الاتحاد العربي للنقل الجوي
Arab Air Carriers Organization

AACO AGM 40th
Syria
2007
SYRIA 23-25/10/2007

Arab Air Carriers Organization Annual Report

40th ANNUAL GENERAL MEETING - SYRIA 2007

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AACO's Mission

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To promote cooperation amongst Arab airlines, and to serve their common interests through service excellence.

AACO's Objectives

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To invest in the synergy of interaction between members through establishment of joint projects.

To promote the highest safety standards, providing a framework for a better economic environment for airline operations.

To promote high standards of consumer driven services, and high quality cost effective framework for human resources development.

Members of the Executive Committee

Eng. Nachaat Numir
President of AACO

Mr. Mohamad A. El-Hout
Chairman of the Executive Committee

Members of the Executive Committee

Mr. Mohamad A. El-Hout, Chairman & Director General
MIDDLE EAST AIRLINES
Eng. Khalid A. Almolhem, Director General
SAUDI ARABIAN AIRLINES
Eng. Atef Abdelhamid, Chairman of the Holding Company
EGYPTAIR
Eng. Samer Majali, President & Chief Executive Officer
ROYAL JORDANIAN
Capt. Sabri Saad Shadi, Chairman
AFRIQIYAH AIRWAYS
Capt. Abdulkalek Saleh AL-Kadi, Chairman
YEMEN AIRWAYS
Eng. Nachaat Numir, Chairman/ Managing Director
SYRIAN ARAB AIRLINES
Sheikh Talal Mubarak Abdulla Al-Ahmed Al-Sabah, Chairman & Managing Director
KUWAIT AIRWAYS

سوريا
Syria
2007

Contents

Milestones

The Fortieth Session of the Arab Air Carriers Organization, for the years 2006-2007, was characterized by four key elements:

- Impressive continuous growth in passenger and freight traffic, to, from, and within the Arab World.
- Expansion plans of AACO members, particularly in the Gulf region.
- Slow progress within the Arab regulatory environment on traffic rights and ownership and control.
- Momentum within AACO, and higher economic returns from collective action.

Looking into some of the topics that are reflected in full in the pages of this report, the Arab Air Transport is about to cross the threshold of one hundred million passengers in 2008. It has achieved significant growth over the last three years. In 2007, growth is expected to exceed the 12% achieved in 2006 over 2005. The market is still divided into almost three equal masses: intra-Arab, with Europe, and with Asia and Australia.

Passenger numbers onboard Arab airlines added up to almost 80 million and RPKs rose by more than 14% in 2006 over 2005. The role of Arab airlines in International Air Transport, and naturally within the Arab world, is on the rise. These airlines today connect all parts of the globe, making the best of the Arab world's pivotal expanse. The rising share of Arab airlines is mainly due to the following key reasons:

1. Renowned services onboard Arab airlines, of much higher quality compared to others.
2. The unrelenting development of Arab infrastructure, predominantly airports at a time when some other regions are unable to develop their infrastructure to meet the mounting demand. The geographical hubs of air transport, dominated in the late 20th century by some European or Asian airports – are shifting to Arab airports, mainly in the Gulf region.
3. The prominent geographical span of the Arab world, almost at the center of the globe.
4. Technological progress which enabled aircraft to fly across the planet with only one stop.

Of course, other elements add to the above, especially the quality of the all-inclusive product offered to passengers, together with the pull factors of the stopping points that feature clever prospects for cut-rate shopping and high-end tourist stop-over.

This growth comes in the face of security and political tension at 3 Arab markets that has prevented – or at best weakened - the national airlines' contribution to traffic growth in this region. Several elements exert pressure on the travel routes in the markets concerned, and affects the contribution of their airlines in the growth of the Arab air travel market, namely: the Israeli occupation of Palestine, the incapacitation of Gaza International Airport, the tense situation in Iraq, in addition to the apprehensions prevailing in Lebanon.

In contrast, Arab airlines are renewing their fleet and adding more planes to pull off two primary goals:

First: Modern aircraft are contributing in cutting unit cost, especially where fuel and maintenance are concerned. The average age of the Arab fleet in 2007 was around 7.9 years, making it the most modern in the world, and offering airlines lower unit costs and a comfortable margin for price competition.

Second: To attain adequate capacity to adapt to the expansion of Air Transport, particularly with the global role that some Arab airlines are carrying out. Change in the structure of the Arab fleet is also noteworthy, with a growing number of regional aircraft, which will grow in importance with further adoption of Open Skies policies in the Arab world.

This strategy is coming to fruition, in spite of the hike in fuel prices. The unit cost of Arab airlines declined, resulting in operating profits of more than USD500 million by one Arab airline.

Be that as it may, Arab Air Transport has not reached the stage of making the best of its full potential: the prerequisite is a change in the Arab regulatory environment toward four key conventions:
- Freedom of movement of people and goods.
- Open Skies.
- Ease up rules governing ownership, control and the privatization of airlines.
- Allow no less than the Arab investment to be held as national capital in the aviation sector.

The Arab regulatory environment is half-way from conceding to the afore-mentioned prerequisites. Full priority should be given to support all efforts towards this ideal environment. The alternative would be the breakdown of the Arab Air Transport market into different pieces with different regulatory structures that will have to acclimatize with other world regions where the Arab contribution will be minor. The individual accession of Arab states into the European or the Mediterranean transport market is not like the Arab group's accession with a European group, or within a general Mediterranean framework. Unfortunately, despite all the pledges on the political level, we believe that the realization of the Arab multilateral agreement or the gradual agreement for the liberalization of Air Transport is not up to speed.

These conditions forced themselves on AACO's work throughout 2006-2007. In addition to AACO's ongoing issues such as Joint Fuel Purchasing, Joint Ground Handling Agreements at outstations, expanding the training framework, expanding MIDT analysis, and more. AACO dealt with the electronic ticketing, passenger core systems, and relations with GDSs, connecting Arab routes, in addition of course to the usual statistical and publication work, organizing forums and functions, etc. In July 2004, one month after IATA adopted the replacement of paper tickets by electronic ones, AACO adopted a three phase plan to ensure conformity by the date set by IATA, which was only recently extended till May 2008. These three phases are:

1. Raising awareness in view that the Arab world has not yet absorbed the e-ticketing concept, unlike the European and the US markets that have dealt with e-tickets since 1985. AACO held several meetings with system providers to unify the vision and the understanding on electronic ticketing application, and the areas that must be dealt with by the airlines during the implementation phase.
2. Collective negotiations with these system providers to get the best prices.
3. Draft plans and set priorities for interline traffic with other airlines.

Then, using the same approach as with e-ticketing, AACO moved to negotiations on the new generation of passenger systems, especially inventory, reservation, departure control, and ticketing.

Upon completion, AACO started negotiations with GDSs to ensure larger savings for Arab airlines in this field, to continue what AACO has already started with a decade ago.

On another level, AACO launched "Arabesk" project, where a group of airlines coordinate schedules and implement codeshares in order to add to their marketing capabilities and competitiveness. This year also saw a breakthrough on the part AACO plays on the technical aspect, particularly the areas of emergency response, maintenance and spare parts.

AACO's Annual General Meeting returns to Damascus, a city that has always played a historic role in the development of transport and cultural convergence. The decade between the last AGM and this year's AGM at Damascus has seen development in elements of attraction in Syria, and so did the services of the hosting national airline, Syrian Arab Airlines. The last AGM in Damascus was attended by no more than 70 representatives from Arab airlines, whereas the number has multiplied many folds today, bringing together AACO members, heads of regional and international associations, and leading figures from the Air Transport industry, in addition to representatives of 45 Industry partner companies and institutions. All this is an indication of the growing value of AACO among its members and on the international scene. One notable example of the weight of Arab airlines is the election of the CEO of Royal Jordanian, Engineer Samer Majali, as the Chairman of the IATA Board of Governors for the term 2008-2009. Among Arab airlines, this position has only been reached by the pioneer, late Salim Ali Salam, former Chairman of Middle East Airlines and the former Secretary General of AACO.

Ultimately, AACO's success would not be possible had it not been for the permanent guidance and support, of which AACO is very proud, by the heads of member airlines, in particular the Chairman and members of the Executive Committee who dedicate a significant part of their time to support and guide joint action. Collective action requires prolonged effort, and that is always offered without hesitation by members of AACO's committees and taskforces, who are the backbone of AACO's work. Moreover, none of this could be accomplished without the growing efforts of all the Secretariat General's staff who spare no time or effort in the service of member airlines.

May peace and God's mercy and blessings be with you,

Abdul Wahab Teffaha

Secretary General

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Arab Air Transport

1 Regulatory Environment

Changes on the Local and Bilateral Levels
The Arab regulatory environment remains constrained, some slow progress was made by some Arab countries that have adopted more liberal policies in granting traffic rights and easing restrictions on offered capacity.

- Some countries adopted full open skies policies, namely; Oman, Kuwait, United Arab Emirates, Bahrain and Lebanon.
- Several other Arab countries concluded either bilateral agreements to liberalize air transport, or agreements to facilitate travel within the Arab region, namely; Egypt with Jordan and UAE, and Oman with Kuwait, Qatar, Jordan and Algeria.
- Till now, the Arab world witnessed 18 bilateral open skies agreements concluded between Bahrain, Jordan, Lebanon, Morocco, Oman, Qatar, Syria, Egypt, Saudi Arabia, UAE and Tunis.

Changes at the level of airline ownership

- Saudi Arabia started partial privatization of 49% of Saudi Arabian Airlines shares. It completed the privatization of the Catering Unit early 2007, and plans to privatize the Cargo Unit towards the end of 2007, and the Technical and Ground Handling Departments during the first quarter of 2008. Moreover, the airline announced plans to establish a low-cost subsidiary in response to the opening of the Saudi Market for start-up companies.

- The Jordanian government pursues the privatization plan of Royal Jordanian. It decided to sell 74% of the airline's shares and to retain a 26% stake, provided that the share of non-Jordanian investors would not exceed 49% of the airline's stake-holding.

- The Kuwaiti government announced its intention to sell 80% of Kuwait Airways, where it will sell 40% of the airline's shares at an IPO during the first year while the other 40% will be auctioned in the Kuwaiti stock exchange market.

- The Sudanese government announced that 49% of Sudan Air shares will be underwritten by a Kuwaiti company, and another 21% by a Sudanese company. The government intends to keep a 30% stake of the national airline.

- Qatar Airways announced it would start privatization after 2012.

- The Egyptian government announced in February 2006 that 20% of EgyptAir shares will be sold by the end of 2007. The IPO aims to raise USD 700 million to support the cost of acquiring new aircraft.

- The remaining Arab airlines are generally government owned, with varying plans for privatization or continuation of government holding.

Changes at the Multilateral Level

The Arab Multilateral Agreement for the Liberalization of Air Transport, which was adopted by the Arab Civil Aviation Commission "ACAC" at the level of Arab Transport Ministers, came into effect on 18 February 2007 following its ratification by five Arab States, necessary for its launch. The five states are Syrian Arab Republic, Hashemite Kingdom of Jordan, Republic of Yemen, State of Palestine, and Republic of Lebanon, joined later by the United Arab Emirates.

