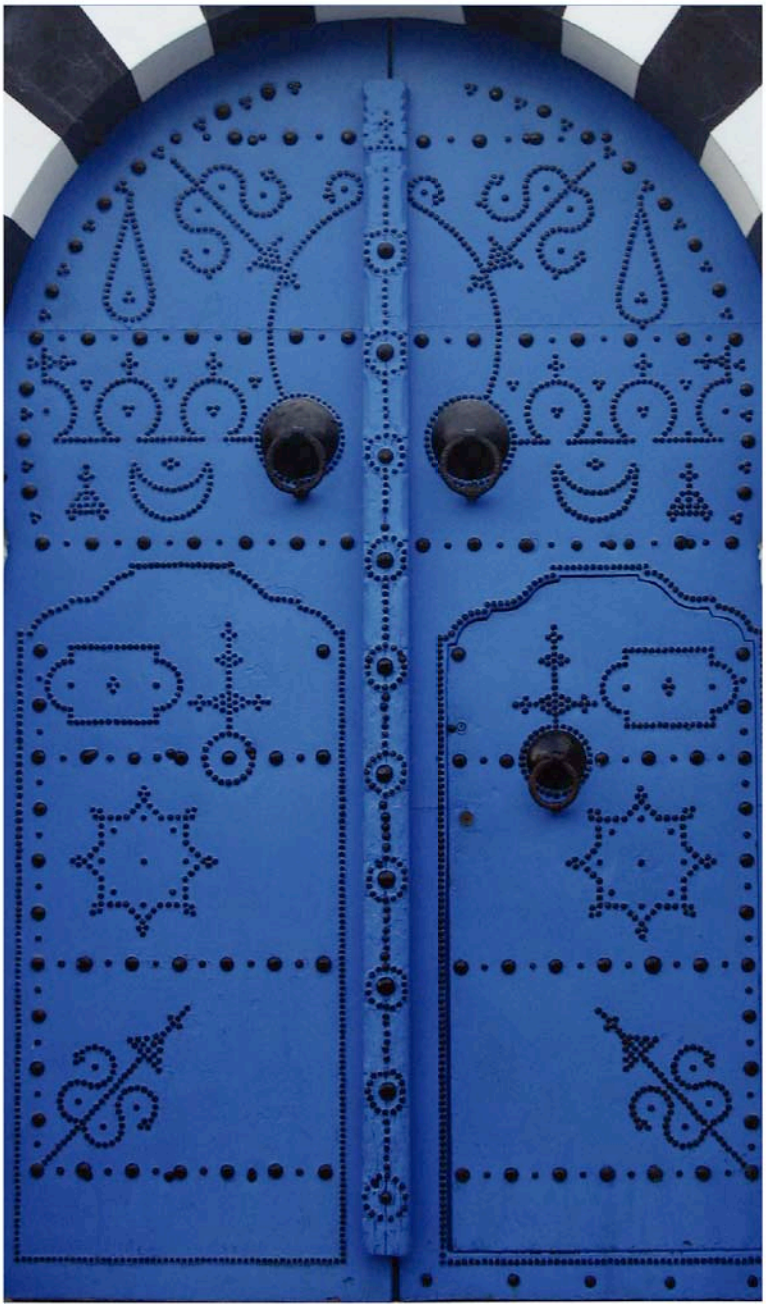
Arab Air Carriers Organization Annual Report

41st ANNUAL GENERAL MEETING - Tunisia 2008

21-23/10/2008

TUNISIA



الاتحاد العربي للنقل الجوي
ARAB AIR CARRIERS ORGANIZATION

AACO 41st **AGM**

Annual Report of the Arab Air Carriers Organization
41st General Meeting - Tunisia 2008

AACO's Mission

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

AACO's Objectives

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

Mr. Nabil Chettaoui
President of AACO

Eng. Khalid Abdullah Almolhem
Chairman of the Executive Committee

Eng. Khalid Abdullah Almolhem, Director General
SAUDI ARABIAN AIRLINES
Capt. Sabri Saad Shadi, Chairman
AFRIQIYAH AIRWAYS
Mr. Adel Abdulla Ali, Board Member & CEO
AIR ARABIA
Capt. Abdulkalek Saleh AL-Kadi, Chairman
YEMEN AIRWAYS
Capt. Tawfik Assy, Chairman & CEO
EGYPTAIR HOLDING COMPANY
Mrs. Ghaida Abdullatif, Chairwoman-Managing Director
SYRIAN ARAB AIRLINES
Eng. Samer Majali, President & CEO
ROYAL JORDANIAN
Mr. Nabil Chettaoui, Chairman & Director General
TUNISAIR

Contents

Milestones

No sooner did Air transport industry emerge from the series of crises of September 11, 2001, SARS, and economic slowdown, that it entered a new crisis under the broad title of Fuel Prices. After nearly five years of loss making, restructuring, and cost cuts, the air transport industry, by the end of 2006 and during 2007 surfaced from the severe crises that struck hard into this sector. However, with a recovery in passenger traffic in 2007 to reach numbers not seen before by the industry, and a return to profit making, oil prices made great leaps in a very short period of time because of a series of economic and political elements that brought the price of a barrel to over USD100 at the end of 2007, then to more than USD140 in mid-2008, and only lately stabilized at USD105 - 110 per barrel. Oil prices are not expected to return to the previous levels where they did not constitute more than 12% of airlines' total costs. High economic growth in China and India, the limited production capacity of refineries, crises in some oil-producing countries, limited exploration, in addition to the speculative elements, make it impossible to provide the market with higher production of oil supply, and leaves no chance in sight for a significant retreat of oil prices. This comes despite the economic downturn in the United States and the slowdown in Europe, which would eventually reflect on the growth in China in the medium term. The problem airlines around the world face is not confined to high costs, but extends largely to their inability to borrow enough money to overcome this crisis because of the global banking sector's problem restricting that sector's ability to lend. Moreover, airlines have made orders in the years 2006 – 2007 for thousands of aircraft that will enter into service, adding to capacity and influencing prices and yields.

However, against this global crisis, the Arab Air transport industry is witnessing unprecedented expansion. Despite the crises that are endemic to the Arab world or its environs; the continued Israeli occupation of Palestine, preventing it from taking part in civil aviation, the situation in Iraq, Lebanon, Sudan and other surrounding crises, the number of passengers carried onboard Arab airlines will reach almost 100 million passengers in 2008, at triple the industry's growth rate in terms of RPKs, exceeding the growth in ASKs by more than 4 points in 2007.

Several elements contribute to this growth, high economic growth in the Arab world - particularly in oil-producing countries, the focus on intra-Arab tourism versus tourism to the West, the development of some Arab airports to become major international hubs, which in turn contribute significantly to the high number of RPKs carried since many flights in transit at these airports are long-haul flights. Development projects at Arab airports gain particular importance against the lax infrastructure development in Europe, the United States and some regions, particularly where airports are concerned. Airport development will help traffic flow and prompt Arab airlines, to play an increasing role in intercontinental traffic. The congestion in European airports makes travel through these airports an arduous experience for passengers, compared to their experience through the Arab airports.

Milestones

AACO members have continued to renew and expand their fleets. Arab fleet at the end of 2007 exceeded 630 aircraft with a remarkable increase in the number of large aircraft, on one hand, and regional aircraft on the other. There are indications for a stronger role of regional transport in addition to intercontinental transport. Arab airlines will receive in excess of 500 new aircraft in the next ten years, even though they have achieved high utilization rates of their aircraft, leveraging lower operating costs of new aircraft– compared to the older ones, especially in fuel consumption.

In spite of the dramatic increase of fuel prices, Arab airlines as a whole managed to realize operating profits in 2007 exceeding USD700 million on revenues amounting to USD21 billion, or about a 3.3% profit/revenues ratios. However, these figures mask high profits for some, and high losses for others, and therefore cannot constitute a lucid vision on the financial situation of Arab airlines in its entirety.

The bigger question now is, does this mean that Arab airlines will be able to ride the crisis besetting the global air transport industry unscathed and without challenges? There is no doubt that many of the Arab airlines, especially those that rely on their global vector, will be affected by the economic slowdown coupled with the increased costs. Although airlines in Europe and the United States are inclined to trim capacity to face dwindling demand, we observe that the plans of some Arab airlines to expand go on; competition will increase sharply in the coming period. But what grants Arab airlines competitive advantage over other players are the four elements that many other companies around the world cannot easily match, namely:

- Modern fleet translating into lower operating costs compared to the others.
- Lower costs of manpower, and social costs are the second largest industry cost component which award Arab companies greater margin of price flexibility.
- Infrastructure development, particularly airports, compared to those in Europe and some other regions, thus granting a competitive edge in the hub operations.
- Quality of service of Arab airlines, reflecting an added attraction for passengers.

But does this mean that the Arab air transport industry does not need to be developed? Of course not, because the whole air transport industry is in for radical changes in the near future, so that it would come out of this crisis capable of growing, profit making, and appealing to investors.

An industry where productivity is liberalized in such a manner that supply exceeds demand by about 25% on continuous basis is an industry with a structural crisis. In the past when the air transport industry operated with load factor ranging from 65 - 70%, the global regulatory environment restricted capacity prices, conditions of carriage, and maintained a rigid operational balance.

However, subjecting the air transport industry to market forces with the deregulation of the industry's market access and pricing should have led the industry to where other industries have gone, namely towards consolidation through mergers and acquisitions. We should push for a model where the air transport industry becomes truly universal, and not subject to the norms of the flag carrier. Only then can this industry absorb regional crises at times of austerity, and attract investments at the times of expansion and growth. The biggest problem facing the air transport industry is that it has one free hand but is required to applaud while the other hand is in cuffs.

The airline industry has tried, through alliances to circumvent restrictions preventing it from consolidation. The industry resorted to marketing cooperation on some routes and to cooperation on cost cutting in some other areas. However, it has been proven that this is only a temporary solution that will not compensate the industry from lack of consolidation. The future is taking place now in Europe, starting with Air France – KLM, Lufthansa – Swiss, and recently British Airways – Iberia. It is hoped, with the second phase of the US–EU agreement, that cross ownership will widen to airlines between Europe and the United States, effectively establishing a new era in the air transport industry, similar to what was witnessed by the telecommunication and banking industries: multinational airlines with little national manifestation, and wider global operations and global outreach, capable of cross-feeding either directly, or through a group of regional airlines which are either wholly, partially owned, or allied with them.

If this is the expected future of the global air transport industry, what is the future of the Arab air transport industry within this global scene? We simply need the work dynamics, in terms of the regulatory environment, similar to what is being applied in Europe. Work dynamics in Europe dealt with sovereign countries, and led to the launch of the pan–European economic activities by its institutions and its citizens in a common market. We simply need, and as soon as possible, these dynamics of freeing the movement of peoples and goods, the liberalization of market access, the liberalization of pan-Arab investment, and to ensure that all participants in the air transport economic process operate within the same parameters of competitiveness.

The legal framework, represented by the Multilateral Arab Agreement for liberalization of Air Transport "The Damascus Convention" is all that is required to simply put all the above into effect. The biggest challenge facing air transport in the Arab region is not only the need to change the regulatory environment, because if it were the case, it would have been possible that Arab countries implement the changed tasks at their convenience, without any urgency. However, two outside factors require urgent action to change the Arab regulatory environment: The first is the implementation of the first phase of liberalization of air transport between the United States and Europe. This will create, at the borders of the Arab World, a huge market where airlines are capable of operating in a large mass market. Moreover, if Europe and the United States arrive at an agreement on the liberalization of ownership, albeit gradually, we will see an accelerating move towards consolidation of major European and American airlines. That will place other airlines, including the Arab ones, at a position worthy of reconsideration of their structure, role and scope of work. In the absence of any possibility of consolidating Arab airlines, the alternative for these airlines is to play a feeder role for major airline groupings in most cases. The second factor, which presses toward changing the regulatory structure of Arab air transport, is the active European trend of considering the Arab region, particularly the Mediterranean one, as a key objective for the expansion of the single European aviation market. The goal of creating a single aviation market between Europe and the Mediterranean, and hence between Europe and the Arab world, is not bad for Arab airlines, but the problem lies in the fact that the Arab countries deal with this issue largely on individual grounds. So far, there is no clear vision for the Arab world for the future of the aviation industry. The continuation of this trend, if there is no quick action at the Arab level to develop a coherent vision for dealing with Arab-European relations, will lead to the accession of a member of Arab countries individually into the European single aviation market, leading to the loss of the opportunity to build a single Arab aviation market with much more weight and potential than individual country markets.

The initiative undertaken by AACO, in conjunction with the Arab Civil Aviation Commission, and the support of DAE and EgyptAir, to organize a summit for the Arab aviation next November, is necessary to create this Arab vision. This summit will gather the heads of Arab airlines and heads of Arab civil aviation authorities, preceded by an executive meeting at the level of the Executive Council of ACAC and the Executive Committee of AACO. AACO, in cooperation with ACAC, also maintains relations with the European Commission to reach a common understanding that will facilitate the materialization of the aspired Arab vision.

