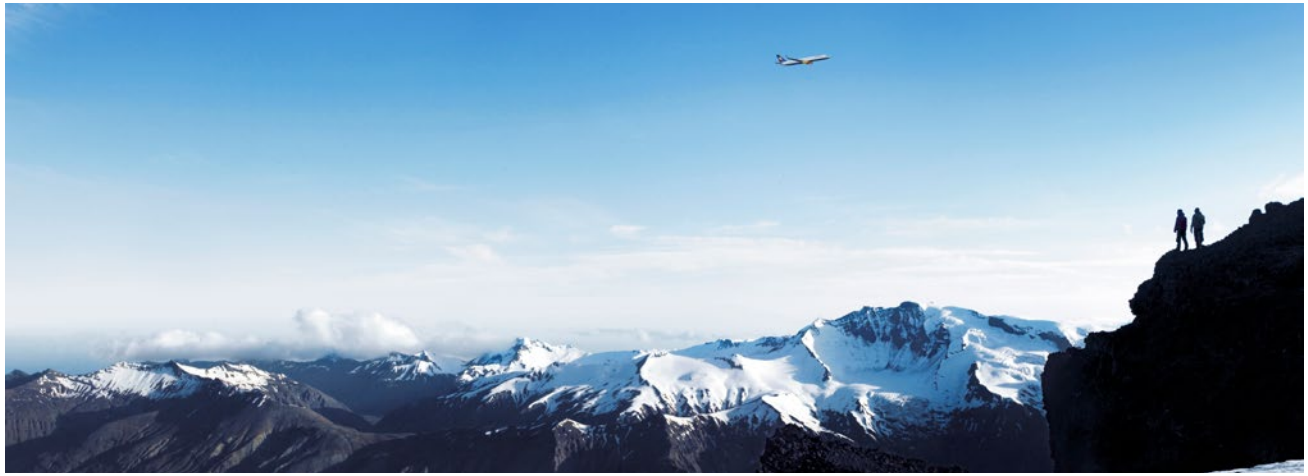
The Group plans to apply IFRS 16 initially on 1 January 2019 using either the modified retrospective approach, with the cumulative effect of adopting IFRS 16 recognised as an adjustment to the opening balance of retained earnings at 1 January 2019, or the cumulative catch up approach with no impact on Retained earnings as at 1 January 2019. Therefore there will be no restatement of comparative information.

The Group plans to apply the practical expedient to grandfather the definition of a lease on transition. This means that it will apply IFRS 16 to all contracts entered into before 1 January 2019 and identified as leases in accordance with IAS 17 and IFRIC 4.

The change in definition of a lease mainly relates to the concept of control. IFRS 16 distinguishes between leases and service contracts on the basis of whether the use of an identified asset is controlled by the customer. Control is considered to exist if the customer has:

- The right to obtain substantially all of the economic benefits from the use of an identified asset; and
- The right to direct the use of that asset.

The Group will apply the definition of a lease and related guidance set out in IFRS 16 to all lease contracts entered into or modified on or after 1 January 2019 (whether it is a lessor or a lessee in the lease contract). In preparation for the first-time application of IFRS 16, the Group has carried out an implementation project. The project has shown that the new definition in IFRS 16 will not change significantly the scope of contracts that meet the definition of a lease for the Group.



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 accessible on the Company's website and the guidelines and the rules for Issuers are on the website of Nasdaq OMX Iceland.

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

In 2012 The Iceland Chamber of Commerce, the Confederation for Icelandic Employers and Nasdaq OMX Iceland hf. granted the Company a recognition for being "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 the management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group's Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee. The committee shall oversee the annual accounts of the Company and the Group's consolidated accounts. The committee is responsible for evaluation of the independence and the eligibility of both the Company's auditor and auditing firm. The committee shall make suggestions to the Board of Directors regarding the selection of the Company's auditor. The Audit Committee held ten meetings in 2018.