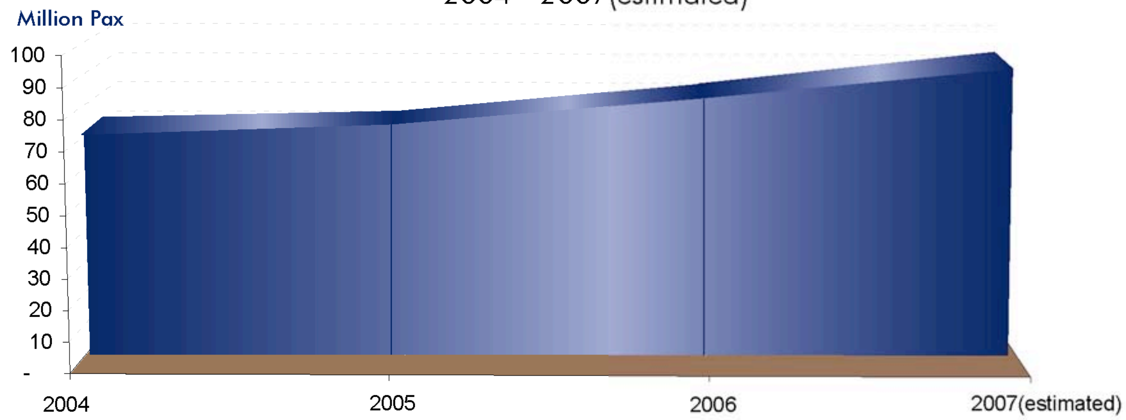
Moreover, some Arab countries have already signed the convention but have not yet ratified it; Bahrain, Tunisia, Sudan, Somalia, Iraq, Oman and Egypt, noting that ratification is a prerequisite to join the convention. Following the launch of the agreement, ACAC is working on the development of an economic regulatory code of air transport, the latter being the executive statute of the Arab multilateral agreement for liberalization of air transport. Regulations will contain the essential elements to address the economic aspects of the Convention.

2 Passenger Traffic in the Arab World Market

The number of passengers in the Arab world totaled 84.5 million passengers in 2006, at a growth of 11.7% over 2005. It is expected that this number will reach 95 million passengers by the end of 2007, an increase of 12.5% over 2006. (Fig.1&2)

Fig. 1

Passenger Traffic and Estimated Growth for the Arab Market 2004 - 2007(estimated)

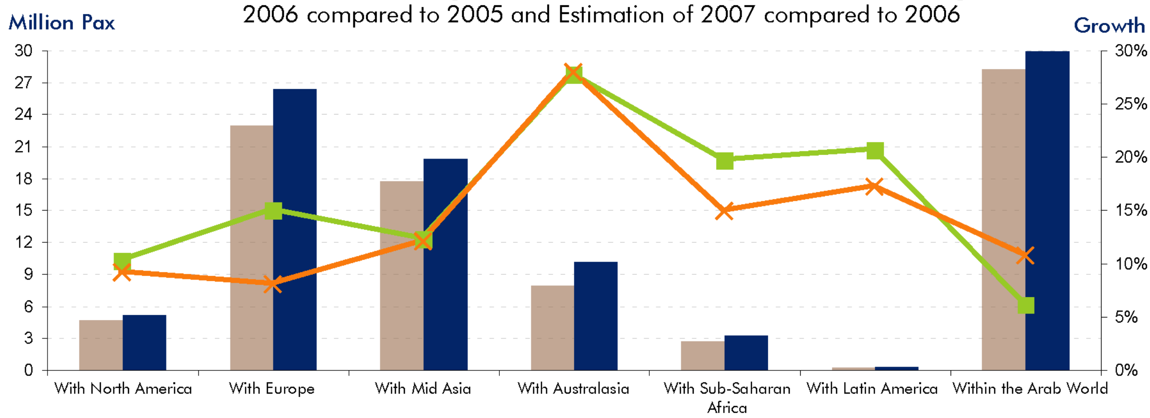


Source: AACO

Fig. 2

Arab Market Passenger Traffic and Change with World Regions

2006 compared to 2005 and Estimation of 2007 compared to 2006



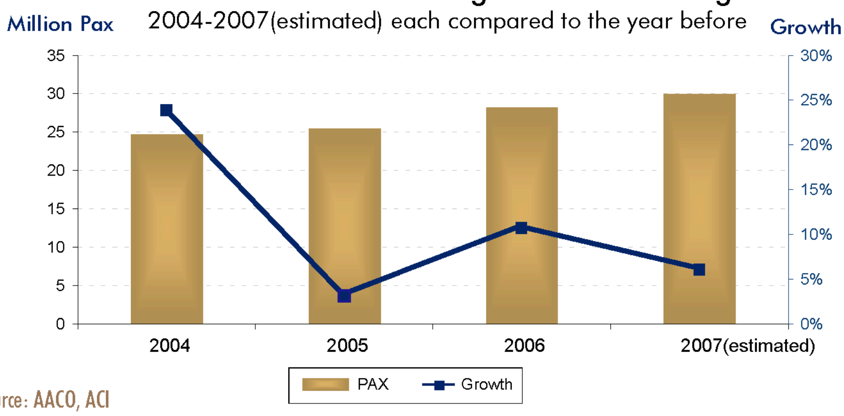
Source: AACO, ACI

In 2006, passenger traffic within the Arab world registered a growth of 10.7% compared to 2005, and is expected to grow by 6% in 2007 over 2006. (Fig.3&4)

Fig. 3

Intra Arab World Passenger Traffic & Change

2004-2007(estimated) each compared to the year before

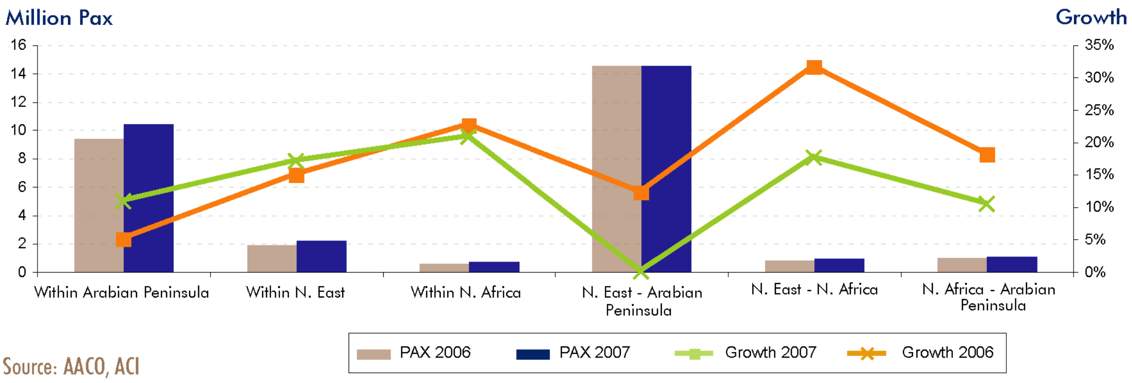


Source: AACO, ACI

Fig. 4

Intra Arab World Sub-Regional Passenger Traffic and Change

2006 compared to 2005 and Estimation of 2007 compared to 2006



Source: AACO, ACI

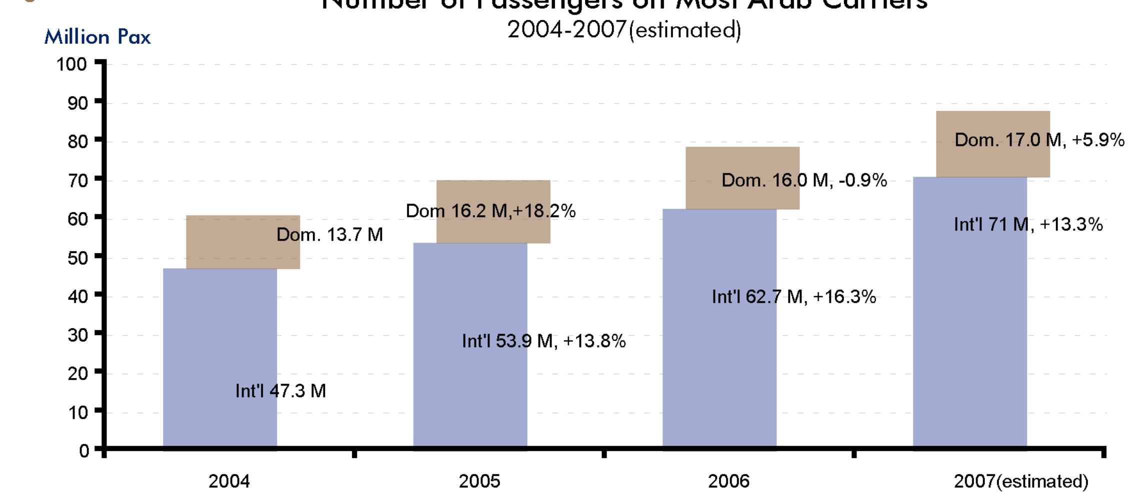
3 AACO Members' Operations

Arab airlines reported a 14.2% growth rate in passenger numbers (RPKs) in 2006 over 2005, and a 188% rate over 1995. Global growth for the same period was 5.9% over 2005, and 63% over 1995.

Overall number of passengers on Arab airlines totaled 78.7 million passengers in 2006, an increase of 12.3% over 2005.

The number of international travelers onboard Arab airlines in 2007 is expected to be 13.3% higher than 2006. The number of passengers on domestic routes is expected to increase by 5.9%. The total number of passengers on Arab airlines is expected to reach 88 million passengers by the end of 2007. (Fig.5)

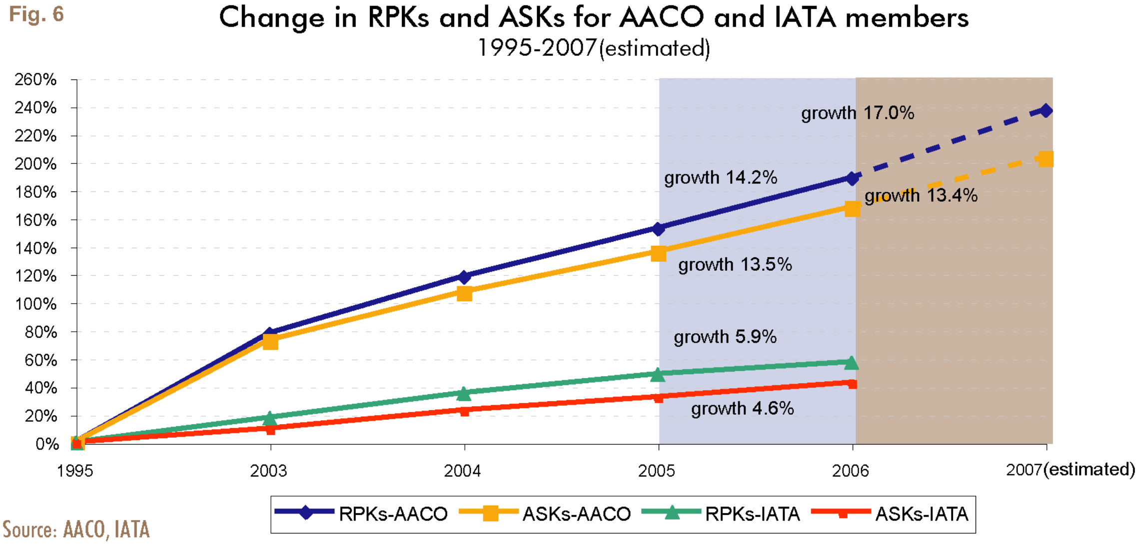
Fig. 5



Source: AACO

It is expected that Revenue Passenger Kilometers onboard Arab airlines will grow by 17% in 2007 over 2006. Available Seat Kilometers are expected to grow by 13.4% in 2007, resulting in higher load factors for AACO member airlines. (Fig.6)

Fig. 6



Source: AACO, IATA

4 Cargo in the Arab World

- Air freight in total has grown at an average of 5.1% yearly over the last two decades. Forecasts promised a growth of 300% for global cargo traffic for the period 2005-2025. These major growth expectations are attributed to several reasons, mainly; decline in transit time, increased capacity and demand and dispensing of the need for warehouses, whereby commodities are hauled directly from factory to aircraft.