The future of the air transport industry requires new thinking of how the Arab Air Carriers Organization can serve its members in this global environment. AACO has so far been able to move from being a framework for coordination– at the age when air transport industry was subject to many controls – into a coalition bringing together airlines as an economic force able through AACO to reduce costs and improve some of the revenues. This is what we have done, and what we do through Joint Fuel Purchasing, Joint Ground Services, negotiations with Global Distribution and Reservation Systems, the Training Center, Arabesk, and technical cooperation, which either reduce the cost of all members, or contribute additional revenues worth more than USD200 million per year. There is no doubt that this is your achievement. However, we aspire to do more to deal with a new air transport industry. We are confident that your leadership and creativity will always provide for AACO a tool to successfully deal with the challenges of tomorrow.

Abdul Wahab Teffaha

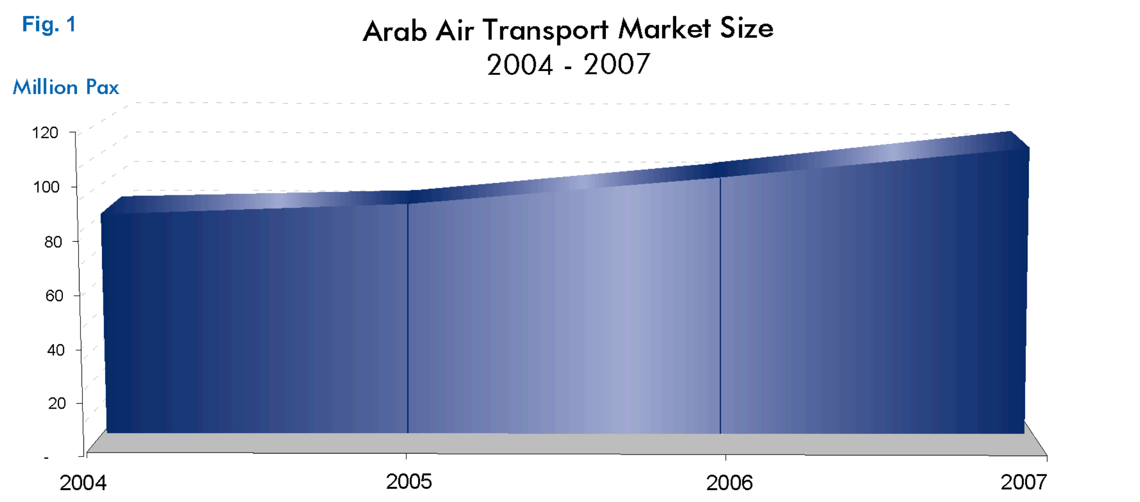
Secretary General

Arab Air Transport

1 Passenger Traffic in the Arab World

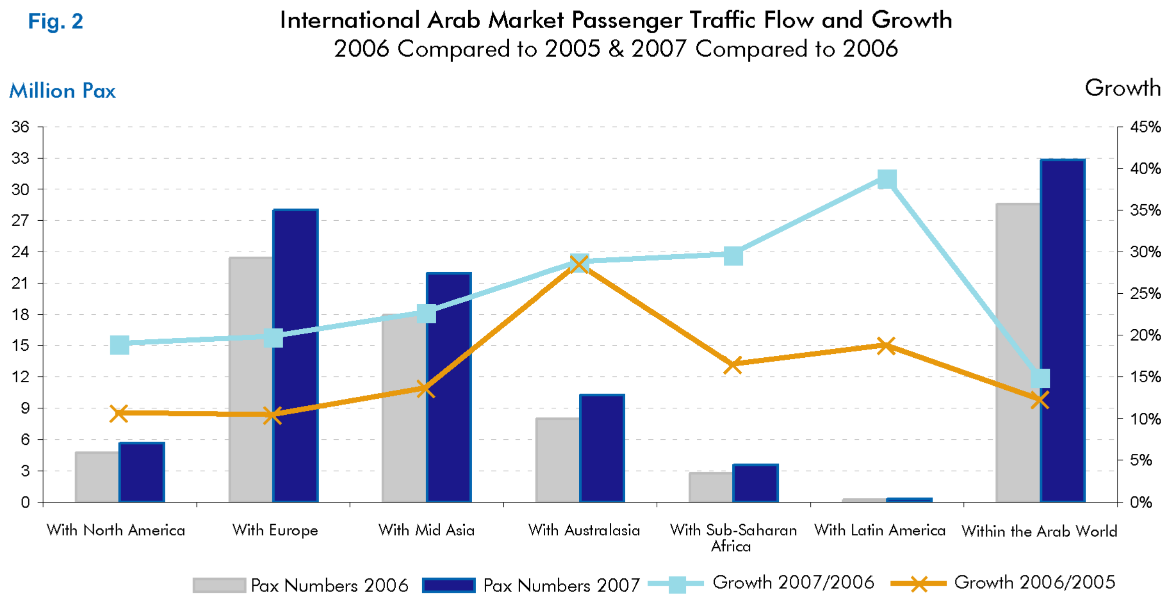
Arab Air Transport market achieved significant growth of 16.6% in 2007 compared to 2006. The number of international travelers in the Arab world reached 117.6 million passengers. (Figures 1 and 2)

Fig. 1



Source: AACO

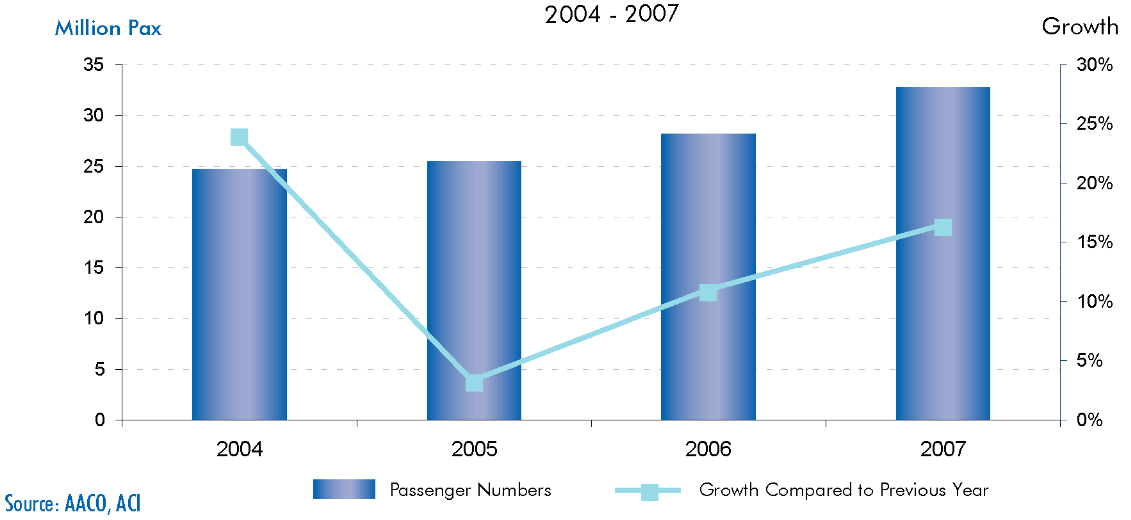
Fig. 2



Source: AACO, ACI

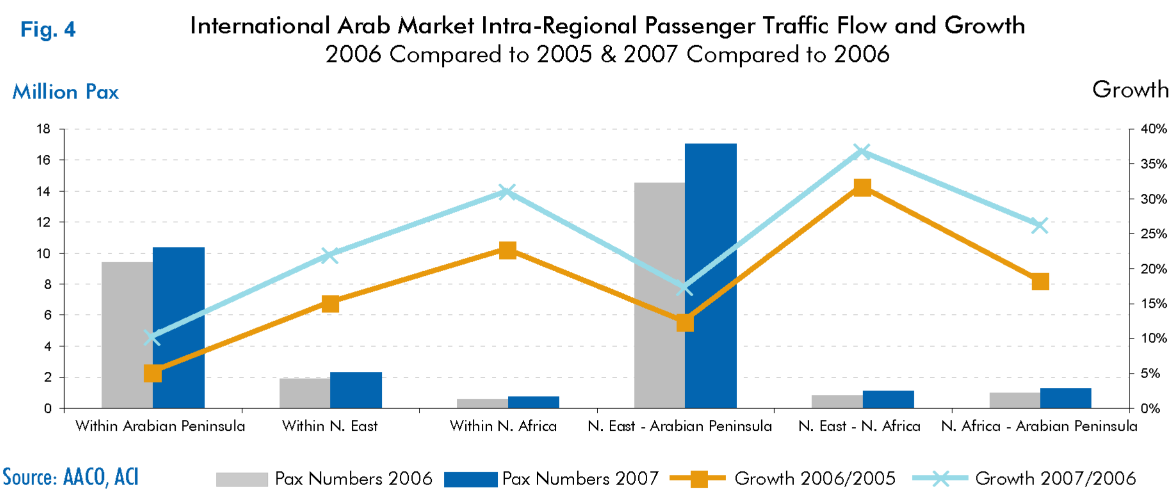
Scheduled international passenger traffic within the Arab world in 2007 grew by 16.2% compared to 2006. (Figures 3 and 4)

Fig. 3



Source: AACO, ACI

Fig. 4



Source: AACO, ACI

2 AACO Members' Operations*

Revenue Passenger Kilometers:

Member airlines registered a growth rate of 18.8% in 2007 in RPKs compared to 2006, and by 243% compared to 1995. Global growth for the same year averaged at 6.3% compared to 2006 and 67% over 1995.

* Based on information from 17 member airlines
* Figure 6

Available Seat Kilometer (ASKs):

In 2007, Arab airlines recorded a growth rate of 14.6% in ASKs over 2006, and by 207% compared to 1995, while the global growth of the same year was 5.2% compared to 2006 and 67% over 1995. (Figure 5)

Load Factor:

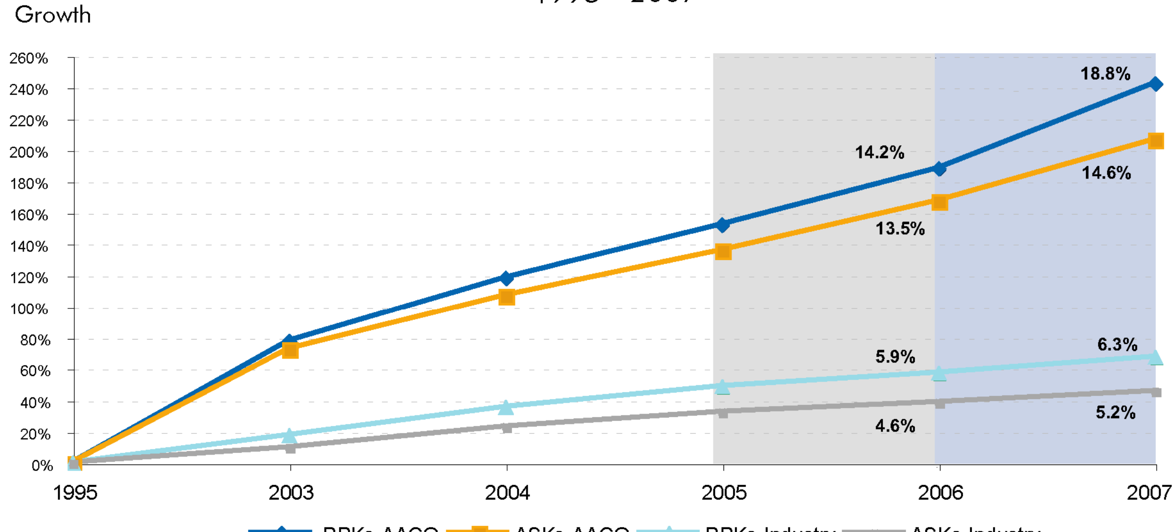
Arab airlines' Load Factor increased by 2.6 percentage points to 73.3% in 2007.

Total number of passengers:

The total number of passengers carried by most AACO members reached 87 million in 2007, an increase of 13.1% over 2006.