Audit Commitee
Ásthildur Margrét Otharsdóttir, Chairman
Guðmundur Hafsteinsson
Heiðrún Jónsdóttir

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

Compensation Committee

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

Compensation Committee
Úlfar Steindórsson, Chairman
Ómar Benediktsson

Corporate Governance Statement, continued:

The Board of Directors and Executive Committee

Board of Directors

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

Ómar Benediktsson, Deputy Chairman
Ómar Benediktsson is the CEO of Farice ehf. He is a Board Member of Landsnet hf. and Húsafell Resort ehf. Ómar has held various positions in the tourist and aviation industry in the past 30 years, among others at Island Tours, Islandsflug, Air Atlanta and SmartLynx airlines as well as being a member on various boards in the industry. Ómar has a Cand. Oecon. degree from the University of Iceland.

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

Guðmundur Hafsteinsson
Guðmundur Hafsteinsson leads product development for Google Assistant at Google. He joined Google in 2014 subsequent to the Merger of Google and Emu, a chat-based virtual assistant start-up he founded in 2012. Prior to the founding of Emu, he was VP Product at Siri and stayed on after the acquisition by Apple through the launch of Siri on iPhone 4S. Prior to Siri/Apple, Guðmundur was a Senior Product Manager at Google, where he managed the initial launches of Google Maps for mobiles and Google Voice Search. Guðmundur holds an MBA degree from MIT and a B.Sc. degree in Electrical and Computer Engineering from the University of Iceland.

Heiðrún Jónsdóttir
Heiðrún Jónsdóttir is an attorney. She is a member of the Board of Directors at Íslandsbanki and Olíuverslun Íslands. Heiðrún is the former Chairman of the Board of Directors at Gildi Pension Fund, Norðlenska and Íslensk Verðbréf. She is a former member of the board of Síminn hf. and Ístak. Heiðrún was the public relations officer of Landssíminn hf. from 2001 to 2003, and, Managing Director and Partner at Lex Legal Services from 2003 to 2005. From 2006 until 2012 she was the Vice President of legal affairs and public relations at Hf. Eimskipafélag Íslands. Heiðrún has a law degree from the University of Iceland, is a District Court Attorney and has finished an Advanced Management Program from IESE Business School in Barcelona.

Corporate Governance Statement, continued:

Executive Committee

Bogi Nils Bogason, *President and CEO*

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

Birna Ósk Einarsdóttir, *Chief Business Development Officer*
Elísabet Helgadóttir, *Chief Human Resources Officer*
Eva Sóley Guðbjörnsdóttir, *Chief Financial Officer*
Gunnar Már Sigurfinnsson, *Chief Commercial Officer*
Jens Bjarnason, *Chief Corporate Affairs Officer*
Jens Þórðarson, *Chief Operating Officer*
Magnea Þórey Hjálmarsdóttir, *Managing Director of Icelandair Hotels*

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

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

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

Corporate Governance Statement, continued:

Board of Directors, continued:

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

The Board of Directors elects a Chairman and Deputy Chairman from its members, and otherwise allocates its obligations among its members as needed. The Chairman calls Board meetings. A meeting must also be held if requested by a member of the Board of Directors or the President and CEO. Meetings of the Board are valid if attended by a majority of its members. However, important decisions shall not be taken unless all members of the Board have had an opportunity to discuss the matter, if possible. The outcome of issues is decided by force of vote, and in the event of an equality of votes, the issue is regarded as rejected. The President and CEO attends meetings of the Board of Directors, even if he or she is not a member of the Board, and has the right to participate in discussions and submit proposals unless otherwise decided by the Board in individual cases. A book of minutes is kept of proceedings at meetings and must be signed by participants in the meeting. A Board member who disagrees with a decision made by the Board 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 which were amended on 10 August 2012 and 9 February 2018. 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 nineteen times during the year and all Board Members attended almost all meetings. All the Members of the Board of Directors are independent from the Company, except Ásthildur Margrét Otharsdóttir. All Board members were independent of the Company's major shareholders in 2018.

Non-Financial Reporting

Business Model

Icelandair Group operates in the international airline and tourism sectors with Iceland as the focal point of its international flight operations. Icelandair Group's core business is built on Icelandair's route network and on marketing Iceland as a year-round destination. In addition to the international flights, operated by Icelandair, the Group has equity investments in the aviation industry and within the Icelandic tourism industry.