- Boeing and Airbus expect that the industry will require 3,563 freighters, mostly widebody, by 2025 compared to 1,789 in 2005.

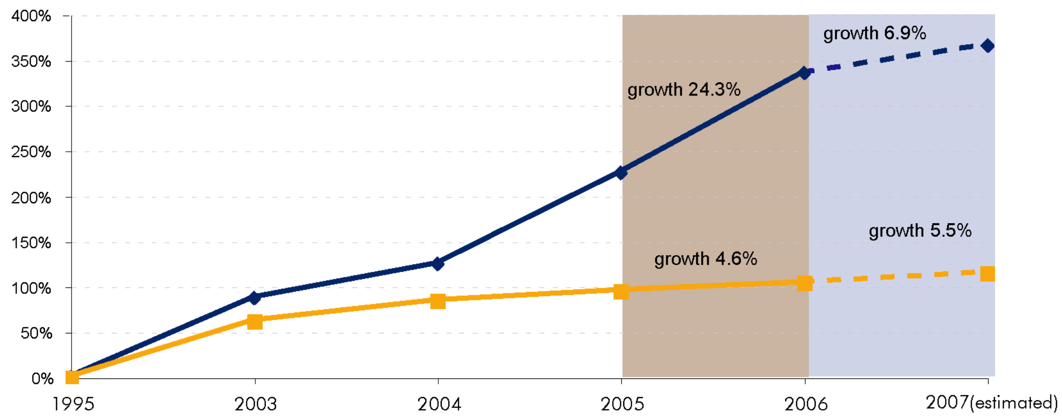
- Generally, Cargo revenues contribute by 15% of the total revenues of an airline.

- Following the significant growth in freight movement, Arab airlines are more set to change their cargo units into separate operational units with designated cargo fleet. This is particularly observable at EgyptAir, Emirates, Etihad, and others. Other airlines are working on the privatization of cargo units to strengthen their financial positioning, as with Saudi Arabian Airlines and Royal Jordanian. Arab Airlines also cooperate through codeshare and special prorate agreements to expand their cargo networks.

- Arab airlines are well aware of the importance of cargo activities, especially with the continuous record growth in RTKs, which in 2006 recorded a growth of 24.3% over 2005, and 336% over 1995, whereas global year-on-year growth did not exceed 4.6% in 2006, and 104% compared to 1995. Cargo traffic is expected to increase by 6.9% onboard the Arab airlines in 2007 compared to 2006, compared with expectations of a 5.5% growth rate in the world.

Fig. 7

Growth for AACO and IATA Members' RTKs
1995 - 2007 (estimated)



Source: AACO, IATA

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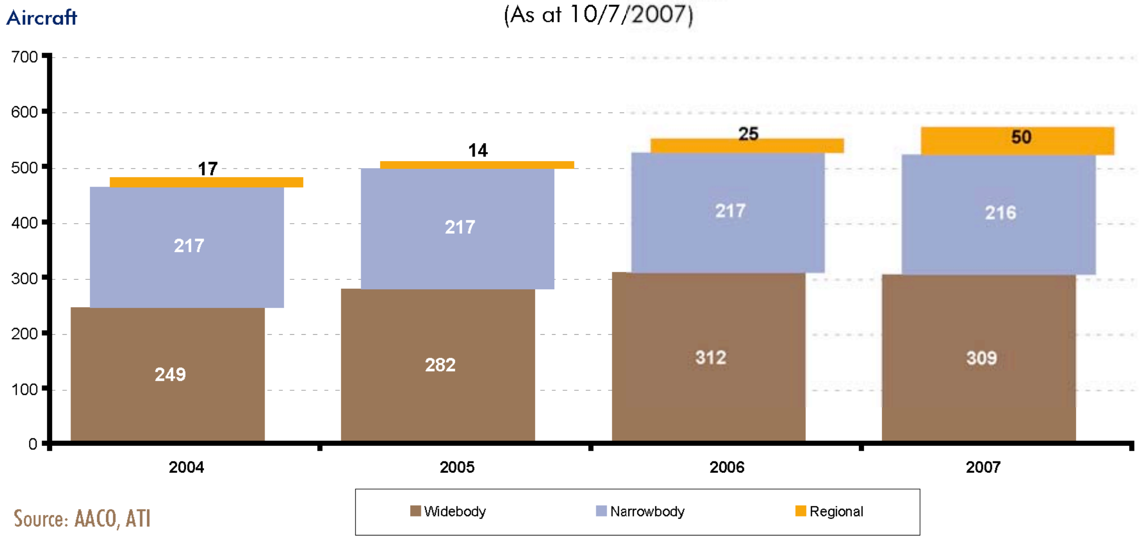
5 Arab Fleet

Current Fleet

The Arab region is experiencing considerable growth in the number of aircraft, and aircraft orders. In 2006, Arab airlines took delivery of 77 new aircraft, 46 were wide bodies. Of the total deliveries, 41 were additions and 36 were replacements of older models, noting that 45 deliveries are planned for 2007.

Fig. 8

Arab Airlines Fleet
(As at 10/7/2007)

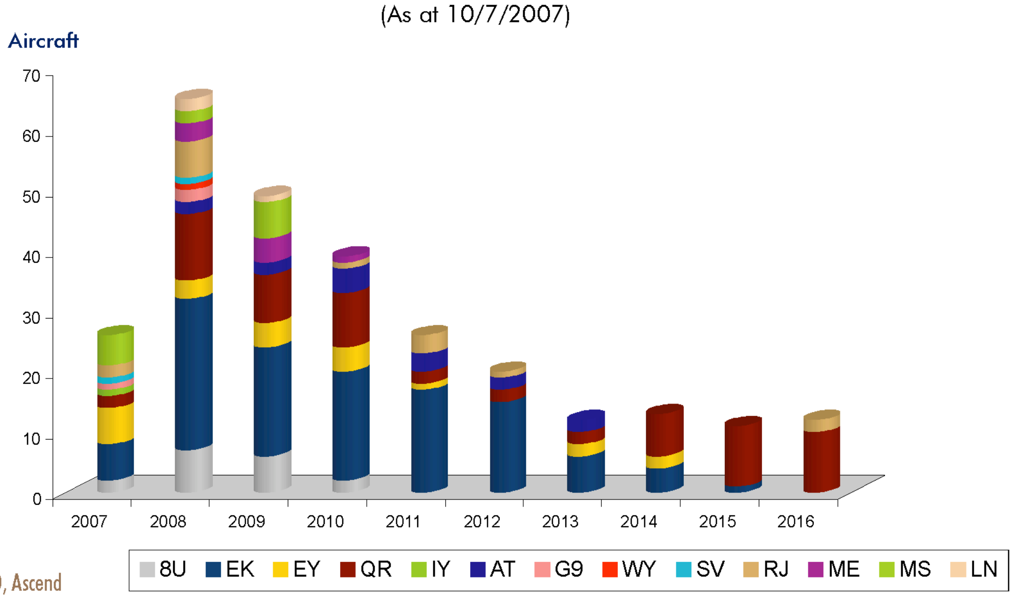


Source: AACO, ATI

Contracted Aircraft

Fig. 9

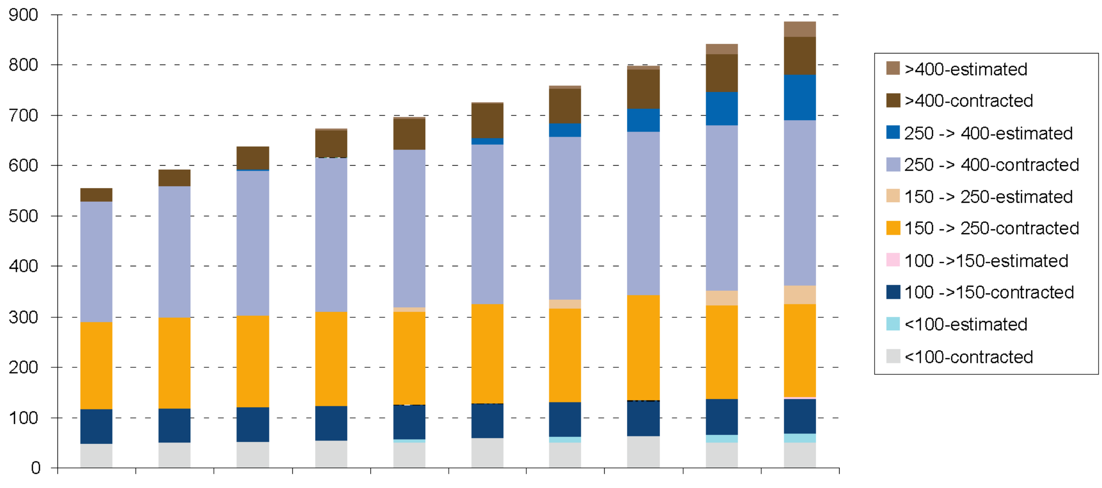
Number of New Aircraft Expected to Join the Arab Airlines' Fleet
(As at 10/7/2007)



Source: AACO, Ascend

Current and Forecasted Growth

Fig. 10 Contracted and Estimated Growth of Arab Fleet by Capacity Type and Estimation of Aircraft Retirement (2006-2015)

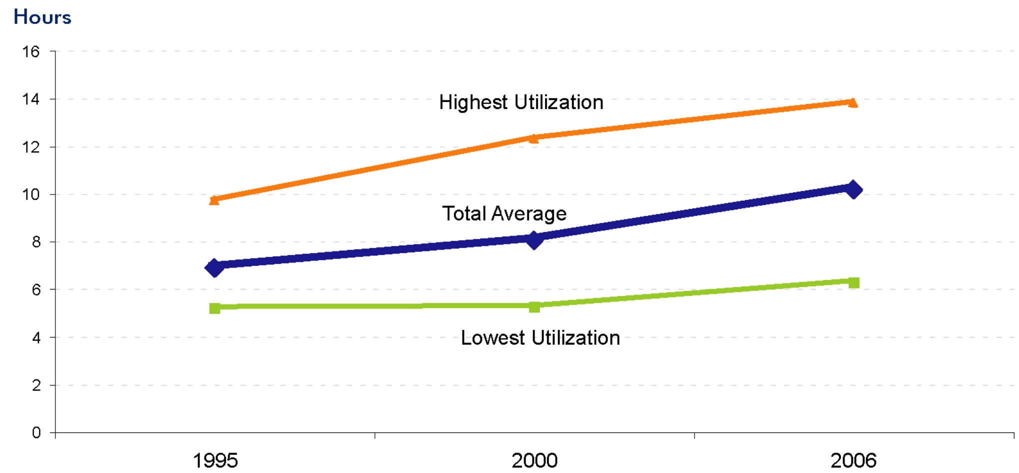


Source: AACO, Ascend, ATI

Average Aircraft Utilization

Aircraft utilization in 2006 has increased, indicating maximal utilization of the capital cost of the aircraft, in addition to higher long haul operations. (Fig.11)

Fig. 11 Average Aircraft Utilization for AACO Members (1995-2006)