Fig. 5

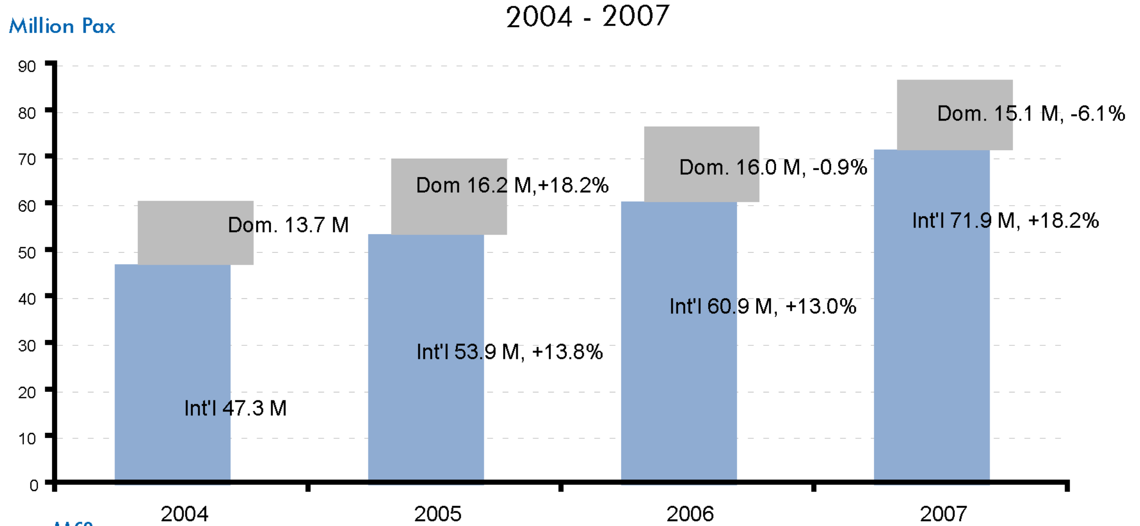
Change in RPKs and ASKs for AACO and IATA members
1995 - 2007



Source: AACO, IATA

Fig. 6

Number of Passengers on Most Arab Carriers
2004 - 2007



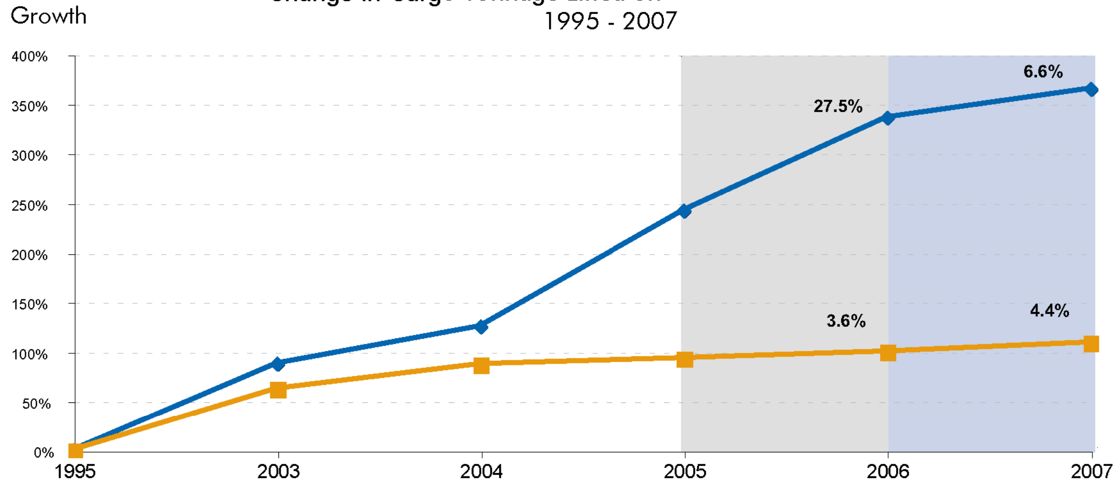
Source: AACO

3 Cargo in the Arab World

Arab airlines recorded a growth of 6.6% in 2007 in cargo compared to 2006 and by 365% over 1995. Comparatively, global growth of the same year was 4.4% over 2006, and 109% over 1995.

Arab airlines achieved a growth rate of 15.6% in 2007 in RTKs over 2006, and 13.2% in ATKs, consequently increasing their Weight Load Factor by 1.3 percentage points, up to 58%. (Figure 7)

Fig. 7 Change in Cargo Tonnage Lifted on AACO and IATA members 1995 - 2007



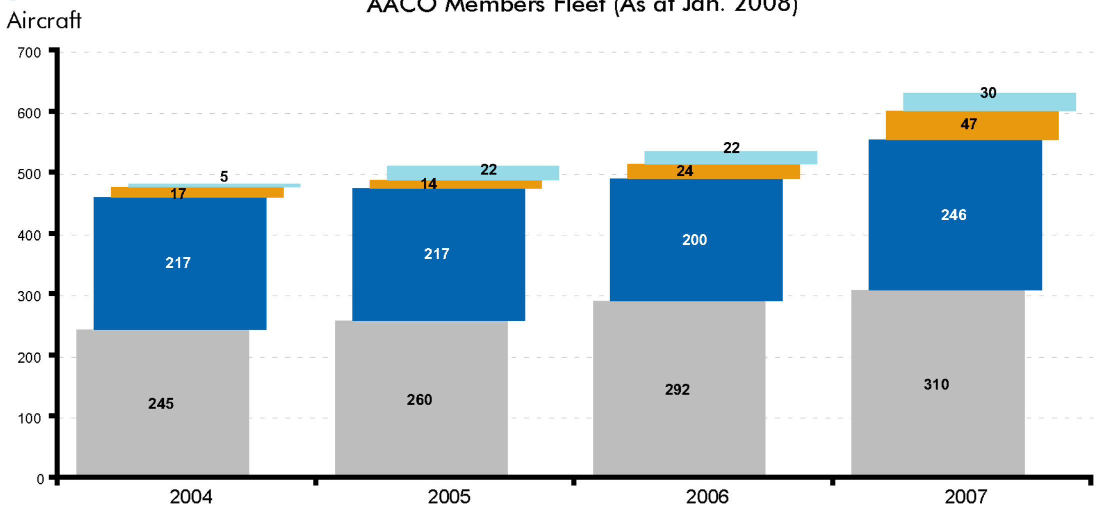
Source: AACO, IATA

4 AACO Members' Fleet

Current Fleet

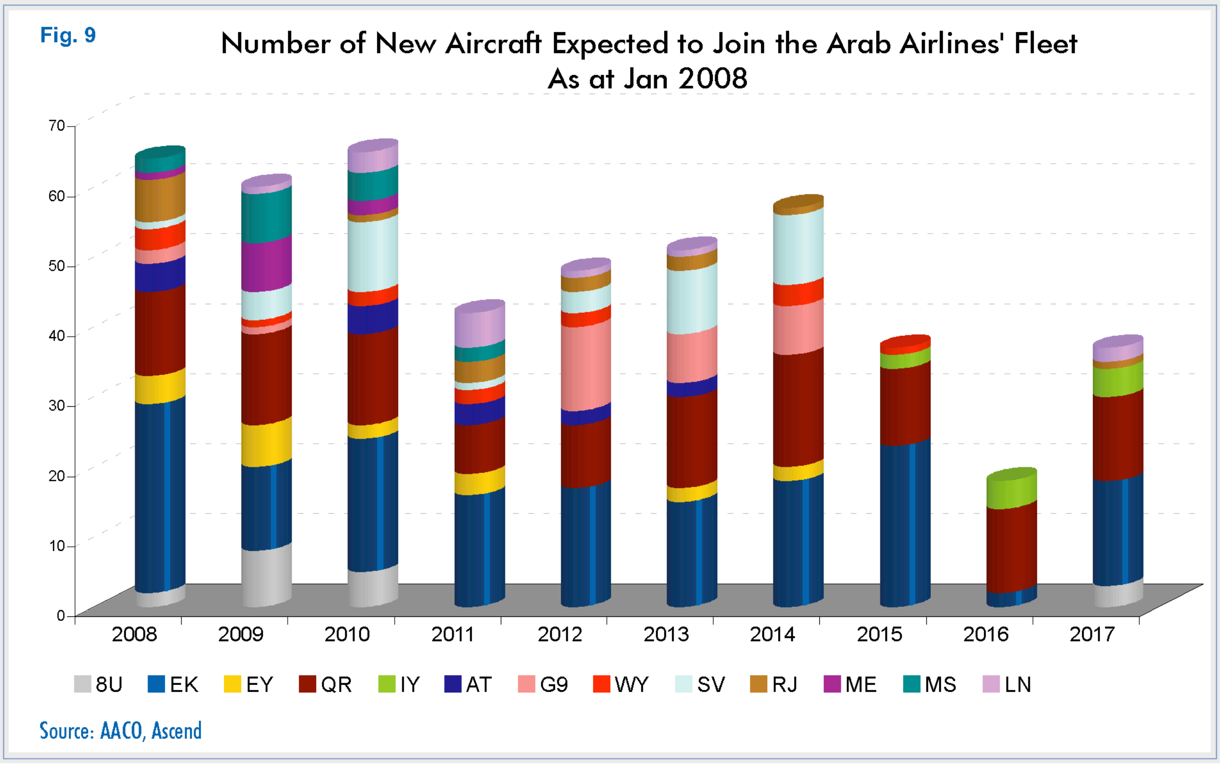
Arab airlines received 182 aircraft in 2007, including 73 wide-bodies. Ninety five (95) aircraft were new additions, and 87 were replacement of older aircraft types. Arab airlines are scheduled to receive 64 aircraft in 2008. (Figures 8 and 9)

Fig. 8 AACO Members Fleet (As at Jan. 2008)



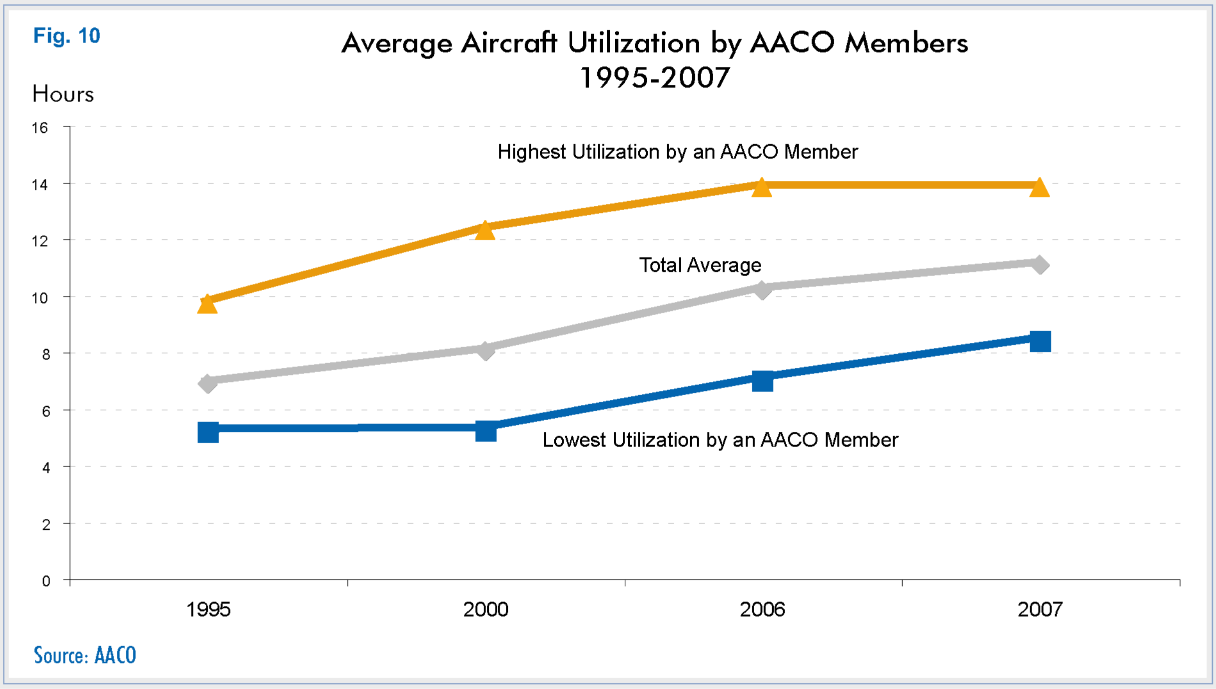
Source: AACO, Ascend

Contracted Aircraft



Average Aircraft Utilization

The rate of daily aircraft utilization increased in 2007, indicating optimal capitalization on the aircraft value. It also signifies the increase in long-haul operations. (Figure 10)

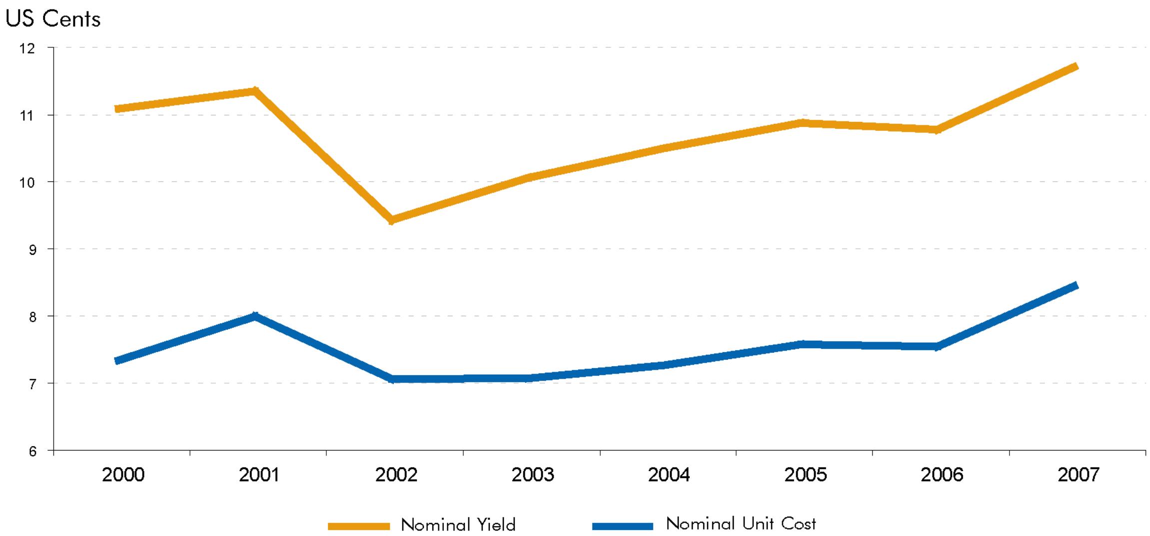


5 Yield and Unit Costs

Yield

Yield of 9 Arab airlines increased by 8% in 2007. Unit costs increased by 10.3% as operating expenses increased at a higher rate because of the increase in fuel. (Figure 11)