Sustainable value creation for the Company's shareholders and other stakeholders lies at the heart of Icelandair Group's business model. It consists of three operating pillars that support the Company's vision – the growth of Icelandic tourism, the growth of connecting VIA traffic and a combination of flexibility and experience.

SUSTAINABLE VALUE CREATION

Commitment to connect Iceland

ICELAND TOURISM GROWTH	VIA GROWTH	FLEXIBILITY AND EXPERIENCE
Taking a driving seat role in increasing tourism to Iceland across seasons from both existing and new markets.	Network growth to strengthen Iceland hub Maintain short connection time at KEF through operational efficiency	Enable rapid reactions to disruptive factors: a structure and culture that foster adaptability and nimbleness.

Enabling positions and capabilities that drive competitive advantage.

Supporting group business that fund growth or provide capabilities.

Environment

Icelandair Group is an environmentally conscious company, committed to addressing its environmental responsibilities. All Icelandair Group subsidiaries have received international environmental certifications from third party auditors.

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

Icelandair Group's Environmental Policy describes the Company's approaches to protecting and preserving the environment. All the Company's employees are responsible for compliance with the policy. Management at all the Company's subsidiaries and entities have adopted guidelines and procedures to comply with the Company's Environmental Policy.

Minimising the environmental impact of its operations is an important part of Icelandair Group's business plan with the focus on employing sustainable practices and ensure optimal use of the resources at our disposal.

Icelandair Group is committed to minimising its impact on the environment by continuously improving the Company's environmental performance, by using sustainable materials and disposing of them in a responsible way, by conducting business with environmentally friendly suppliers and by adhering to environmental protection principles.

Icelandair Group shares important principles with its subsidiaries.

Non-Financial Reporting, continued:

In addition to compliance with applicable laws and regulations, the Company demonstrates its commitment to this policy through:

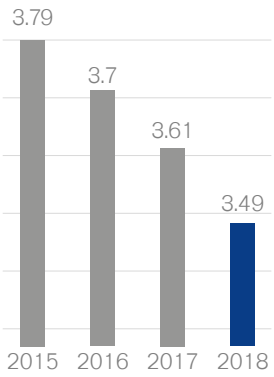
- Minimising carbon footprint and raising awareness
- Reducing waste by increasing recycling
- Promoting responsible use of resources
- Increasing the use of environmentally friendly products and services

Icelandair Group is committed to supporting continuous improvements by setting measurable targets, raising awareness and benchmarking performance.

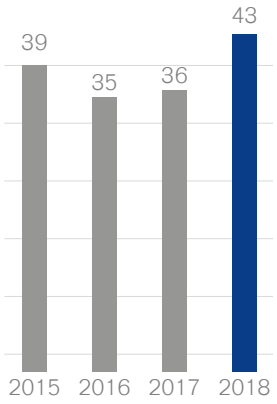
An example of measurable improvements is that Icelandair has undertaken various measures to improve aircraft fuel efficiency, such as adding winglets to all airplanes and changing landing approaches with visible results.

Icelandair Group has initiated various projects to improve waste recycling overall within the Company.