Source: AACO, IATA

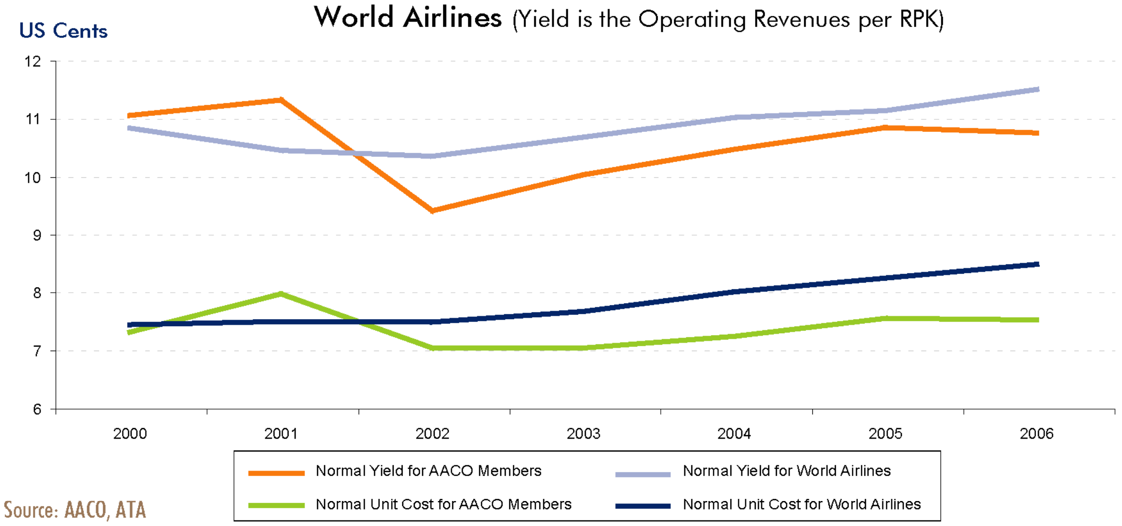
Yield and Unit Costs

Yield

Yield of Arab airlines declined by (0.9%) in 2006. In turn, the (0.4%) decline of the unit cost helped to correct the decline in yield, noting that unit costs around the world and the global average for yield rose by 2.8% and 3.3% respectively. (Fig.12)

Fig. 12

Comparison of Yield and Unit Cost between AACO Members and World Airlines (Yield is the Operating Revenues per RPK)



Source: AACO, ATA

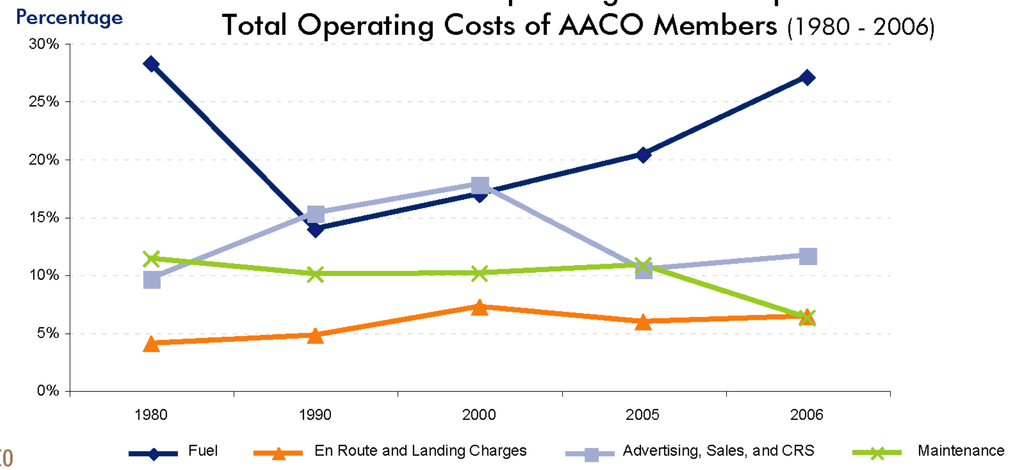
Changing Costs

Looking at the financial results of 12 Arab airlines, operating expenses rose by 17.2% versus 19.3% increase in operating revenues. The growing productivity of Arab airlines coupled with proper revenue management led to operating revenue profits.

Fuel prices still represent the biggest element of airlines' costs, as they constitute 27% of the overall costs, and have increased by almost 34% compared to 2005. Fuel costs to AACO members, and around the world, historically accounted for 30% of the operating costs, as shown in Fig.13. However, the decline in oil prices and the rising costs of other components over a decade brought down the cost of fuel to about 14% of the total costs before the recent hike.

Fig. 13

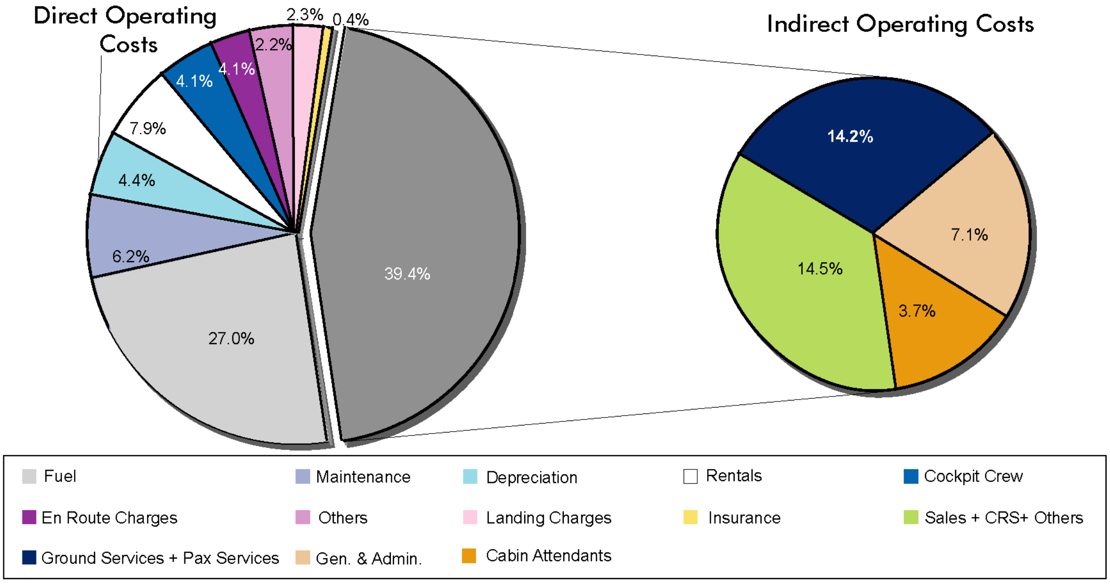
Contribution of Some Operating Costs Components in the Total Operating Costs of AACO Members (1980 - 2006)



Source: AACO

Fig. 14

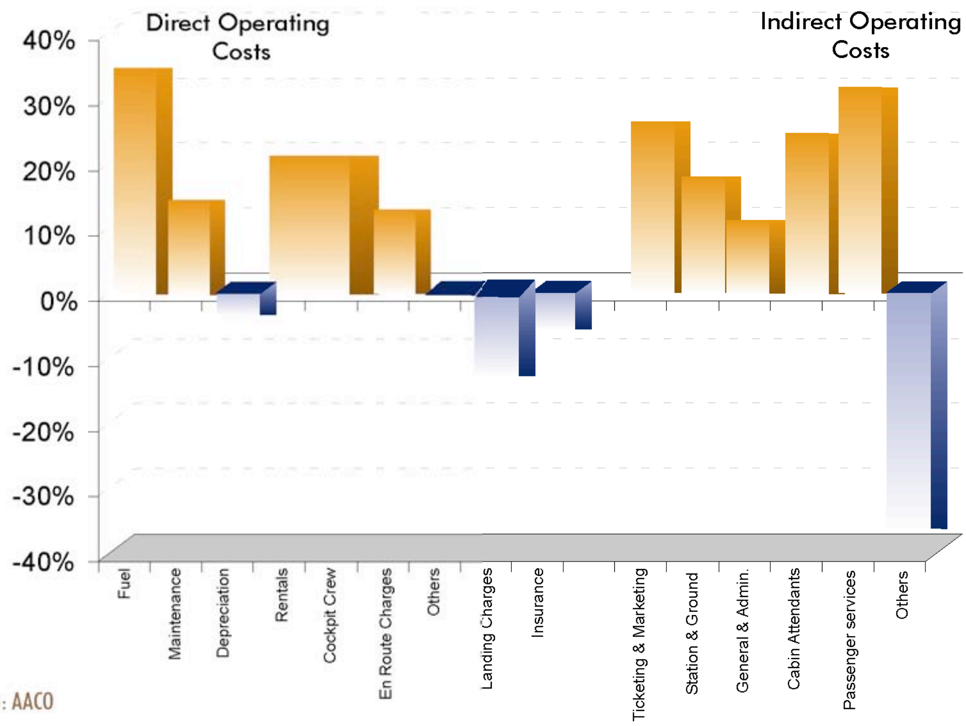
Cost Distribution
(Year 2006)



Source: AACO

Fig. 15

Cost Changes
(Year 2006)



Source: AACO

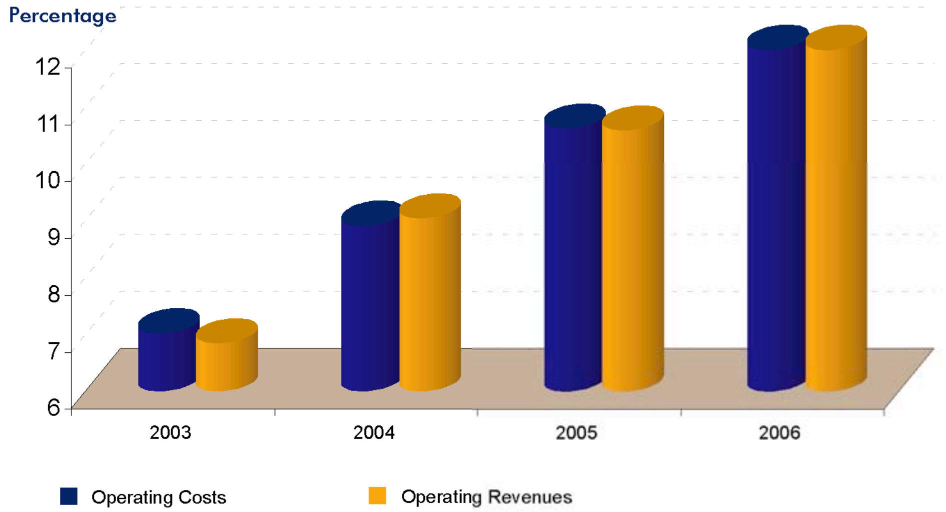
7 Financial Results

Arab airlines achieved good financial results in 2006: Gross and operating revenues rose, although there was an increase in operating costs. Given the financial results of 12 Arab airlines, the operating revenues rose by 19.3% to reach USD14 billion, and gross revenues by 18.6% to USD14.5 billion, resulting in operating profits of almost USD350 million for these airlines, despite the 17.2% increase in operating costs that touched USD13.6 billion.

Within the 12 airlines, the highest operating profits for an airline in the group were USD518 million, and the highest operating losses for another amounted to USD321 million.

Fig.16 illustrates a comparison between the operating revenues and operating costs for 8 AACO member airlines.