Fig. 11 AACO Members Yield and Unit Cost (Yield is the Operating Revenues per RPK)

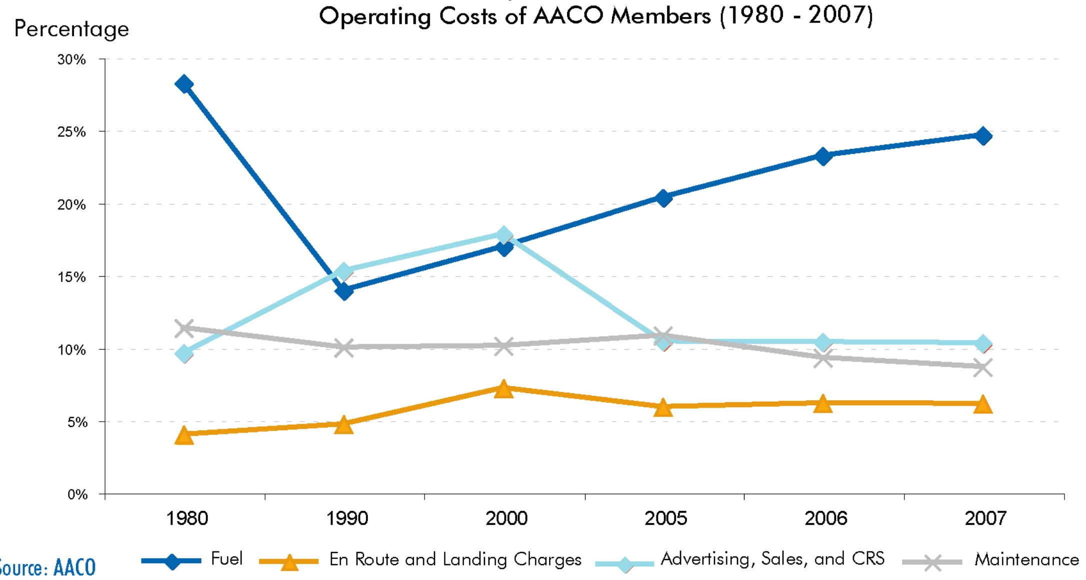


Source: AACO

Changing Costs

Looking at the financial results of 12 Arab airlines, operating expenses rose by 14.2%, while the increased productivity of Arab airlines and revenue management led to an increase in operating revenues by 16.3%, and consequently to operating profits. Fuel prices still represent the larger element of airlines' costs, absorbing 24.7% of the airlines' costs, especially that fuel costs have increased by almost 21% over 2006. (Figures 12 -13- 14)

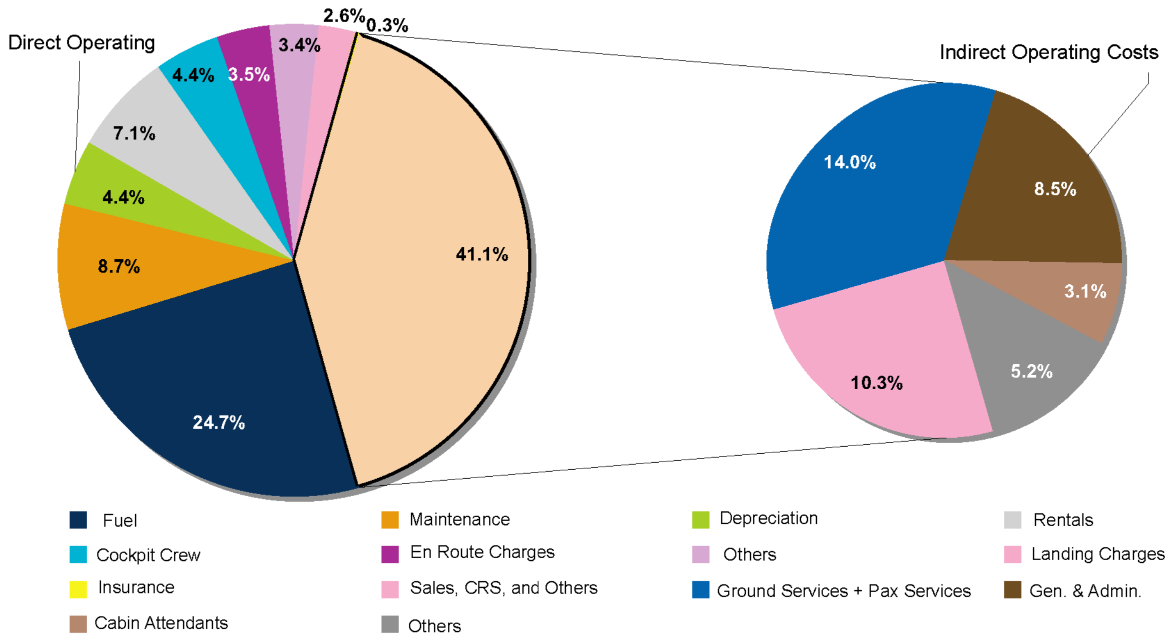
Fig. 12 Contribution of Some Operating Costs Components in the Total Operating Costs of AACO Members (1980 - 2007)



Source: AACO

Fig. 13

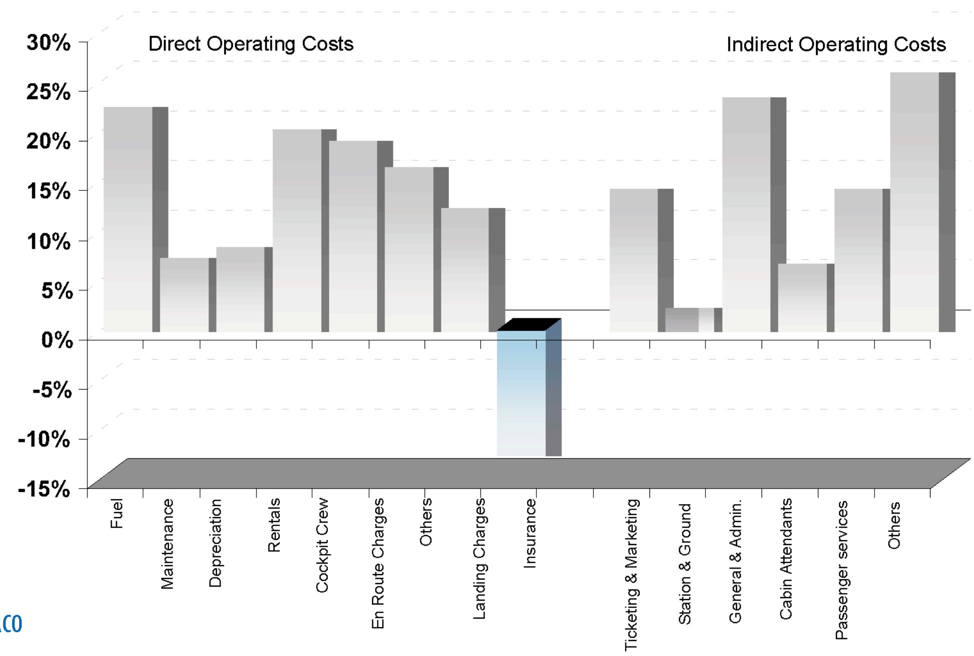
Cost Distribution - 2007



Source: AACO

Fig. 14

Cost Changes - 2007



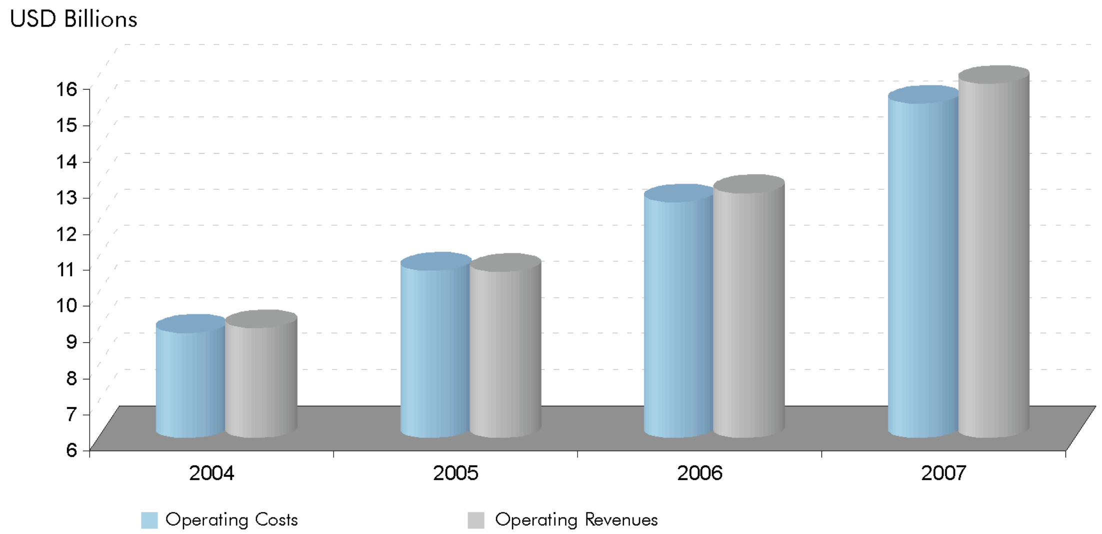
Source: AACO

6 Financial Results

Arab airlines achieved good financial results in 2007. Total and operating revenues increased with the increase in operating costs. Looking at the financial results of 12 Arab airlines, we observe that the operating revenues increased by 16.3% - amounting to USD21 billion, and total revenues by 19.1%, amounting to USD21.6 billion, leading to operating profits reaching approximately USD725 million for these companies, approximately 131.7% increase over 2006.

Amongst these companies, the highest operating profits touched on USD992 million, and the steepest operating losses reached USD306 million. Figure 15 demonstrates a comparison between operating revenues and operating charges for 8 AACO members.

Fig. 15 Comparison of Operating Revenues and Operating Costs for Some AACO Members 2004-2007



Source: AACO

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

Regulatory Environment and International Relations

1 The Regulatory Environment within the Arab World

Arab Air Transport Regulations – determined by national policies

- National policies within each of the Arab countries determine regulations involving air transport, including the regulations governing the movement of people, goods, market access, airline ownership, and others. These aspects should be given priority in liberalization to reach an optimal environment, whereby airlines can take maximum benefits from the opportunities offered by the geographical location of the Arab world, the continued development of the infrastructure at Arab airports, the rapid growth of the Arab fleet, along with the development in aircraft technology.

- Despite the collective efforts to accelerate the liberalization of the skies in the Arab world, and the fact that the Damascus Convention went into effect in February 2007, and the gradual liberalization of airspace on bilateral basis, the implementation of these programs is regrettably not moving at the desired momentum.

Therefore, the level of liberalization varies from one Arab country to the other.

Developments during 2007-2008 – slow progress

- The list of Arab States which adopted unilaterally open skies policy has not changed, namely: Oman, Kuwait, United Arab Emirates, Bahrain and Lebanon.
  The number of open skies bilateral agreements between some Arab states is 19 comprising Bahrain, Jordan, Lebanon, Morocco, Oman, Qatar, Syria, Egypt, Saudi Arabia, United Arab Emirates and Tunisia. One of the most recent open skies agreements was signed between Jordan and the United Arab Emirates in July 2008.

Ownership and privatization of Arab Airlines – most Arab airlines are government owned

Some Arab countries started to carry out operational procedures towards the partial privatization of their national carriers and towards opening their markets to the establishment of private aviation companies:

- Jordan, where the Jordanian government set 71% of Royal Jordanian's capital for sale in December 2007.
- Saudi Arabia, which began preparing Saudi Arabian Airlines for privatization through accelerated expansion of its fleet and strengthening its IT and operational platforms. Privatization will be phased over two years. So far, 49% of the Catering Unit was privatized in September 2007. Saudi Arabia intends to privatize five other units - Cargo Unit, Maintenance, Technical, Ground Services, and the Prince Sultan Aviation Academy, starting with the Cargo Unit.
- Kuwait, where the Kuwaiti Parliament approved the government's plan to sell 40% of Kuwait Airways shares to the public sector, and 35% to be sold off to long term investors.
- In the United Arab Emirates, Air Arabia is the only airline whose shares (55%) are traded in the market.

Most other markets remain closed to Arab investment in national carriers.