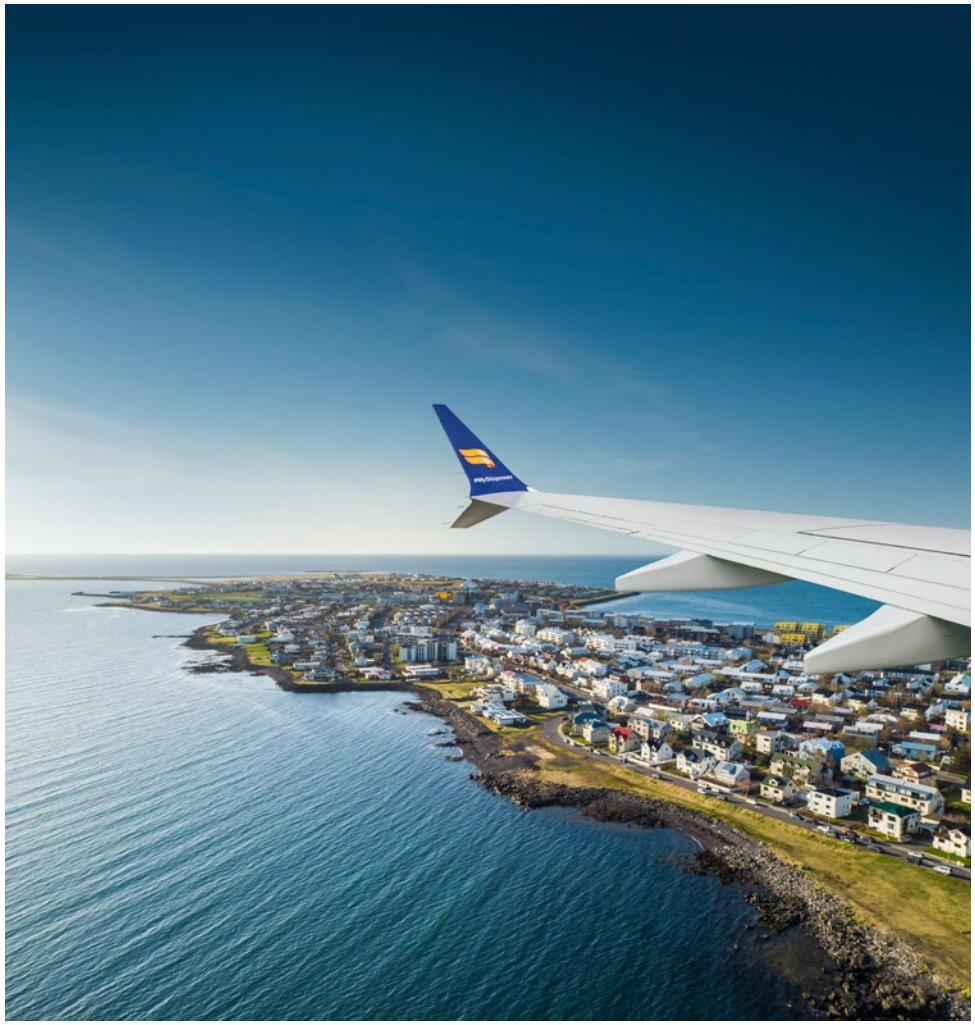
As an integrated part of the Environmental Management System risk assessments have been carried out on a regular basis and appropriate actions have been initiated.



Fuel burn per 100 revenue passenger kilometre (RPK)



Percentage of recycled waste



Non-Financial Reporting, continued:

Society

Icelandair Group is a part of the Icelandic society and is proud of its role in the Icelandic community. The Company continues to seek new opportunities to expand its ties to society at large. That is how the Group harnesses the power of the Icelandic tourism industry for the benefit of Iceland as a nation. The Company focuses on creating sustainable value for its stakeholders by integrating a wide range of efforts to ensure social responsibility.

Icelandair supports and works alongside students and teachers at Reykjavik University on a wide range of projects on annualy basis. Knowledge-sharing is key and each year we strive to engage new talent to work on various projects within the Company.

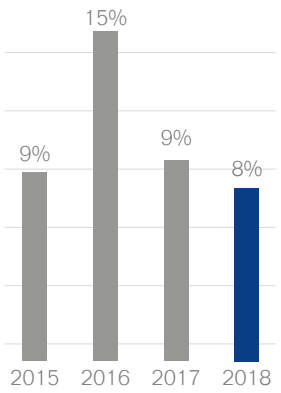
Icelandair Group is a leading shareholder of the Icelandic Tourism Fund, an investment fund focused on new projects that increase the diversity of Icelandic tourism and strengthen its infrastructure. A key focus is on all-year-round projects that provide additional recreational options for tourists and make better use of the existing infrastructure, in particular over the winter season.

The main objective of Icelandair's Special Children Travel Fund, established in 2003, is to help children suffering from long-term illnesses or other difficult circumstances to travel with their families. The fund is supported both directly by Icelandair and through the generous donations of its customers. In 2018, 40 children and their families received travel grants from the fund to go on their "dream journey".