Fig. 16 **Comparison of Operating Revenues and Operating Costs for 8 AACO Members** (2003-2006)



Source: AACO

This graph includes the statistics of the following Arab carriers: AH, AT, EK, GF, KU, ME, RJ, WY

International Relations

Arab World and Europe

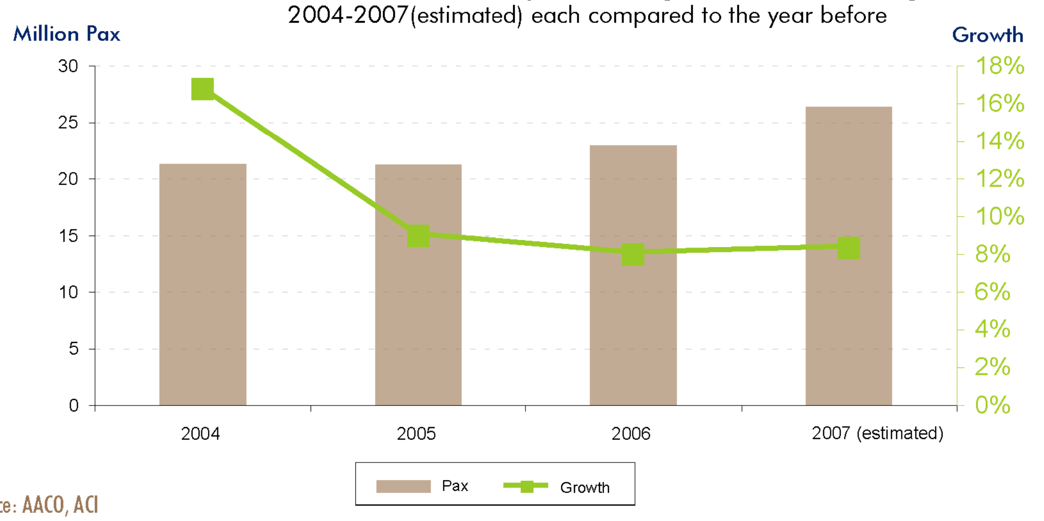
Passenger Traffic

In 2006, traffic between the Arab world and Europe grew by 8% compared to 2005 and is expected to grow by 8.3% in 2007 over 2006. (Fig.17)

Fig. 17

Arab World with Europe Passenger Traffic & Change

2004-2007(estimated) each compared to the year before



Source: AACO, ACI

Regulatory Relations

AACO and ACAC continue to hold talks with the European Commission over bilateral agreements with EU countries, in light of the European Court of Justice ruling to substitute the "national ownership" clause in bilateral agreements between any EU country and a third country by the "EU Ownership".

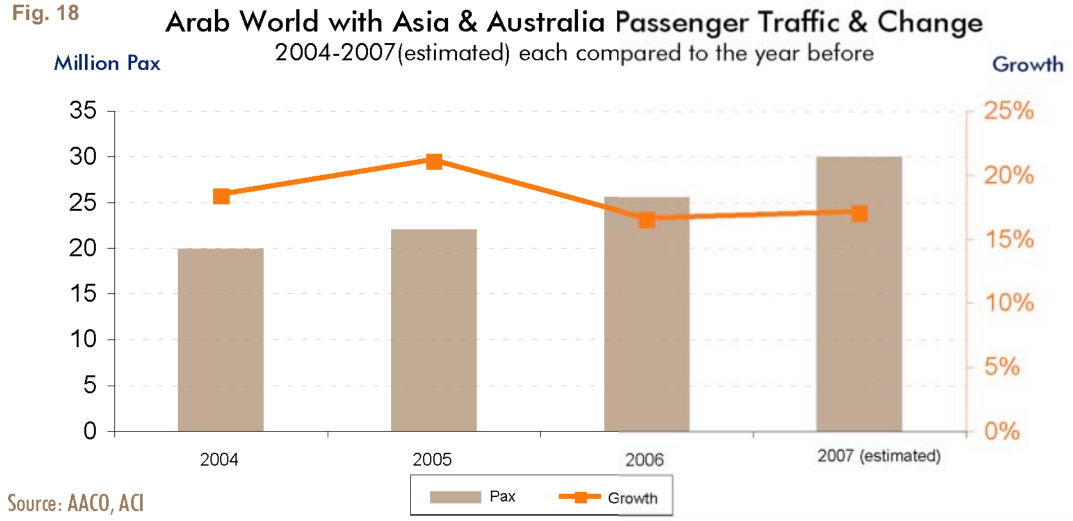
AACO and ACAC had agreed with the European Commission on general principles within the framework of the collective Arab mechanism for negotiations with regional or sub-regional blocs, which sets the framework of bilateral negotiations between any Arab country and the European Union. Although not formally signed, these principles are valid and have been circulated to Arab airlines, each of which addressed the civil aviation authority in its respective country to request the same conditions as in this memorandum of understanding in their agreements with the EU.

Arab World with Asia and Australia

Passenger Traffic

Total passenger traffic between the Arab world and Asia and Australia grew by 16.5% in 2006 compared to 2005. Growth is expected to reach 17% in 2007 compared to 2006. (Fig.18)

Fig. 18



Source: AACO, ACI

China and the Arab World

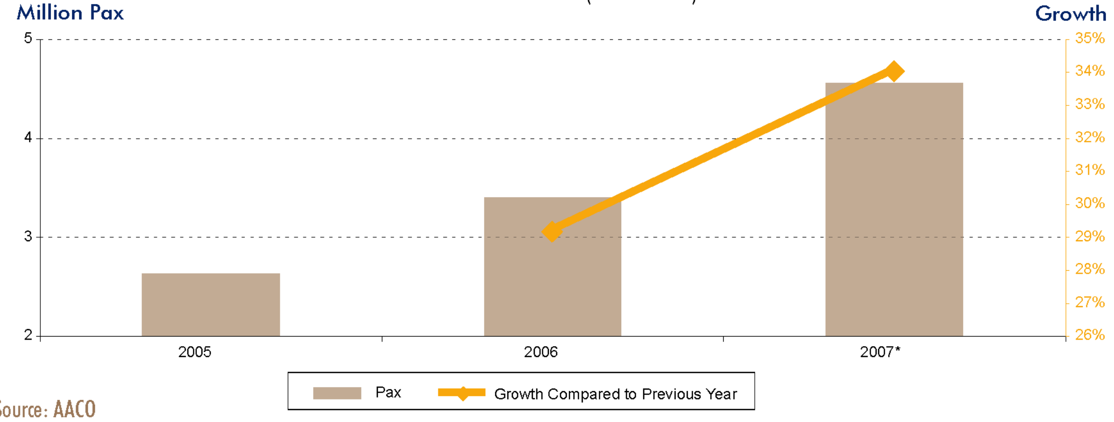
Chinese Market:

- China is the second-largest market for air transport after the United States.
- The Civil Aviation Authority in China forecasts 14% annual growth in profits for the period 2006-2010.
- Significant expansion of Chinese airlines fleet; 45 additional aircraft joined the Chinese fleet in the first 4 months of 2007, and up to 150 aircraft will join the fleet by the end of 2007, 140 aircraft in 2008, 160 in 2009, and 140 in 2010.

China - Arab World Market:

- Travel market between the Arab world and China grew by 29.15% in 2006 over 2005, and the number of passengers is expected to increase by 34% in 2007 over 2006.
- China-Arab World market size counts 3.4 million passengers, and we expect this number to reach 4.55 million passengers in 2007. (Fig.19)
- The Arabian Gulf region accounts for 65% of the market volume between China and the Arab World. The largest growth rates however are between North Africa and China by 41.13% for 2006.
- Five Arab airlines operate routes into three major cities in China; Beijing, Shanghai and Guangzhou.
- There are 35 routes between the Arab World and China on which Arab and non-Arab airlines operate.

Fig. 19 Arab World and China Passenger Traffic and Growth
2005 - 2007(estimated)



Source: AACO

India and the Arab World

Airports:

The Indian government recently announced expansion projects for 35 airports in India, worth USD4 billion, to be completed within two years. Private investors are developing 4 Indian airports in Mumbai (USD1.5 billion), Bangalore (USD300 million), Nagpur (USD580 million) and New Delhi (USD1 billion).

Overview:

- Full or partial bilateral air transport liberalization agreements between India and 15 countries in the Arab region.
- Arab airlines operate from 10 Arab countries to India.
- Indian airlines operate to six Arab countries directly, or through codeshares.
- The Arab world is the second largest market for India after the Indian domestic market.
- Geographical proximity between India and the Arab region allow operations of aircraft with short and medium range.

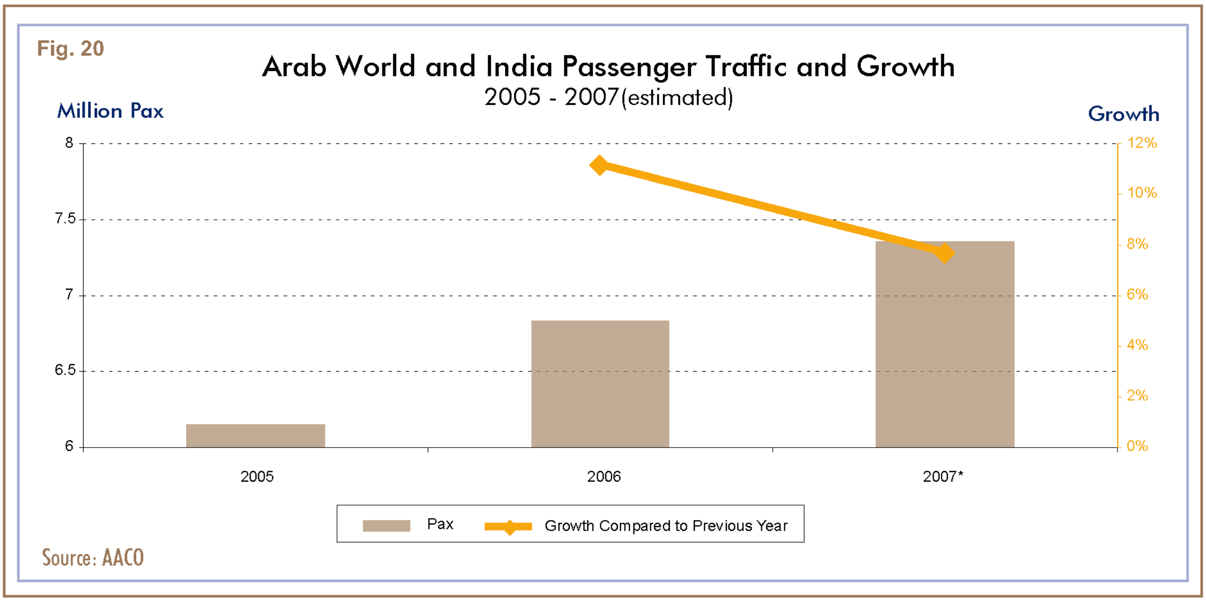
Latest Developments

Passenger traffic grew by 11.12% between the Arab world and India in 2006 over 2005, with a market volume of 6.8 million passengers. The market between India and the Arab world is expected to grow by 7.65% in 2007 over 2006, and to maintain an average of 6% annual growth until 2020. (Fig.20)

The Gulf region comprises 98% of the market volume between India and the Arab world. This percentage is due to the number of Indian expatriates at various Gulf countries. It makes this market one of the most important short to medium haul markets, and at the same time allows the operations of wide-bodied aircraft.

In turn, Arab airlines are increasing flight frequency to India, owing to the increased demand for travel to that country. To date, 10 Arab airlines operate direct flights to several cities in India, with plans to expand by the end of 2007.