As part of AACO's efforts to protect the interests of member airlines and to ensure a better regulatory environment for their operations, AACO calls for:
First, speeding up the implementation of the air transport gradual liberalization program at the bilateral level.
Second, accelerating the implementation of the Arab Multilateral Agreement for the liberalization of Arab air transport.
Third, liberalizing the restrictions on ownership, control, and privatization of airlines, and to consider Arab capital as national investments, at least in aviation.
Fourth, facilitating the movement of persons and goods within the Arab world.

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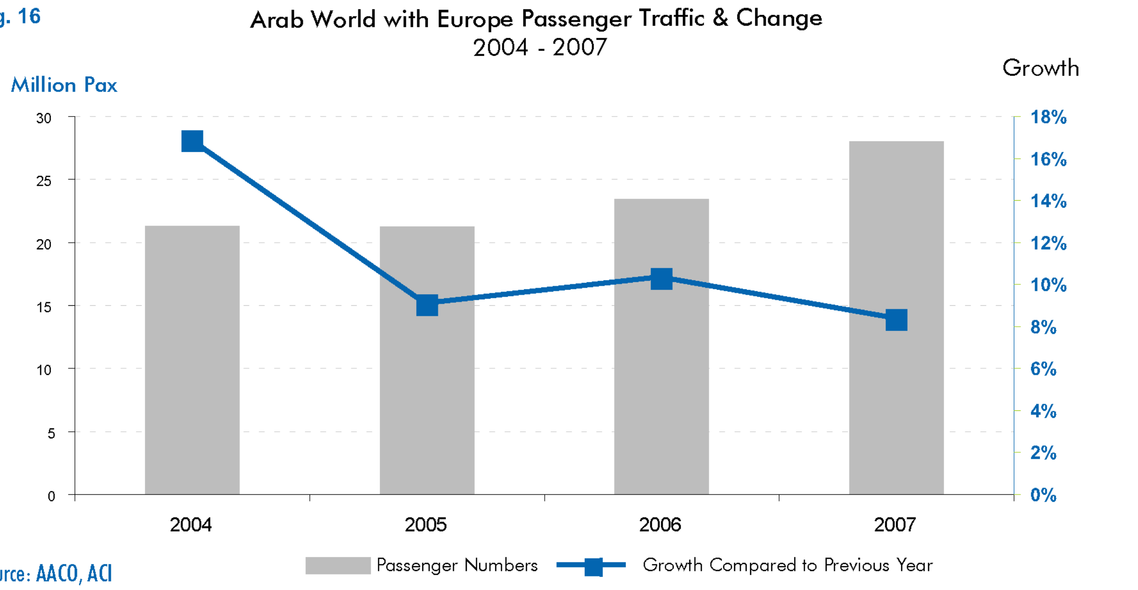
2 Arab World and Europe*

Air Traffic - Sustained Growth

Air traffic between the Arab world and Europe rose by 8.3% in 2007 compared with 2006.

Fig. 16



Source: AACO, ACI

* **Europe** includes all EU Member States

Regulatory Frameworks - a continuous dialogue with the European Commission

- The European market is of great importance to AACO member airlines, given that this market constitutes 34% of the total traffic of these airlines.
- The Arab – European market covers 26% of International traffic, and member airlines carry 56% of that.

Accordingly, AACO and ACAC held talks with the European Commission to support the development of air transport between the Arab world and Europe, and to facilitate and strengthen the regulatory framework for airlines to take fair advantage of opportunities in this market.

AACO held three meetings with the European Commission during the past year, two of them with ACAC. The dialogue focused on three cooperation frameworks, namely:

1. General principles to set the framework for bilateral negotiation between the Arab Civil Aviation Authorities and the European Commission to amend the bilateral agreements between Arab states, and European states.
2. Euro-Mediterranean Aviation Project.
3. European Emissions Trading Scheme and cooperation in environmental affairs.

1. First cooperation framework:

- The Arab and European parties follow up on the developments of bilateral agreements with EU countries and amending them in accordance with the decision of the European Court of Justice, eliminating the "national ownership" clause in bilateral agreements concluded between any country in the EU and a third country.
- A "Joint Minutes" was signed between ACAC, AACO, and the European Commission to set the framework for bilateral negotiations between the Arab Civil Aviation Authorities and the European Commission towards amending the bilateral agreements, in October 2007.

- The principles in the Joint Minutes may be used by the Arab Civil Aviation Authorities during negotiations with the European Commission, till a time comes when those principles are put under a "Joint Euro-Arab Aviation Agreement" on the basis of the authorization granted by Arab Ministers of Transport and Civil Aviation to establish a negotiation mechanism with regional blocs. These principles are:
  - To maintain operations at their current levels, without modification in terms of operators, number of flights, or capacity – except through negotiations between Arab and European countries at the bilateral level or under the "Joint Euro-Arab Aviation Agreement".
  - Prevent operations under the European ownership clause by European airlines from European countries that do not have bilateral air transport agreements with the Arab country concerned.
  - The possibility for Arab and European airlines to revert to the states concerned, or to ACAC and the European Commission, in the event an airline considers it is being treated in a manner that exceeds the ICAO standards, including the right of any airline to operate under fair and equal opportunity, and equitable schedules to those granted to the other party.
    The right of Arab states that have already signed agreements with the European Commission to benefit from these principles.
  - As for the subject of allowing Arab countries to appoint other Arab carriers to European routes on codeshare basis, the European Commission has promised to encourage the EU states to assign Arab carriers as codeshare partners on routes to Europe, especially if the Arab state concerned has already signed the Horizontal Agreement with the European Commission. The Commission also promised to intervene to resolve any problems facing the Arab airlines in this matter.

- Arab states that have signed the Horizontal Agreement with the European Commission so far are: Jordan, United Arab Emirates, Lebanon, and Morocco. Those agreements included the removal of the “national ownership” clause from 21 bilateral agreements with Jordan, 23 with Emirates, 19 with Lebanon, and 20 with Morocco. In addition, the European Commission has amended, within the framework of seperate bilateral negotiations, 7 separate bilateral agreements between Bahrain and European Union states, 2 agreements with Egypt, 10 agreements with Qatar, and one agreement with each of Kuwait, Oman, and Syria.

2. Second Framework: Euro-Mediterranean Aviation Project

- The Euro-Mediterranean Project stems from the Ministerial Aviation Conference held in Marrakech in December 2005 for the development of cooperation between the Middle East and Europe.
- The project aims at reaching a common Euro-Mediterranean aviation area through providing support in five major areas: aviation, safety, security, environment, and air traffic management or control.
- The project currently includes Morocco, Algeria, Tunisia, Egypt, Syria, the Palestinian Authority, Jordan, and Lebanon from the arab region on one hand, and European Union countries on the other, and other Mediterranean countries. Under this project, the European Commission provides massive training programs funded entirely by the European Union, including training fees, accommodation cost, and air tickets to the citizens of the project member states.
- AACO supports this project, provided it is expanded to include the whole Arab region. The European Commission welcomed the participation of delegates from all Arab states in the activities of Euro-Mediterranean project.

3.Third Framework: European Emissions Trading Scheme and cooperation in environmental affairs

- Upon the mandate of AACO AGM, AACO is following up on the developments of the European Emissions Trading Scheme, given the importance of this market for Arab airlines.
- Both the Arab and European parties realize the urgency of addressing the global environmental challenges and the importance of direct action on aviation in this area, hence the importance of "cooperation" It was agreed to take into account, when formulating the EU emissions trading scheme, the modernity of the Arab fleet, and the investments incurred by Arab airlines

which must be reflected positively on the treatment of Arab fleet – unlike the older fleets that produce more harmful emissions.

- It was agreed to establish an Arab Joint Environmental Bureau that gathers experts for Arab airlines to monitor their environmental performance. European Commission will help AACO and ACAC on the establishment of the bureau to train environmental monitors who would help Arab airlines and Arab civil aviation authorities.
- It is important to mention that if an Arab state, or any other state implements an emission capping scheme, not necessarily identical to the European scheme, then the airlines registered in that scheme would be exempt to avoid duplication of charges.

In short, both sides noted the added value of the inclusion of aviation in a cap and trade emissions scheme and the importance of cooperation in this area, with commitment to achieve as a matter of preference and priority a global scheme for emissions cap and trading.

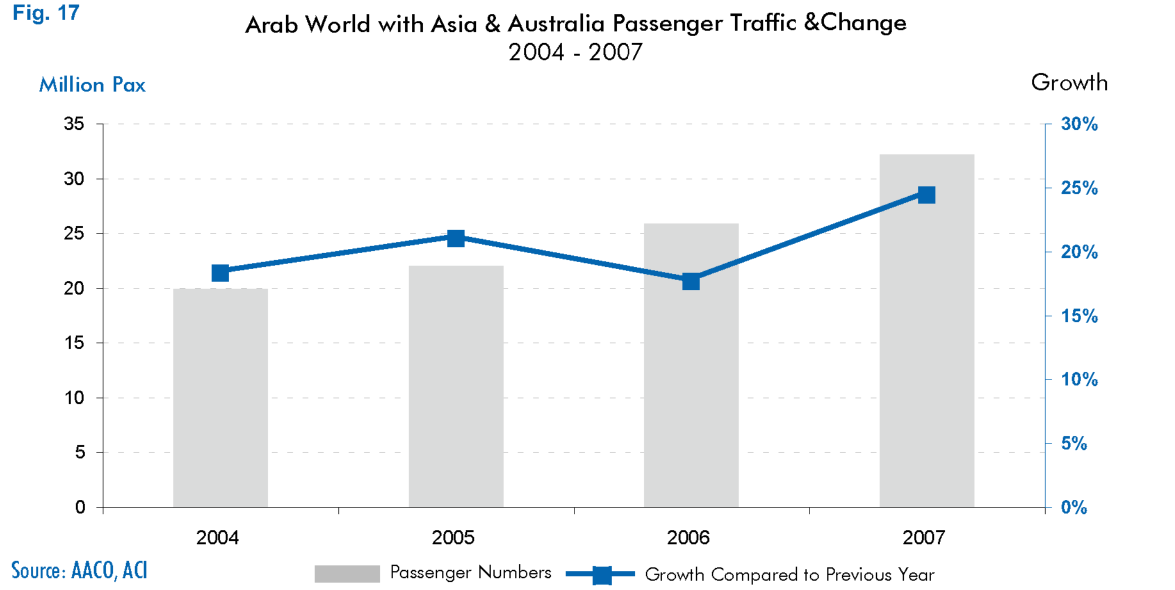
The dialogue will focus over the coming period on the following issues:
- Holding an Arab-European air transport summit in early 2009.
- Developing "joint Minutes" into a "joint declaration" that includes the principles that were agreed for bilateral negotiations, while addressing the Euro-Mediterranean aviation project and cooperation over the environment.
- European Union participation in the Joint Environmental Bureau dedicated for Arab aviation.
- Following-up on the developments of the European Emissions Trading Scheme.
- Including all the Arab states in the Euro-Mediterranean project after 2010.

2 Arab World, Asia and Australia

Total Passenger Traffic

Scheduled passenger traffic between the Arab world, Asia and Australia grew by 24.4% in 2007 compared to 2006.

Fig. 17



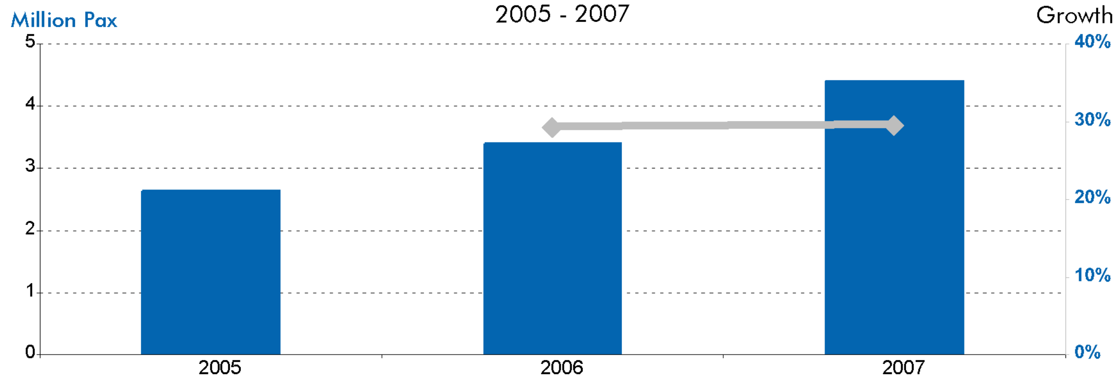
Source: AACO, ACI

* Asia and Australia include China, India, Bangladesh, Afghanistan, Turkey, Pakistan, Sri Lanka, Hong Kong, Malaysia, Philippines, Singapore, Thailand, Japan, Indonesia and Australia

China and the Arab world

- China's market is the largest air transport market after the United States; this market should be under focus as far as the Arab world is concerned. In 2007, passenger traffic between the Arab world and China grew by 29.44% compared with 2006. The total market volume between China and the Arab world comprised about 4.4 million passengers. (Figure 18)
- The Arabian Gulf region comprised 64% of the market volume between China and the Arab world in 2007. On the other hand, the largest growth rates for this market are between North Africa and China, growing by 45.4% in 2007 over 2006.
- Six Arab airlines operate 83 flights weekly to four major cities in China: Beijing, Shanghai, Shenzhen, and Cangzhou; 121 weekly flights are operated by Arab and non-Arab airlines. Therefore, Arab airlines operate 68.5% of flights between the Arab world and China (week 40 – 2007 Source: OAG).