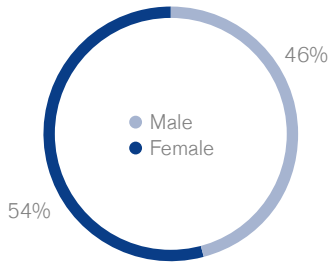
Icelandair Group has since December 2014 been one of the main sponsors of ICE-SAR, the Icelandic Search and Rescue operation. The Company's objective is to provide support to enable the organisation to engage in efficient accident prevention and rescue efforts and to enhance the safety of tourists travelling in Iceland. The purpose of the co-operation is to represent an important factor in promoting safer tourism by various means, including the sponsorship and marketing of the safetravel.is website to tourists through Icelandair Group's distribution channels. Icelandair Group's subsidiary, Icelandair Hotels, promotes safer tourism in all of its properties and has conversations with its guests by distributing safe travel cards and educate them about the road system and weather conditions, for example.

Employees

Icelandair Group has grown at an extremely robust pace in recent years, adding many destinations, increasing the number of its passengers and the number of hotel rooms, and generally growing across all segments. As the business has expanded, so has the Company's staff, which has increased annually in number by 10.4% on average. Full time equivalents were 4,604 on average in 2018. The gender ratio in 2018 within Icelandair Group is close to equal.



Average growth of 10.4%



Gender ratio is close to equal

Non-Financial Reporting, continued:

Icelandair Group's HR strategy emphasises equality and non-discrimination and embraces diversity. The Group makes sure that its employees are provided equal opportunities and equal rights are a part of the Equal Rights Policy and Equal Rights Plan which have been approved by the Management Board.

Icelandair Group seeks to attract talented and qualified employees who can help the Company meet the challenges of the future while at the same time fitting into the existing corporate culture. The onboarding process, goals and measurable targets are being developed for 2019.

It is important that Icelandair Group employees have the drive to develop and learn every day so that the Company can perform better today than yesterday. We provide access for our employees to further development and training. Several courses for work development have been scheduled. Icelandair Group upholds safety and security standards and we have in place detailed action plans designed to achieve our goals, mandatory training is carried out for all employees working in a risk environment and occupational health and safety policy is a natural part of new employee training.

We make every effort to improve the wellbeing of our employees, maintaining an attractive, yet challenging and demanding workplace, and enabling them to flourish and achieve their highest potential. A comprehensive Health and Attendance Policy has been put forward, alongside its introduction, even more emphasis is being placed on employees' health and wellbeing, and by offering various health lectures and other initiatives.

Early 2018 Icelandair Group sharpened its policy and actions against bullying, sexual and gender-related harassment and violence. The policy and its related actions include clear procedures and preventive measures. Information on the policy can be accessed on the intranet, together with a plan of action that details the options available to employees who feel victimised. All managers received appropriate training and open lectures were held for all employees to attend.

In accordance with the Gender Equality Act No. 10/2008 Icelandair Group has implemented an Equal Pay Policy in order to improve gender equality and to acquire an Equal Pay Certification. The Company wishes to enforce the current legislation which prohibits discriminatory practices based on gender and requires women and men working for the same employer to be paid equal wages and enjoy equal terms of employment for the same jobs or jobs of equal value. Icelandair Group has been certified and expects to receive the Equal Pay Certificate in February 2019.

Above all, Icelandair Group endeavours to make sure that all its employees feel that they are part of a team. Every year work audit surveys are carried out among Icelandair Group employees and the next one is scheduled in February 2019. The aim of the surveys is to measure various indicators, such as employee engagement, leadership performance, adherence to relevant company policies. It is also used to evaluate the Company's HR strategy and to measure how preventive actions that have been taken since the last work audit have impacted employees.

Anti-corruption and anti-bribery policy

Icelandair Group's anti-corruption and anti-bribery policy establishes the Group's and all its subsidiaries' global standards regarding the prevention of corruption and bribery. The Company policy is to conduct all its business in an honest and ethical manner and the integrity of each and every member of staff serves to maintain the good reputation and trust of Icelandair Group. The Company policy addresses bribery and corruption, facilitation payments, extortion and whistle-blowing. The policy applies to the entire Icelandair Group workforce at all levels and grades (whether permanent, fixed-term or temporary), and all operations, subsidiaries and affiliates in all countries where the Company operates. All persons, representing or performing services for or on behalf of Icelandair Group must comply with applicable anti-bribery and anti-corruption legislation and policies and Icelandair Group's Code of Conduct. Those who work for or on behalf of Icelandair Group will not be penalised in any way for business advantage lost due to adherence to this policy. Deviations or non-compliance, including attempts to circumvent or manipulate this policy, may result in disciplinary action, including termination.