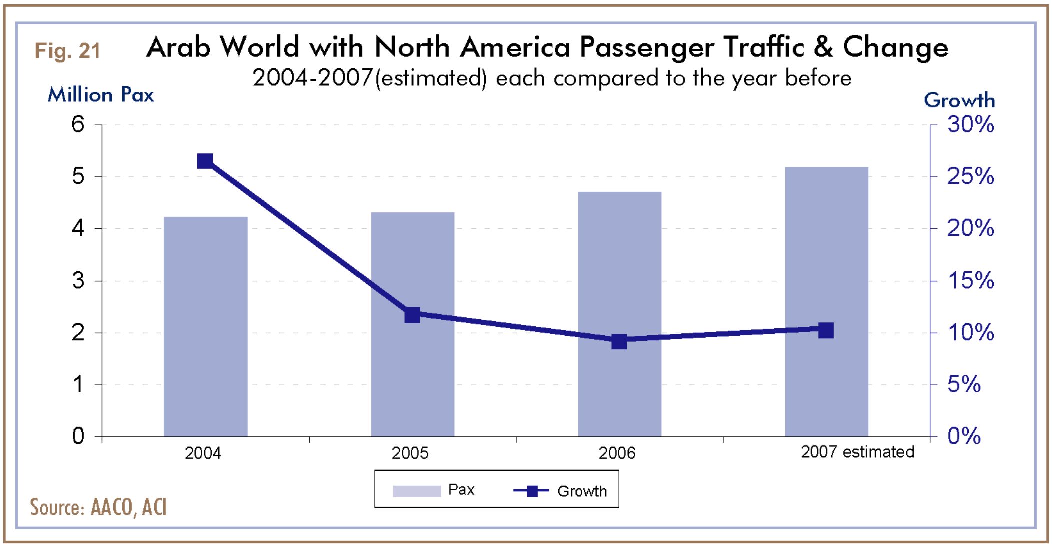
Private Indian airlines will start operations to the Gulf region in January 2008, when the Indian government suspends legislations that prevent private Indian airlines from operating international flights.



Arab World and America

Traffic with North America:

Passenger traffic grew by 9.1% in 2006 over 2005 between the Arab world and North America, and we expect this growth to reach 10.1% in 2007 over 2006. (Fig. 21)

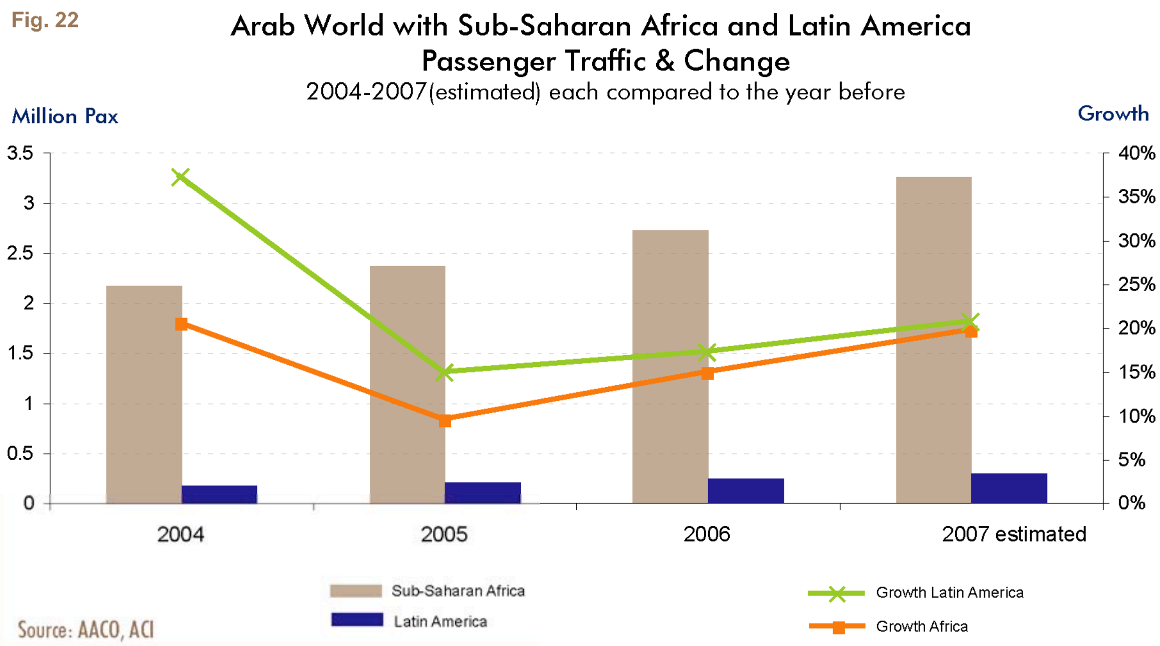


Recently three Arab airlines have launched direct services between Arab capitals and the USA.

Arab World with Sub-Saharan Africa & Latin America

Passenger traffic grew by 15% in 2006 over 2005 for those two regions, and we expect this growth to reach 19.7% in 2007 over 2006.

Fig. 22



Source: AACO, ACI

Arab Air Transport and Industry Issues

Safety

No doubt that the year 2006 aviation safety review could be well marked as the safest year in air transport history. ICAO's figures for the year 2006 show 13 fatal accidents on scheduled flights carrying at least seven passengers. Fatalities tolled up to 755 in 2007, up from 712 in 2006.

In general, the number of accidents declined, noting that the commercial jet fleet during 2006 flew 5.2% more departures as per the statistics of the Flight Safety Foundation.

According to IATA, the 2006 industry hull loss rate recorded 0.65 accidents per million flights for western-built jets, which is equivalent to one accident for every 1.5 million flights, hence showing 14% improvement on 2005. The main causes for accidents remain for the larger part mainly from human error and poor weather conditions.

Again, AACO members secured a 4th consecutive year with zero fatal accidents. This proves their commitment to safety with the ongoing efforts towards promoting safety culture within their companies.

The safety initiatives have started few years back with IOSA. Currently, most of AACO carriers possess the seal of safety and quality excellence. It is expected that all AACO members will be listed on the IOSA Registry by the end of 2008.

Emergency response is certainly another field of interest to our members in both safety and cooperation. As safety remains the highest priority, an efficient Emergency Response program is being established through AACO's newly established Emergency Response Planning Working Group with the support of AACO Regional Training Centre.

Maintenance

Most Arab airlines are modernizing and expanding their fleet. Operation of wide body aircraft is on the rise in the region, in light of high demand on this type of aircraft, notably the A380.

These changes push for more development of the maintenance operations in the region, and the importance of dealing with some of the challenges to bring maintenance operations to the highest standards. Some Arab airlines have started to include training programs for the schooling of local labor; this must extend to all airlines and suppliers of maintenance and repair services in the region.

It goes without saying that cooperation in the areas of maintenance and rehabilitation between member airlines helps to achieve comprehensive benefits and produces significant revenues for the Arab aviation industry. This is also the objective of the MRO Technical Group recently established within AACO.

Security

Air transport security remains the top priority for AACO, which is committed to keep up with the rapid developments in that area.

AACO Security Working Group works on the following points:

- Constant exchange of information on aviation security between member airlines.
- Coordination with third party providers of security services, training organizations, regional and international bodies.
- Adherence to the latest developments in the field of aviation security, and informing member airlines of these developments.
- Coordination with AACO Regional Training Center to run introductory and advanced training programs in the area of aviation security for all AACO members.

The aviation industry is constantly faced with multiple dangers; liquid explosives were recently added to the list of threats. The unsuccessful attempts to blow up aircraft on flights across the Atlantic originating from the United Kingdom was a turning point in aviation security and led to the imposition of strict security measures on travelers, including regulations to determine the permitted amount of liquid placed in hand luggage, and the size of luggage allowed onboard. Travel to these airports turned into a cumbersome and prolonged process because of extensive security checking procedures. Chaos at airports marred the first phase of the implementation of the new regulations. No doubt that the strict adherence to these procedures is important for passengers' security, but it nonetheless added to the sense of frustration among passengers. Cooperation to coordinate and standardize security measures, which must include international bodies, governments and other concerned organizations, is enough to counter terrorist threats in the global aviation industry, and at the same time bring back the concept of comfort to air travel.

Aviation Industry and the Environment

Aviation industry generally contributes 2% of the total global output of carbon dioxide, and 13% of the total output of all means of transportation, versus 75% resulting from the road transport vehicles alone. Given the fact that the fleet of Arab airlines is the youngest fleet among international airlines, aviation related emissions in the Arab world are very limited compared with other countries.

Various parties in the aviation industry are working to reduce emissions of carbon dioxide, as follows:

Before Take-Off:

- The adoption of electronic ticketing reduces the use of paper and this positively reflects on the environment.
- Consuming less fuel during take-off and during flight, through mobilization portfolios in a more meaningful way.
- Funding studies on reducing emissions through minimal financial levies added to the price of tickets.

At the Airport: Airports are now using ground vehicles operated by alternative fuel (bio-fuel, natural gas, etc.)

Take-off: Coordination between Air Traffic Controllers and the crew ensure the least operation of aircraft engines on the ground.

During the Trip: Shortening air routes through free flight will bring significant environmental benefits, such as those in Europe.
Landing and Arrival: Following more effective landing procedures to reduce fuel consumption and noise levels.

On the other hand, aircraft and engine manufacturers are working on the production of lighter aircraft and engines with less fuel consumption to reduce the emissions of carbon dioxide.

Studies which started in 2003 on finding alternative fuel for jet fuel, have concluded that the best alternative is to use synthetic fuel, as approved by ASTM and Defense Standard. These studies have taken into account all elements of fuel efficiency, emissions, fuel quality, and noise. Arab airlines are currently looking into this; Qatar Airways announced that it will be the first Arab Airline to seek the use of alternative fuel, in coordination with Boeing.

The key issue remains that improving the environmental impact is at the hands of some of the civil aviation authorities in Europe, the United States and Asia to improve and expand the infrastructure in order to overcome congestion, which increases unnecessary fuel consumption.

Inclusion of the Aviation Industry in the Emissions Trading Scheme

The European Union believes that the aviation industry should be included in the Emissions Trading Scheme (ETS). European ministers agreed to apply this to flights between EU airports at the first phase starting 2011, and then extend it to all flights to and from any airport in the EU early 2012. The European Union continues to work to complete the details of this program.

ICAO Committee on Aviation Environmental Protection (CEAP) has put in place guidelines to ICAO's 189 members on the inclusion of emissions resulting from air transport, summarized below:

- Aircraft operators be the accountable international aviation entity.
- Obligations to be based upon total aggregated emissions from all covered flights conducted by each operator included in the ETS.
- States to consider aggregate carbon dioxide emissions and/or aircraft weight as the basis for the application of any inclusion threshold.
- Initial ETS to only include CO2.
- States to ensure that aviation emissions are counted separately and not against specific reduction targets identified by the Kyoto Protocol.
- States to address the integration of foreign operators under a mutually agreed basis.

As for "trading units", States are required to review the economic feasibility and environmental integration, fairness and competition when making a decision.

A study carried out by "Ernest & Young" and York Aviation, on behalf of a group of aviation organizations, has revealed that the scheme as proposed by the European Commission would reduce airlines revenue between USD12.83 and USD54.71 billion between 2011 and 2022. The study stated that airlines would not be able to transfer to passengers except one third of the additional costs resulting from the inclusion in the scheme. Moreover, the study expects a reduction in passenger and freight traffic due to a decline in customer options in terms of range and frequency of routes, in addition to the loss of 8000 to 42000 jobs.

Alliances and Mergers

The concept of alliances was initially a means for airlines to expand their international networks. Currently, there are three global alliances (table below), controlling over 60% of international air transport in the world, namely; Star, Oneworld and SkyTeam. The 3 alliances bring together more than 40 airlines from around the world.

In spite of the presence of more than 40 airlines in alliances, there are basic geographic gaps. Alliances cover most routes in North America and Europe, but have limited operations in India and South America. Only two African airlines are alliance members. In China, the four largest airlines are in the process of joining alliances.