Fig. 18 Passenger Traffic and Growth between the Arab world and China
2005 - 2007



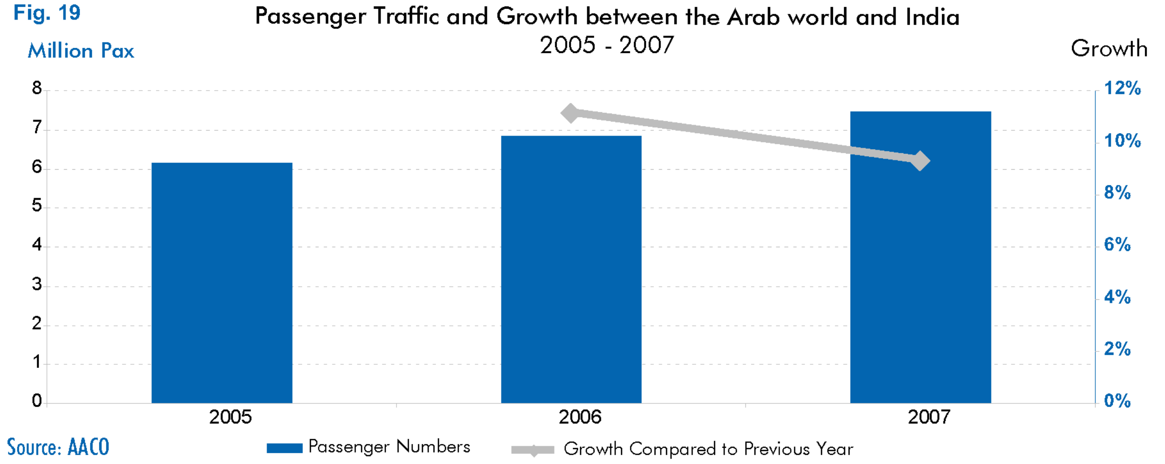
Source: AACO

India and the Arab world

- 33 Airlines operate 206 weekly flights to 18 cities in India.
- Most flights are concentrated between the Arabian Gulf region and India; these flights constitute about 98% of the market between India and the Arab world.
- 12 member airlines operate 95 flights out of 206 weekly flights to India. This represents approximately 54% of the total flights to India.
- In 2007, passenger traffic between the Arab world and India recorded a 9.28% growth rate over 2006, at a total market size of nearly 7.5 million passengers. (Figure 19)
- This growth is mainly due to strengthening the air transport bilateral agreements between India and various Arab states; 17 Arab states already have bilateral agreements with India for the partial or complete liberalization. In 2007, India built up its bilateral air transport services with Oman, Saudi Arabia, and Bahrain.
- In January 2008, the Indian government cancelled a law that suspends the operations of private Indian carriers on international flights, sparking large numbers of new flights to the Arab world by Indian carriers.

It should be noted that the Indian air transport market has become the ninth largest market in 2007, up from rank 12 in 2006. This growth is due to the significant steps to liberalize air transport on domestic and international routes, which in turn opened the door for the merging of indian carriers, and their accession to global airline alliances, in addition to strengthening the air transport infrastructure in major and secondary hubs and the restructuring of civil aviation institutions in the country.

Fig. 19



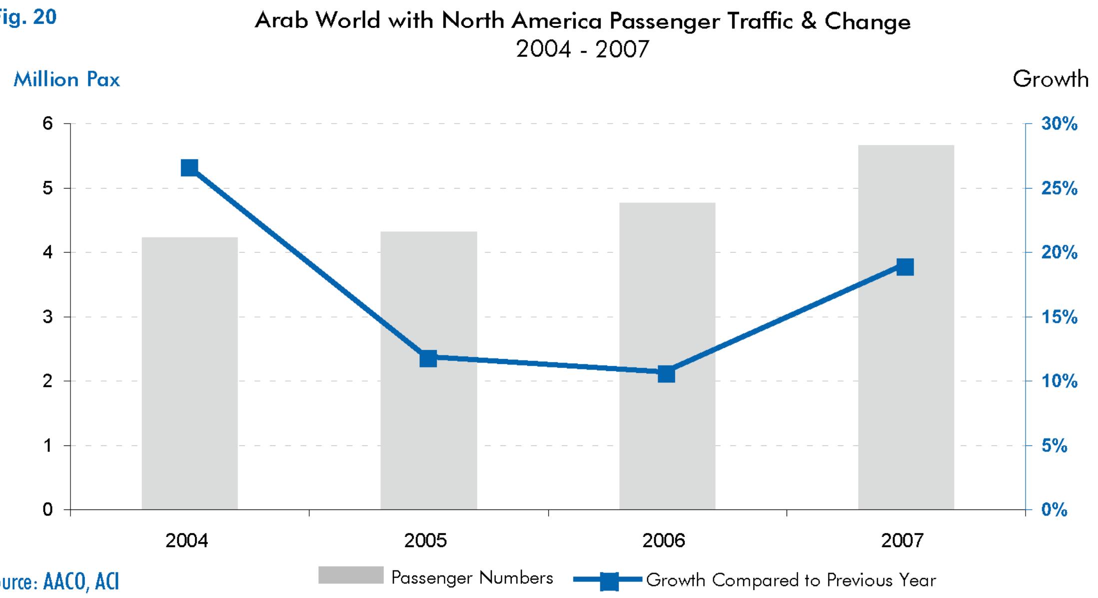
Source: AACO

4 Arab World and North America

Passenger Traffic with North America

The growth rate of passenger traffic between the Arab world and North America was 18.8% in 2007 compared to 2006. (Figure 20)

Fig. 20



Source: AACO, ACI

Arab – American Aviation Relations

- The North American market constitutes 5% of the total air traffic for AACO members.
- The Arab-American air transport market constitutes 5.27% of the global air traffic, where Arab airlines operate 38.4% of the movement in this market.
- The United States follows two paths in its civil aviation and air transport international relations; at the bilateral level, and the second at the multilateral level.

Bilateral Relations:

The U.S. is working on concluding bilateral agreements to liberalize air transport with various countries. It has succeeded so far in concluding 90 open skies agreements involving passenger and/or cargo traffic and 2 agreements to liberalize cargo traffic (with Argentina and Australia since 1999). These agreements started in 1992.

On March 30, 2008, along with the implementation of the first phase of the open skies agreement with the European Union, the agreement applied automatically to 27 European states that already have bilateral agreements with the United States.
It is worth noting that 7 Arab States have open-skies agreements with the United States, namely: Jordan, United Arab Emirates, Bahrain, Morocco, Oman, Qatar and most recently with the State of Kuwait.

Multilateral Relations

In addition to concluding open skies agreements on bilateral basis, the United States is a member of the Multilateral Convention to Liberalize International Air Transport "MALIAT" which has gone into effect on December 21, 2001, and includes the Sultanate of Brunei, Chile, New Zealand, Samoa, Singapore, Tonga, and Cook Island, in addition to the United States. Mongolia also acceded to the Convention on February 23, 2008.

Latest developments in the operations between the Arab world and the United States (2008)

Flights between the Arab world and North America are increasing because of higher demand for travel and the technological developments for long-range aircraft that allow such flights. During 2008, growth could be observed in the number of flights between the two regions, especially by the following airlines:

- Delta Airlines: Dubai-Atlanta, Cairo-New York, Amman-New York in June 2008, Kuwait-Atlanta in November 2008.
- Emirates to San Francisco in October 2008, and to New York, Houston, Los Angeles in September 2008.
- Qatar Airways to Houston in November 2008.

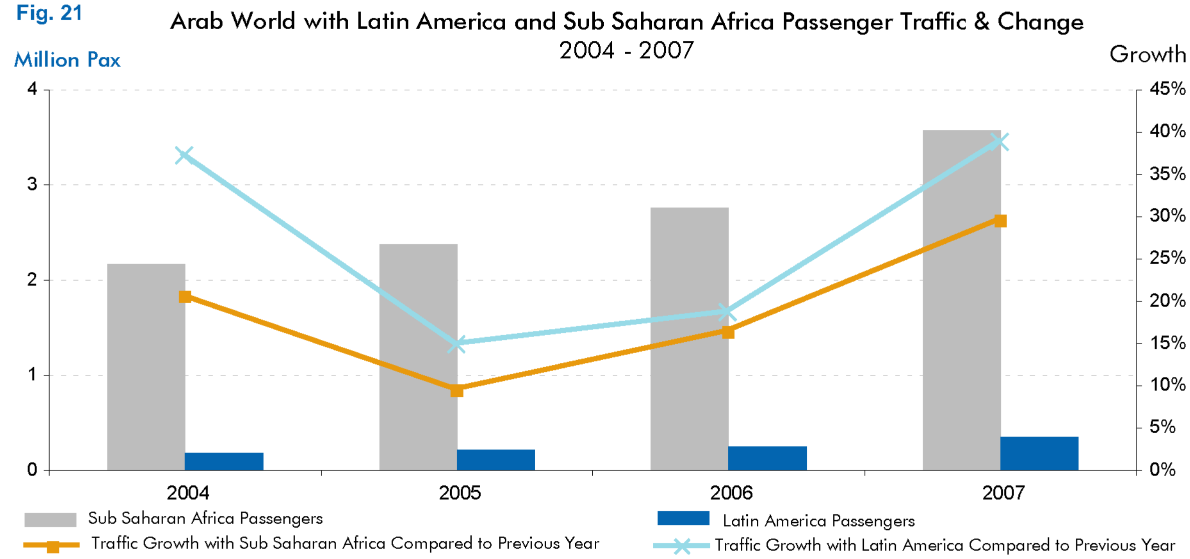
Codeshare Agreements: There are 7 codeshare agreements between Arab and American Airlines:

- Royal Jordanian with American Airlines, America West, and U.S. Airways
- Emirates with Continental
- Gulf Air with American Airlines
- Qatar Airways with United
- Royal Air Maroc with Delta

5 Arab World with Sub Saharan Africa, and Latin America:

Passenger traffic recorded a growth of 30.2% in 2007 over 2006 for these regions.

Fig. 21



Source: AACO, ACI

4 Euro- American relations

- On March 30, 2008 the first phase of the Trans-Atlantic Air Services Agreement was launched. The first phase allows for the opening of air transport services between the European Union and the United States through abolishing all route-restrictions, pricing, and the number of weekly flights between the two markets. This step came after long discussions that began in 2003, though the European party has demanded the right to cancel its obligations towards the first phase if the parties are unable to reach an agreement on the second phase of the Convention by mid 2010.

- The second phase, over which negotiations started on 15 May 2008, may lead to the elimination of all restrictions on airline services and cross-border investment.

- Negotiations aim at "an open aviation area," and may include the mutual abolition of restrictions on airline ownership for investors from the European Union and the United States. In addition, the second phase could allow all airlines with bases on both sides of the Atlantic to carry passengers on domestic routes on both sides.

- The importance of phase II of the Convention is that it encompasses more than one billion passengers annually and more than 50% of global air traffic, in addition to facilitating trade through the promotion of cross-border investment. Moreover, the EU and the United States are each other's largest trade-partner, exchanging over 1.7 billion Euros daily.

- Adding to the stronger economic ties will require wider cooperation in the regulatory framework, so both parties have committed to cooperate on regulatory matters. Moreover, the EU aims to reinforce the cooperation to reach stages of mutual recognition of standards of safety, security, environment, and air traffic management.

- The most important items to be tackled in the second phase are:
  - Facilitating foreign investment
  - Broadening liberalization across the Atlantic
  - Discussing the restrictions on environment and airline structures
  - Larger entry rights to the United States market - "Fly America"
  - Wet-Lease

- Time Plan
  - Negotiations began 60 days after the introduction of the first phase (May 2008).
  - Review after 18 months (year-end 2009).
  - If there has been no progress in 12 months (year-end 2010), some rights will be suspended.

Arab Air Transport and Industry Issues

Safety - Excellent Performance in 2007 ... Emergency Planning Operations at Member Airlines

Emergency Response Planning
- A joint project between the 12 member airlines, launched in 2007.
- The purpose of the project is to establish closer support among members for emergency response planning and management in order to ensure preparedness for emergencies should they occur.

- The Global Aviation Safety performance remains excellent but not as good as in 2006. A setback in safety results is clearly visible with an IATA hull-loss figure per million flights at 0.75, up from 0.65 in 2006, a negative variation in the steadily descending accident figures of recent years.
- Leading countries on the list with a high hull-loss rate are Indonesia and the Democratic Republic of Congo. Prospects for change to a better safety position depend on the intention of the national authorities to upgrade their aviation infrastructure with the establishment of stringent oversight measures.
- According to the flight Safety Foundation, over 50% of all major accidents are still occurring during approach and landing with commercial jet loss of control and turboprop CFIT (controlled flight into terrain) related accidents dominate the fatality numbers.
- In 2007, AACO members have again enjoyed a year with zero fatal accidents, backed up by the fact that most carriers have acquired the IOSA seal for safety excellence. In 2008 however, Sudan Airways suffered a fatal accident at Khartoum Airport.
- Constant development of safety initiatives remains a high priority at AACO. Most noticeable is the solid step in facilitating to member airlines the process towards raising the overall English proficiency level of pilots and air traffic controllers as per the ICAO mandate. Moreover, partnerships for safety are forming up especially through the Emergency Response Planning project which is expected to kick off widely during 2008.