Human Rights Policy

Icelandair Group respects human rights, as set out in the UN Universal Declaration of Human Rights and requires all its employees to treat others with trust, dignity, respect, fairness and equity. The Company respects fair labour practices and contractors, sub-contractors or work agencies working for Icelandair Group shall ensure that wages, wage-related obligations and safety in the workplace all comply with Icelandair Group's standards. All Cabin Crew have been trained in relation to Human Trafficking Awareness and preventive actions.

Further information

Further information about Icelandair Group's Corporate Social Responsibility and non-financial aspects of the business is published in the Company's Annual Report as well as on the Company's website, icelandairgroup.is.

Quarterly Statements (Unaudited)

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

Year 2018	Q1	Q2	Q3	Q4	Total
Operating income	267,624	398,901	545,193	298,800	1,510,518
Operating expenses					
excluding depreciation	(285,835)	(384,208)	(430,200)	(333,796)	(1,434,039)
Operating (loss) profit bef. depr. (EBITDA)	(18,211)	14,693	114,993	(34,996)	76,479
Depreciation	(28,002)	(34,491)	(36,698)	(34,256)	(133,447)
Operating (loss) profit (EBIT)	(46,213)	(19,798)	78,295	(69,252)	(56,968)
Net finance income (expense)	1,408	(11,975)	(1,575)	(452)	(12,594)
Share of profit (loss) of associates	1,266	293	213	(20)	1,752
(Loss) profit before income tax	(43,539)	(31,480)	76,933	(69,724)	(67,810)
Income tax	9,011	5,752	(14,904)	12,381	12,240
(Loss) profit	**(34,528)**	**(25,728)**	**62,029**	**(57,343)**	**(55,570)**
Other comprehensive profit (loss)	7,583	611	(16,329)	(46,722)	(54,857)
Total comprehensive (loss) income	**(26,945)**	**(25,117)**	**45,700**	**(104,065)**	**(110,427)**
Net cash from (used in) operating activities	67,115	60,062	(50,635)	(14,989)	61,553
Net cash (used in) from investing activities	(129,159)	(60,861)	(76,540)	136,627	(129,933)
Net cash from financing activities	30,802	52,412	62,976	3,146	149,336

Year 2017	Q1	Q2	Q3	Q4	Total
Operating income	222,075	367,300	537,032	291,580	1,417,987
Operating expenses					
excluding depreciation	(232,052)	(326,725)	(381,128)	(308,006)	(1,247,911)
Operating (loss) profit bef. depr. (EBITDA)	(9,977)	40,575	155,904	(16,426)	170,076
Depreciation	(25,887)	(30,850)	(34,291)	(29,403)	(120,431)
Operating (loss) profit (EBIT)	(35,864)	9,725	121,613	(45,829)	49,645
Net finance (expense) income	(1,944)	1,959	397	(2,007)	(1,595)
Share of profit (loss) of associates	470	61	(109)	170	592
(Loss) profit before income tax	(37,338)	11,745	121,901	(47,666)	48,642
Income tax	7,454	(1,835)	(24,716)	7,993	(11,104)
(Loss) profit	**(29,884)**	**9,910**	**97,185**	**(39,673)**	**37,538**
Other comprehensive (loss) profit	(13,201)	5,628	486	13,026	5,939
Total comprehensive (loss) income	**(43,085)**	**15,538**	**97,671**	**(26,647)**	**43,477**
Net cash from (used in) operating activities	125,497	90,801	(19,749)	9,054	205,603
Net cash used in investing activities	(75,782)	(51,297)	(53,154)	(48,186)	(228,419)
Net cash from (used in) financing activities	23,520	(6,416)	(2,399)	(151)	14,554