The adoption of the European citizenship of airlines in the European states has paved the way for airline mergers inside Europe, taking advantage of transport rights of the merged airlines without the limitations of national ownership in operations, or pressures exerted by major airlines on their respective governments to liberalize the terms of ownership and control. The air transport industry is rapidly moving towards the conversion of the alliance formula towards the merger formula and exchange of ownership. Though this is currently seen in Europe, following suit of the United States, most likely the same pattern would be seen across the Atlantic, in Asia, or between the three continents.

Low cost carriers generally avoid joining global alliances, as that would contradict the LCC business model.

All these facts place Arab airlines in a harder competitive position because of the small size of the Arab market, and the governments' ownership and control over most of these airlines. This has limited the number of Arab airlines acceding to the global alliances, except for Royal Jordanian, the first airline in the Middle East to join a global alliance, Oneworld.

This has given rise to "Arabesk" initiative between seven Arab airlines, cooperating on their network to strengthen their respective competitive position regionally and globally. Arab airlines are generally following the "codeshare" strategy in order to open their domestic markets and expand their network of regional and international destinations.

	Members	Passengers	Destinations
OneWorld	10	321 million	688
SkyTeam	10	364 million	744
Star	17	405 million	8 55

Low Cost Airlines

The liberalization of air transport created the basic ground for the emergence of new airline models that were not previously known. In the United States, Southwest rose in the early 80s, and coined the term and working model of "low-cost airline". Other airlines adopted the same model and expanded significantly after the internet boom, which enabled airlines to market their products on a more individual level, without incurring high costs.

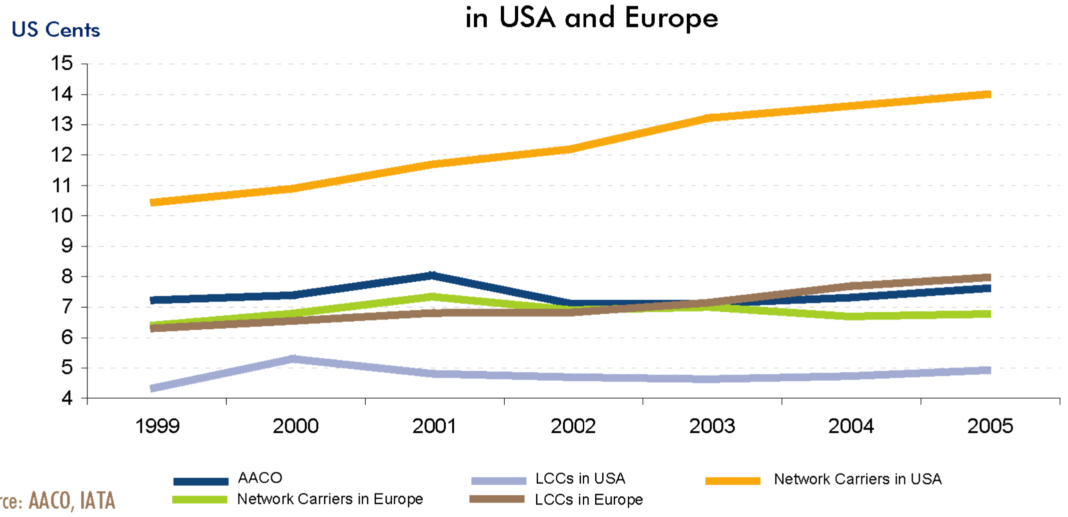
This model emerged in Europe after the full liberalization of air transport in 1997, with EasyJet and RyanAir. Many airlines followed suit, and succeeded in developing and attracting a significant share of the market.

In the Arab world, changes were taking place in the regulatory environment on one hand, and in the growing role of the private sector and changing operational standards because of the economic competition on the other. The first Arab low cost airline – Air Arabia, based in Sharjah, managed since its launch in 2003 to carry over 4.6 million passengers, and has successfully increased its fleet size, and a very successful IPO.

A number of low cost carriers emerged in the Arab market:
- Jazeera in Kuwait
- Nas and Sama in Saudi Arabia
- Atlas Blue and Jet4U in Morocco
- Red Sea in Egypt

Fiercer competition is expected between network carriers and low cost carriers as they serve common destinations on short sectors and face similar economic and operational pressures. The national airlines are preparing to face competition, especially on domestic routes, where several airlines have started restructuring processes to establish subsidiaries that follow the same business model of the low cost airlines, namely Saudi Arabian Airlines and EgyptAir.

Fig. 23 Unit Cost Comparison between AACO Members and Airlines in USA and Europe



Source: AACO, IATA

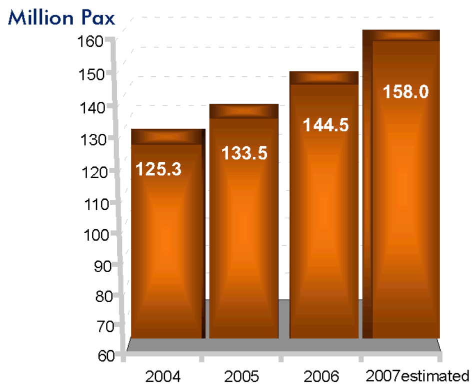
Arab Airports

Arab Airports Traffic:

The number of passengers at Arab airports increased by 8.2% in 2006 over 2005, to reach 144.5 million passengers, amidst expectations to touch 158 million passengers by the end of the year 2007. (Fig.24)

Fig. 24

Passenger Traffic at Arab Airports
2004-2007 (estimated)



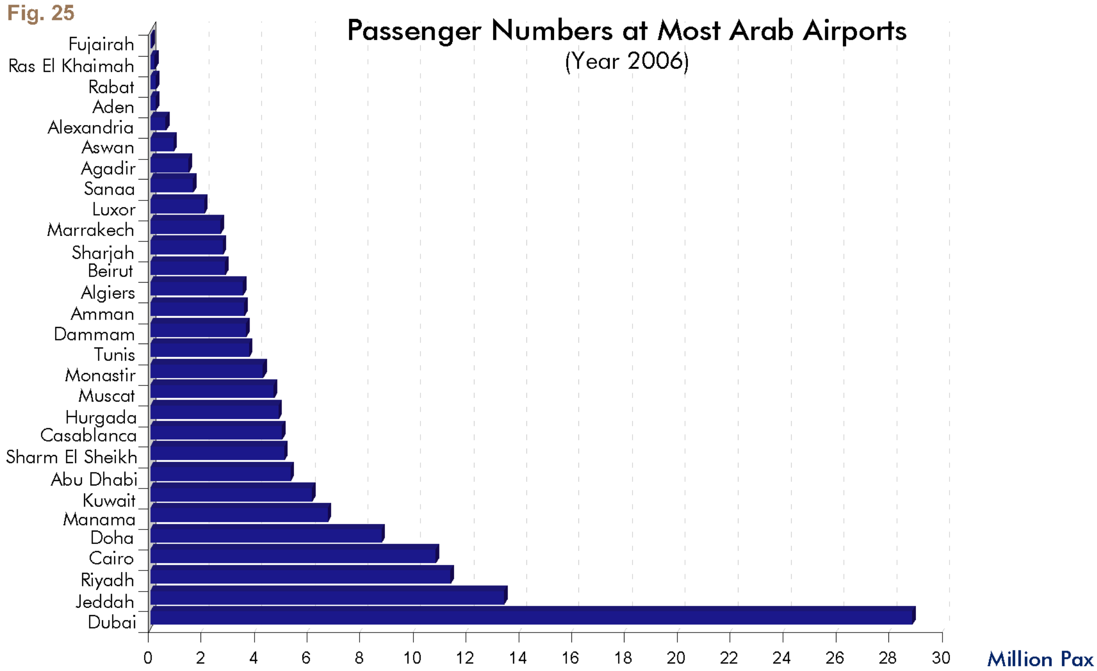
Source: AACO, ACI

Passenger and Cargo Movement at Arab Airports:

Most Arab airports recorded good growth in the number of passengers during 2006 compared with 2005. Ras al-Khaimah Airport in the United Arab Emirates registered the highest annual growth rate of 74.3%. Airports outside major cities in the Arab world are part of the accelerated growth, especially those that attract tourist movement.

Fig. 25

Passenger Numbers at Most Arab Airports
(Year 2006)



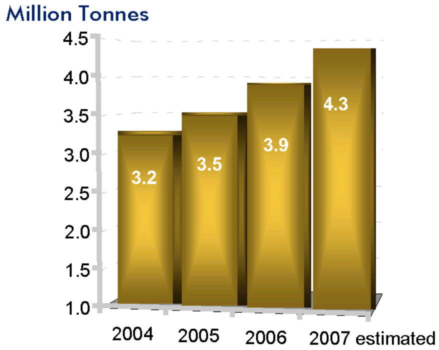
Source: AACO, ACI

The movement of air freight at Arab airports registered remarkable growth in 2006, at 11.3%, and is expected to reach growth of 11.6% at year-end 2007.

Fig. 26

Cargo Traffic at Arab Airports

2004-2007(estimated)



Source: AACO, ACI

Expansion Projects at Arab Airports:

The current number of Arab Airports is 142 in 18 countries. The large number of expansion and development projects at airports around the Arab world can be attributed to many reasons:

1. To increase capacity to meet the needs of airport operations during peak hours or in certain seasons. Also, to accommodate and serve giant aircraft types.
2. To develop efficient airport operations.
3. The strong competition between airports to act as a central "Hub".
4. To Keep abreast with security requirements, and facilitate the movement of passengers or cargo.

Airports' building and development projects in the world vary from one region to another for several reasons, namely the ownership of airports, lack of decision making power, capital availability, the environment and the political situation. In America, the issues related to the environment lead to the postponement of a number of projects to build and expand a number of airports. In Europe, these projects are limited to four, building two airports at Berlin and Lisbon, and additional terminals in Heathrow and Frankfurt. China has a large number of construction and development projects of more than 42 airports at a price tag of USD17.4 billion.

India has allotted USD 4 billion to modernize 35 airports. In Africa, projects in Kenya and South Africa are estimated at USD807 million, in anticipation of the projected growth in passenger traffic during the coming two decades.

In the Arab world, an estimated investment of USD40 billion will be put in 30 projects during the coming years in building, modernizing and developing Arab airports. The biggest in terms of size or investment are in the Arabian Gulf region, at USD34 billion, noting that the United Arab Emirates alone accounts for half the total investments in airport infrastructure around the Arab world.

The capacity of Arab airports, by the time the projects conclude, will rise to 400 million passengers annually.

Fuel

Fuel Prices

Fuel is the major element of the airlines' cost and returns. External variables, and consequently the geopolitical factors in 2006 and 2007, resulting in the fluctuating fuel prices, reflect negatively on airlines' proceeds.

Year 2006 witnessed a sharp rise in fuel price – USD66 per barrel at the beginning of 2006 up to a USD90 per barrel in August – then relatively decreasing to USD81 per barrel in December. This fluctuation was a result of several factors; environmental, political and economic.

Nonetheless, fuel prices dropped back to USD50 a barrel early 2007, after OPEC stated its intentions to a planned increase in production to maintain price levels. The increase to USD60, followed the wave of cold weather in February 2007, and then to USD71 in June 2007 due to Hurricane Gonu. Unrest in Nigeria, the largest oil producer in Africa, also contributed to the recurrent trend of price increase.

The dramatic rise in fuel prices, coupled with high demand on fuel in the second quarter of 2007, had had their toll on airlines' operating costs. This negatively reflected on the global economy and the global aviation industry. Forecasts indicate that global demand for fuel will grow moderately in 2008, with increasing supplies from competing oil producing countries.

Taxes and Charges

It has become evident that taxes and charges are on the rise year after year inline with the rise in fuel prices. This fact is a major hurdle to airlines, and restricts their ability to maintain a moderate margin between cost and operating revenues.