Maintenance, Repair and Overhaul (MRO)

Maintenance, Repair, & Overhaul
- Joint Project for 9 member airlines, launched in 2007.
- Project Objective: increase cooperation to reduce cost and facilitate exchange of maintenance services and technical expertise.

- The worldwide growth in MRO business carries on as one of the most lucrative segments for investments in the aviation industry.
- In the Arab region, a combination of fleet expansion and an increase in the number of startup airlines is expected to continue in the foreseeable future. In turn, demand for diverse MRO services will increase in tandem to cope with the upcoming demand especially that several regional airlines have recently upgraded, or even added their engine maintenance capabilities to their business.
- Moreover, the aviation MRO related industries have a crucial role in environmental preservation, and in moving the aviation industry into greener zones.

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- The MRO project at AACO is the newest among the technical initiatives. Highly noted is the increasing cooperation between members in MRO where services are being offered bilaterally with less dependence on foreign providers. Moreover, standardizing the certifications and requirements of MRO centers is currently one of AACO's main goals as this will result in increasing efficiencies and also manage the lack of skilled labor-force which could in turn be exchanged between members. Joint purchasing of highly utilized materials is also planned and shall have positive outcome in terms of cost efficiency within the member base.

Security

Much has been achieved in the area of civil aviation security since September 11 2001 terrorist attacks in the United States. From the implementation of biometrics systems and advanced detection technologies, employment of more security staff and improved security training and remuneration schemes, up to reinforcement of cockpit doors. The distressing concept of air travel from the travelers' point of view is starting to improve due to better facilitation procedures at most international airports.

Yet, the security topic remains an unpopular subject for both airlines and travelers due to two main challenges:

Perhaps the first challenge is the poor security practice witnessed at some airports which is downright offensive. It is actually the fact of stereotypical threats which are over emphasized at some airports. Such threats are related to perceptions based on ignorance. It is eminent that security decisions have to be based on informative data rather than on stereotyping factors. For this reason, arising need to better evaluate travelers of a different race or religion is a challenge for all security service providers. A sense of balance should be created while appreciating the reality that a very probable danger exists not only from specific elements of society. The right balance should also be formed between the creation of a secure environment and ensuring that civil liberties are not violated.

The second challenge is associated with the aviation security industry costs. The question of who is going to finance the escalation of security measures remains unanswered. It is very likely that the increasing upfront bill for security will accordingly be passed on to the end user, the passenger! But will the full increase be passed on to the customer? This will result in another question which needs to wait for a while before being answered, while bearing in mind that most airlines are already hampered by the skyrocketing fuel prices which have eroded all profits.

Aviation security remains a high priority at AACO. Through the task force dedicated to security, AACO has instituted a credible group which supports the interests of member airlines in all matters related to aviation security. The most prominent achievements of the group were in promoting security cooperation between members especially in out-station audits set to be accepted bilaterally between member airlines. Such an advantage shall result in cost efficiencies and increasing mutual support in the security field.

Alliances and Mergers

Global Alliances

- Alliances are aimed at strengthening the cooperation frameworks between airlines through improving revenues and expanding networks. Current alliances are the Star Alliance, Sky Team, and oneworld.
- Alliances have expanded into Cargo; WOW Cargo Alliance includes companies of the Star Alliance, and oneworld Cargo alliance includes a number of oneworld carriers.

- Year 2008 saw the expansion of alliances in the Arab world and Asia, particularly towards Egypt, with EgyptAir joining Star, and towards India and China to increase the alliances network coverage in the fastest growing regions in the travel sector in the world: China Southern joined Sky Team, Air China and Shanghai Airlines joined Star Alliance, which in turn succeeded in attracting Air India.
- The sky rocketing fuel prices have driven airlines to consider consolidation or closer cooperation – notably in the U.S. and across the Atlantic, which could transform the existing form of alliances as consolidation between major companies transcends the traditional notion of alliances.
- Year 2008 witnessed negotiation talks between Delta and both of United and Northwest, followed by an announcement of merger between Delta Airlines and Northwest. Once completed, the merger would turn the "New Delta" into the largest carrier in the world. Remarkably, both Delta and Northwest filed for bankruptcy protection in September 2005, and made use of that protection to reduce cost and capacity.
- Almost simultaneously with the Delta/Northwest announcement in February 2008, advanced merger talks started between United and Continental, and between United and U.S. Airways. Negotiations between United and Continental did not succeed because of United first quarter 2008 losses, and due to the strong objection by Pilot and Trade Unions for the United and U.S. Airways talks. However, the talks yielded cooperation on codeshares between United and Continental, and an announcement by Continental of its intention to exit Sky Team to join the Star Alliance. Nine Star Alliance airlines filed an antitrust request at the U.S. Department of Transportation to prepare for Continental accession to Star Alliance. The companies filed for license to establish an expanded cross-Atlantic cooperation zone.
- On their part, British Airways and American Airlines are studying the possibility of cooperation with Continental. In other words, in the alliance world, airlines are switching alliances and forging inter-alliance cooperation.
- The U.S. Department of Transportation has granted antitrust immunity for Delta/Air France and Northwest/KLM for closer cooperation between these companies. It is striking that the ability of airlines to consolidate is often tied to obtaining the regulatory consent, and that antitrust laws play a major role in restricting such moves – particularly at the local level. On the international level, airlines that merge with foreign companies risk violating their national ownership standing, and with it transport rights.
- The US-American open skies agreement in March 2008 may reflect a change in the role of alliances, pushing higher the edge of competition, and driving towards greater integration and cooperation to increase operational efficiency, fuelled this time by the enormous rise in aviation fuel prices in 2008.
- While alliances are restructuring, "aligned" airlines are seeking cooperation with "non-aligned" carriers. For example, Air Canada, a member of Star Alliance, has signed agreements for codeshares and mileage points exchange with Brazilian TAM, and a similar cooperation between TAM and LAN, member of oneworld.

Arabesk

Joint Project for 9 AACO member carriers, launched in 2005
Objective: strengthen competitive stance and connecting networks

In the Arab world, Arabesk Network Cooperation project has expanded to include 9 member carriers, following the joining of Etihad Airways and Syrian Arab Airlines end of 2007. The project combines airline autonomy and quasi-alliances benefits. Two Arabesk members have in turn joined global alliances; Royal Jordanian was the first Middle Eastern Carrier to join oneworld, while EgyptAir officially joined Star Alliance in July 2008. In addition to the success of Arabesk project, AACO has launched an Inter-Regional Cooperation Project for stronger ties with regional carriers that represent valuable partners for Arab airlines. The initiative is expected to expand in 2009.

Low-Cost Carriers

The number of low cost carriers is growing in the Arab region, despite the increase in fuel prices, and the shortage in pilots and trained engineers.

Air Arabia was the first low cost Arab airline, established in 2003 in Sharjah-UAE. Air Arabia currently operates 11 leased Airbus A320s, with plans to expand the fleet into 19 aircraft by 2010. Air Arabia currently operates to 37 destinations, to become 50 by 2010 out of 3 hubs. Air Arabia has a remarkable 14 hour aircraft utilization rate. Air Arabia has a confirmed order for 39 A320s, as at August 2008.

More low cost Arab airlines were established. Atlas Blue in Morocco, and Jazeera Airways in Kuwait were established in 2004. Jazeera operates 6 Airbus A320s to 25 international destinations out of its hub in Kuwait and has a confirmed order for 34 Airbus A320 until 2014.

Two startup carriers were established in Saudi Arabia – Sama and Nas, and one in Bahrain – Bahrain Air. Sama and Nas started domestic operations, and obtained license to operate on international routes. Nas Aviation started to operate to Abu Dhabi and Sharjah on the Arabian Gulf, with plans to operate to Egypt. Sama currently operates to the Arabian Gulf region, Egypt, and Jordan.

Emirates announced its plans to launch a low cost carrier in response to market demand. Emirates will call the Jabal Ali startup, FlyDubai, and have placed an order of 50 Boeing B737-800 aircraft, to be delivered starting May 2009, in addition to 4 leased aircraft.

EgyptAir also launched a domestic subsidiary – EgyptAir Express, which operates 6 Embraer ERJ-170, with another 6 aircraft on order. It serves local destinations, and a few international tourist destinations. Another Egyptian low cost startup, Nile Air has made a confirmed order for 9 aircraft, and will mainly serve the gulf market, Beirut, Khartoum, Aleppo and Damascus.

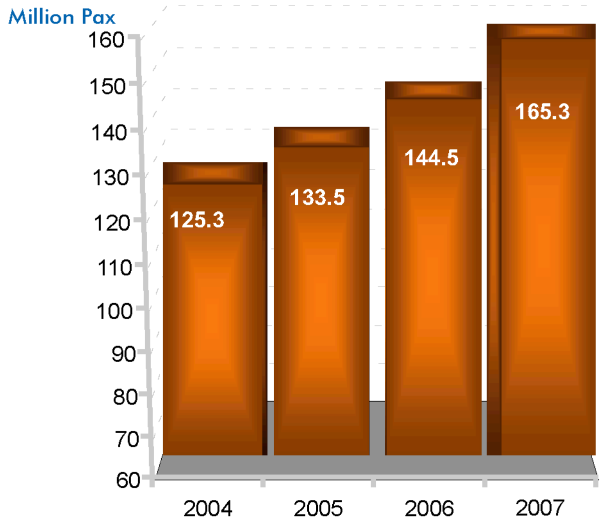
Arab Airports

1- Arab Airports Traffic

Passenger traffic through Arab airports increased by 14.4% in 2007 over 2006, touching on 165.3 million passengers. (Figure 22)

Fig. 22

Passenger Traffic at Most Arab Airports
2004 - 2007

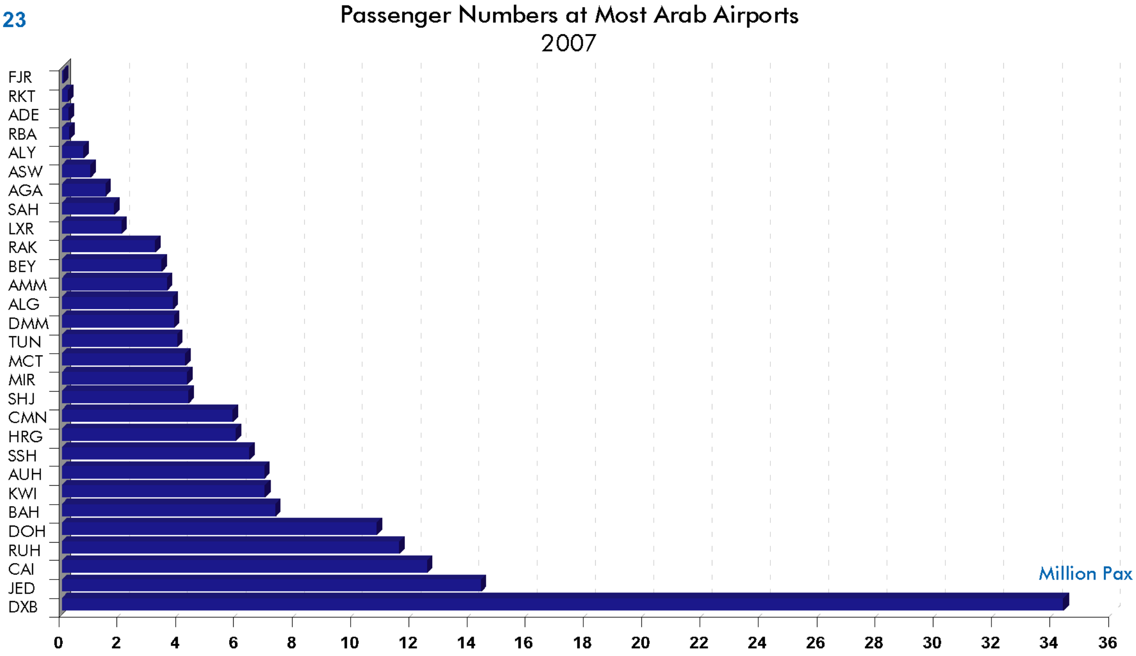


Source: AACO, ACI

2- Passenger and Cargo Traffic in Arab Airports

Most Arab airports registered good growth in passenger numbers in 2007. Sharjah airport led the way by 58.2% growth over 2006. Only one Arab airport had negative growth in 2007, compared to 6 airports with negative growth in 2006. (Figure 23)

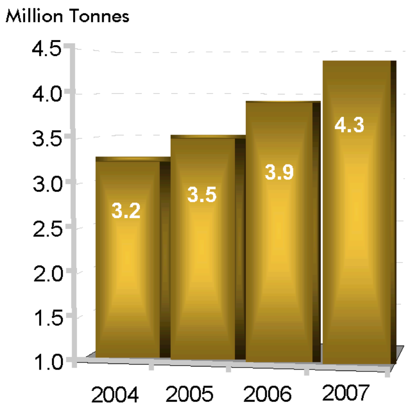
Fig. 23



Source: AACO, ACI

Cargo traffic at Arab airports grew by 12.1% in 2007 over 2006. (Figure 24)

Fig. 24



Source: AACO, ACI

3- Expansion Projects at Arab Airports

Economic growth in the Arab region and the fast development seen by the Arabian Gulf airlines has triggered an even wider investment in expansionary projects at Arab airports. Total investment in those airports amount to US86 billion; US43 billion in the GCC – out of which are US21 billion in the United Arab Emirates alone. These investments will increase the region's passenger capacity to 300 million passengers in 2015, or 3 times the current capacity.