The increased levies imposed by government and airport operators at global airports have expanded from European and American airports to include Arab airports.

In addition to landing fees, which account for 2.3% of airline cost, and over-flying charges, which represent 4.1% [which in turn increased by 11.9% over 2005], civil aviation authorities impose 1% levies on each refueling process, already in place at Jordanian airports. Elsewhere, taxes imposed on fuel duties at Egyptian airports increased from 1 cents/gallon to 2.5 cents/gallon. This means that Arab fuel companies are together under pressure with the Arab airlines.

The Secretariat General is coordinating with ACAC and IATA to discuss the issue of user charges, given the negative impact on the operations of Arab airlines under the monopolistic situation of airports.

Joint Action

Year after year, AACO is developing a transparent joint fuel purchase methodology for negotiations with global suppliers, amassing savings of tens of millions of dollars.

The distinct group mechanism achieves value of each bid, despite the external factors that affect global fuel prices, high operating costs, and taxes and fees in most airports, including Arab airports.

The 2007 tender included 540 airports around the world, including European airports. The bids cover the needs of 17 member airlines for about 470 million gallons. Among the airports where maximal advantages and preferential prices and contractual terms were attained are, Khartoum, Indian airports, Kuala Lumpur, Bangkok, Manila, Charles de Gaulle, New York, Karachi, Islamabad and Nairobi.

Group Action Plan for 2008

In addition to preparations for the 2008 bid, and redistribution of airports in AACO tenders, the group will examine the application of electronic bid processing "e-tendering" in order to improve and develop the team's joint purchasing efforts, and to support collective negotiations.

On the other hand, the Joint Fuel Technical Committee is keeping abreast with the developments and technical mechanisms for the safety of member airlines and fuel companies. Following the release of Aviation Fuel Handling Manual in 2006, the committee issued a second technical manual in Arabic on inspection procedures and analysis during the exchange of aviation fuel. This manual is a practical guide for the step by step procedure that should be taken by the inspectors to determine the adherence of those involved in the circulation of fuel instructions, and the proper procedures and high-professional standards.

Sales, Marketing & Distribution:

The need to adopt a new distribution policy comes in response to the change in that environment, particularly in core systems, the size and type of competition, changing customer demand for travel, and increased awareness. Amidst the increasing pressures on airlines to reduce costs is the need to reduce the distribution bill, which currently accounts for about 15% of the total cost of the airline in the following areas:

- **GDS**: in particular booking and ticket issuing fees. Even at an average fee of USD10 per ticket, the GDSs are still the cornerstone for airline distribution, specifically in the Arab region. At the global level, major airlines are pressuring the GDSs to reduce fees, and some airlines have succeeded in getting some discounts in their domestic markets against content for airlines across distribution systems, or through shifting the GDS cost burden to travel agents. AACO's 39th AGM mandated AACO to bring together a taskforce to negotiate with global distribution systems the expansion of the existing distribution agreements between airlines and GDSs in the Arab world. No doubt, the distribution contracts that are valid till end 2008, have somewhat shielded the Arab airlines from the high costs of distribution at a time when major airlines around the world felt the full thump of distribution costs.

- **GDS New Entrants "GNE"**: the emergence of a new generation of global distribution systems is a possible move in the right direction. It remains however that the new generation of distribution systems at present does not represent a strong global competitor for the legacy GDS, especially that GNEs are not adequately spread.

- **Travel Agencies' Commissions**: Some airlines around the world ceased paying travel agencies commissions, and called on travel agents to replace the airline commission with a service charge paid by the passenger. The success rate varies from one region to another. In view of the high dependence of airlines on travel agencies, particularly in the Arab world where travel agents enjoy power and spread, there is no solution in the foreseeable future.

- **Payment Gateways and Credit Card Commissions**: one of the most important manifestations of the shift into direct online sales is a noticeable increase in credit cards commission, them being the most common means of payment in the world for online shopping. Credit Card companies and issuing banks charge around 3-4% of the transaction value, and this is borne by the airline. That is why airlines are looking into guiding passengers to use other modes of payment, such as debit cards, online-bank transfers, wire transfers, and others, especially that the cost of using these payment methods does not exceed USD1 per transaction. AACO's Customer Systems Taskforce sought offers from various online payment systems providers, and successfully received offers that grant the airlines substantial operational cost saving on one hand, and a wider margin to accept most of the known payment methods in all currencies at reduced prices.

- **Cost of Upgrading Direct Sale Systems**: At a time when airlines around the world, in particular Arab airlines, seek to diversify their distribution channels, especially direct ones, either online or via the new generation of global distribution systems directly to the travel agents, the initial cost factor to upgrade to the new platforms cannot be overlooked. Therefore, the objective of moving to new platforms would be to reduce the cost of direct sales in the medium term and long term - after absorbing the initial investment cost. The upgrading process permits integration with other systems to generate additional income, such as tourist packages, hotel accommodation, insurance and other services closely associated with the travel experience, as well as upsell, a domain where airlines can differentiate and sell their product – such as preferred seats, extra baggage allowance, or access to airlines' lounges at airports, and other sources of additional income. The Customer Systems Taskforce has worked for over a year to secure the best offerings, and to create the optimal conditions for the migration of Arab airlines to the new environment.

Electronic Tickets and Interlining

In 2004, IATA AGM announced the implementation of electronic ticketing by the end of 2007, and later extended the deadline until the end of May 2008. IATA explained the benefits to the airlines and passengers that upon the full implementation of electronic ticketing the following would result: reducing costs to airlines and to travel agents, where the cost of issuing one paper ticket at USD10, will be brought down to USD1 with the electronic ticket. In addition, other related costs will decrease such as the cost of maintenance, distribution and others. Where travelers are concerned, it would be easier for them to change their reservations without the need to visit airline offices or travel agents at no risk of losing tickets, in addition to encouraging the use of the Internet for bookings. AACO's AGM resolution (7/ 2004) decided to establish a special working group to collectively negotiate with electronic ticketing services suppliers, and to develop an action plan that will enable all members to meet the deadline.

- A team, headed by AACO Secretary General was formed to study the techniques and to negotiate collectively. The team was able to secure tangible reductions compared to the individual proposals received by respective airlines.
- AACO developed a detailed action plan for the implementation of electronic ticketing, and it was endorsed by AACO Executive Committee.
- AACO identified the difficulties and problems associated with the implementation of electronic ticketing, and worked on resolving them wherever possible, and urged IATA to find the necessary solutions.

As a result, AACO urged its members to exchange the largest number of interline agreements among themselves in order to face the challenges resulting from the mismatch priorities with big airlines. Ten Arab airlines agreed to complete interline agreements among themselves no later than March 2008, two months before the IATA May 2008 deadline.

New Generation Passenger Services Systems

In 2005, AACO AGM commissioned AACO to conduct a consultancy study on the future of passenger services systems, the capabilities of new systems, and to identify Arab airlines' requirements to strengthen their marketing position, and to keep up with the development of customer management systems. The working group worked on the basis of the results of this study, and initiated contact with suppliers of the new generation systems in order to properly assess the various systems. The team conducted field visits to all the suppliers to ensure the readiness of all elements of these systems and their technical, operational and functional features, and their respective cost. The group is in the final stage of this evaluation process. Results will be announced at the end of 2007 for each airline individually regarding its preferred provider.

Ground services

Joint cooperation in outstations

The objective of joint cooperation at outstations exceeds cost rationalization and financial benefits towards improving the quality of service offered.

The project has evolved over the years. It mainly tackles:

1 Ground Handling agreements at outstations, to collectively contract ground services providers at outstations. The Ground Handling Steering Board at AACO successfully worked out agreements at a number of airports, namely Athens with Swissport, Istanbul with Havas, Frankfurt with Fraport and Rome with Flight Care (formerly ADRH).

2 Expand the project during this term.

3 Follow developments and changes in airports and regulations, and coordination among Arab airlines on various issues that impact the operations of Arab airlines.

4 Cooperation on purchase and management of ULDs.

Developing Human Resources

AACO continues its efforts to train human resources through the Regional Training Center (RTC) in Amman, which was established in 1996, and had trained 10,506 trainees since its establishment until the end of 2006 through 644 training course.

The training center achieves annual savings, estimated at around USD7 million in 2006 for AACO members. The center provides top quality training with international standards, but with lower costs. The result was an increase in the number of trainees who have graduated from the training center over the past three years to 1,397 trainees in 2004, 2,130 trainees in 2005, and up to 2,838 trainees in 2006, compared to 684 trainees in 2000 – a growth of 415%.

The RTC also provides the main frame for cooperation with Industry Partners, with 181 training scholarships during 2006. As well as organizing several free courses annually those are granted gratis for each member airline.

In adherence with AACO's mission to provide excellent services at low cost and to promote human resource development of member airlines, AACO works on providing the following services:

- Joint purchasing service tests for pilots and aviation controllers for English proficiency language imposed by the ICAO, and the duty application with a deadline of 2008. RTC has been providing this test electronically, and has also been providing electronic training services.

- Preparing airline instructors. During 2007, ICAO aviation security courses were conducted and Train the Trainers sessions on handling dangerous goods to meet the IOSA requirements, as well as civil aviation authorities' regulations in most countries.

- AACO is also working on developing a specialized academic program in the field of aviation to provide employees to prepare high level resources in air transport, in agreement with Helwan University for the first Arab accredited postgraduate specialization program, recognized by all Arab states, under the credit-system. Agreements were also signed with the American University of Cairo to provide postgraduate specialization diplomas in the field of air transport, such as airline marketing and sales, and airline management. Moreover, there is an ongoing cooperation with the training centers of member airlines to organize courses to grant these diplomas, with the purpose of creating a highly proficient workforce in the respective markets.

Arab Air Transport Database

AACO constantly follows up on the development in Arab air transport, and posts them daily either on its website, or in electronic and/ or printed publications, mainly:

- **"The Nashra" – Industry's Pulse & Arab Aviation**: AACO's official monthly bulletin which is published monthly in English, and distributed electronically to all air transport industry parties on the regional and international levels.
- **"AATS" - Arab Air Transport Statistics**: Covers detailed Arab airlines and airports statistics, and the overall economic impact on the air transport industry.
- **"Weekly Web News"**: Distributed electronically and covers latest development in the aviation industry.
- **"Safe & Level"**: A bulletin on safety and security issues distributed monthly.
- **"Quarterly Statistical Bulletin"**: Covers data statistics on the Arab air transport market.

External Representation and Regional Cooperation

Maintaining close coordination with different parties in the air transport industry is one of AACO's key functions to provide a broad framework of cooperation for member airlines, and the basis for a better economic environment for better operations. AACO works closely with international organizations, governmental bodies and non-governmental groups, foreign airlines, regional associations, manufacturers and service providers for that purposes.

The coordination and cooperation takes place at various levels; commercial, regulatory, legal, operational, and through continuous communication with each of the IATA, ICAO, ACAC, EC, US DOT and regional organizations around the world. AACO also has a solid base of industry partners. The industry partnership program was founded in 1998, and today brings together 42 partners of aircraft and engines manufacturers, information technology companies, global distribution systems, fuel companies, aircraft and engines leasing companies, consulting firms, ground-handling companies, and other financial firms. The program helps to create a mutually beneficial environment for member airlines and for industry partners. Partners benefit from AACO's functions to consolidate their relations with member airlines, and in turn, AACO members benefit from partners' support in various areas, mainly training programs.

AACO's Secretariat General maintains close relationship, in particular with regional organizations, in order to expand the network of airline members through identifying common points of interest to all parties. In turn, joint cooperation under AACO umbrella improves the negotiation position for airlines, and a stronger incentive for regional cooperation.

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