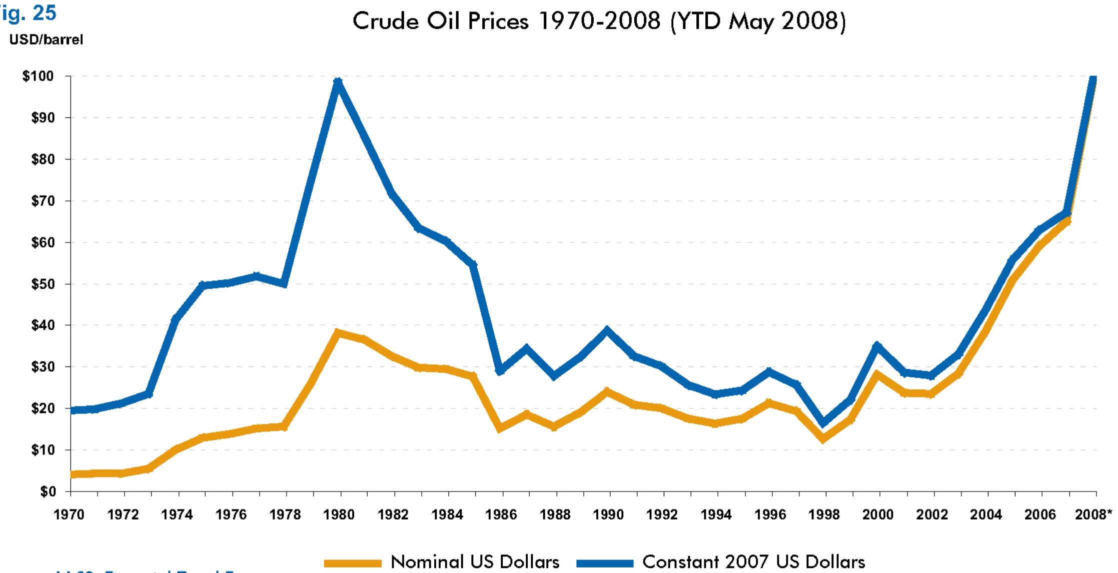
- Several elements have encouraged the Arab governments to finance those mega projects, despite the challenges that face the Air Transport sector. Some of these elements are:
  1. Expected increase in air traffic: the Arab region is expected to witness the highest increase in Air Transport in the world until 2011, 40% above global average, driven by the distinctive geographical position of the Arab world, its geographical stretch, and growing young population.
  2. Economic boom in the Arabian Gulf: while soaring fuel prices represent a constant challenge to Arab airlines and all airlines, increase in oil prices translate into higher returns for the oil producing Arab countries, prompting investments in infrastructure such as airports, airlines, and support services.
  3. The Arab area is on top of the aircraft orders list, and has the newest fleet of 600 aircraft.
  4. Intra-Arab tourism has grown significantly, and is expanding towards previously untapped areas.

Jet Aviation Fuel and Crude Oil

Fuel cost topped the airline bill in 2007, including AACO members. Fuel expenses have tripled over 2003 – amounting to US136 billion compared to US44 billion in 2003, representing 29% of operating expenses. For AACO members, the fuel bill has increased by 21.3% in 2007 over 2006, and by 360% over 2003. Nonetheless, fuel cost represented 24.7% of the overall operating expenses due to the hedging tactics undertaken by the Arab airlines, and the AACO joint fuel purchasing project.

The increase in jet fuel price is attributed to the global increase of oil prices over the last few years. Oil prices have increased about 6 folds between 2002 and 2008, and reached an all time historical high in July 2008, exceeding the 1980 inflation adjested crest (Figure 25). Subsequenly, this increase disrupted almost all industries.

Fig. 25 Crude Oil Prices 1970-2008 (YTD May 2008)



Source: AACO, Financial Trend Forecaster

The increase in oil prices is due to four major reasons: economic, geological, political, and financial.

On the economic level, the rapid growth in developing nations, particularly in China and India, was not anticipated in the last two decades, and caught the market off guard, triggering a price hike due to norrowing the historical margin of oil supply to demand.

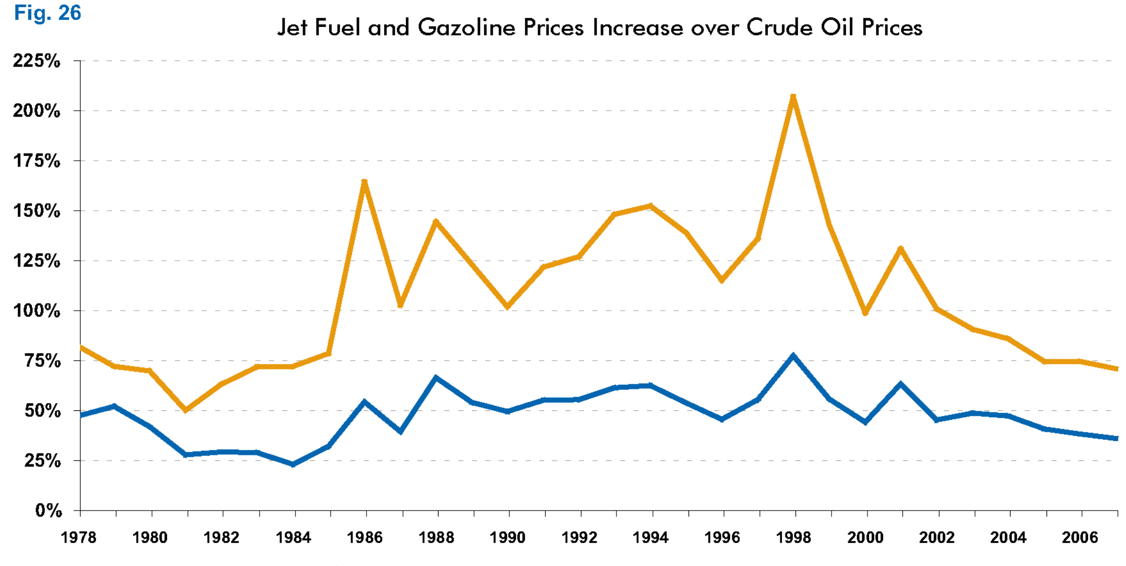
On the geological level, many geologists believe that global oil production has reached its peak, and believe it is unlikely that there are any major oil fields that have not been discovered yet, especially with the advancements in technology and geology over the last few years.

On the political level, the political and military conflicts in the Middle East and West Africa reflect negatively on the market confidence, and consequently lead to price increases.

On the financial level, trading oil contracts in the commodity markets, and using financial trade tools to reap profits on buying and selling oil contracts reflect on oil prices. OPEC estimated that demand in the financial market is 15 times more than the realistic demand. Moreover, the fear of recession and imbalance in financial markets are adding to oil prices volatility.

Unlike other means of transportation, the airline industry depends entirely on Jet Fuel. The lack of alternatives restrict elasticity on that product, leading to a higher increase in jet fuel compared to other derivatives, as shown in Figure 26, where this figure shows the increase of jet fuel and gasoline prices over crude oil prices.

Fig. 26



Source: AACO, IEA

Joint Fuel Purchasing Program – Ten Years of Growth and Development

Joint Project for 18 member airlines, launched in 1999
Objective: Reduce Cost

The joint fuel purchasing program has expanded drastically despite the economic challenges faced by the Arab airlines due to the constant fluctuations and to the soaring global fuel prices.

The development of the technical and administrative mechanisms in 2008 helped the team to increase the number of airports included in the two tenders to 550 airports, covering the needs of 18 members, having started with 30 stations and 8 airlines in 1998.

AACO has implemented the electronic tender through signing with "Tijari" company. On the other hand, the team has redistributed the airports on geographical basis between the first and the second tender, in line with the members' price and contractual term requirements. The team adopted a new negotiation strategy with suppliers – transparent, fair, and clear. This has contributed immensely to the USD 20 million profits from first and second tenders.

Among the most prominent achievements by the team was in Indian - Morocco - Pakistani - Sudanese and some U.S. airports. The project caters for the needs of 18 airlines for about 400 million gallons at 500 airports through collective negotiations. Team meetings were held in Tunis on 3-8 December 2007, in Casablanca on 2-7 June 2008 for the second 2008 bid.

On the other hand, AACO convened workshops on Fuel Price Risk Management, as well as a training course on fuel management to provide members with all the necessary hedging skills, and the implementation of financial and management tools in fuel purchasing, in addition to some technical matters that would help reduce consumption and fuel cost.

On the environmental side, which holds top priority for AACO, AACO will also hold a training course on fuel management hand covering all technical, financial, and environmental subjects in October 2008.

The technical fuel committee is preparing to hold the fourth Technical Forum in Damascus on July 2009. The committee is also working on releasing the second version of the Fuel Handling Manual, in addition to studying the possibility of establishing a small fuel inspection team at Arab airports on behalf of Arab member airlines.

Action Plan for Joint Fuel Purchasing Team 2009

- Increase the economic returns for the airlines through focus on a negotiation mechanism with suppliers and restrict competitors at airports.
- Follow up the application of the Hedging Program.
- Continue direct negotiations at Arab Airports.

Charges and Taxes - New Burdens on the Aviation Industry

While fuel is an essential operational cost constituent, it cannot be blamed for the full increase of airlines' costs, as there are other hidden fees imposed by the governments in the form of airport and over-flying charges which represent 3.5% of costs, having increased by 15.8% over last year, in addition to landing charges that comprised 2.6% of operational costs, having increased by 11.7%. Normally changes in these charges follows the taxation system implemented at airports, and is therefore influenced by fluctuation in exchange rates.

On the other hand, airlines around the world seek to reduce their fuel bill at Arab airports imposed by civil aviation authorities and airports bodies, such as transport and operations fees, and pipes and municipalities charges imposed in Jordan, Kuwait, and the United Arab Emirates.

AACO is working on three fronts to protect the interests of member airlines where charges and taxes are concerned:

- First: to negotiate with developers of the Emissions Trading Schemes to take into account the investments made by Arab airlines to renew their fleet and to include more environmentally friendly aircraft.
- Second: coordination with the Arab Civil Aviation Commission "ACAC" and IATA to discuss the issue of user charges, given the negative impact on the operations of Arab airlines because of the monopolistic status of the airports.
- Third: mediate with civil aviation authorities, oil and finance ministers, to consider canceling or reducing charges that are imposed on the fuel bill, where some accomplishments were achieved in Jordan and Kuwait.

Sales, Marketing, and Distribution

Distribution Agreement with Amadeus: A joint agreement between 7 member airlines launched in 2001.
Objective: To reduce distribution costs.

Distribution Agreement with Galileo: An agreement between 8 member airlines from 1991 until 2008.
Objective: To reduce distribution costs.

Distribution Agreement with Amadeus: a joint agreement between 13 member airlines and Amadeus starting 2009.
Objective: To reduce distribution costs.

The last few years have proven that airlines still need global distribution systems, travel agents, in addition to various sales and distribution channels. Airlines are faced with constant pressure to reduce cost, and in view of the colossal cost of developing independent distribution systems, the huge investments that are made by the global distribution systems is attractive to airlines. Global distribution systems have eventually learned to understand the airlines' requirements, the more important step is for these systems to play their real role in expanding the sales coverage. Airlines are resorting to long term agreements with global distribution systems to exchange content versus distribution and favorable booking frees in order to arrive at a mix of distribution channels in various corporate and tourism sectors. The distribution mix includes, in addition to the global distribution systems, direct distribution through ATO/CTO, airline websites, direct link between airline systems and travel agents, in addition to joint travel portals.

Low cost carriers are gradually turning to participate with GDSs in order to expand their passenger outreach, and to attract new high yield sectors, such as the corporate travel sector. The breach between the low cost carriers and the GDSs is gradually healing after the need of low cost carriers to expand their customer base was met with the GDSs willingness to develop the necessary model for this particular type of operations.

The last period also saw a change of heart between the GDS New Entrants, dubbed GNEs, and the traditional GDSs. Both parties moved from confrontation to cooperation, where GNEs turned from developing alternative airline distribution systems to developing pricing and supporting airline system tools. It is ironic that the GNE revolution triggered change within the GDSs, and has driven some GDSs, such as Travelport – the owner of Galileo, to purchase another GDS – Worldspan, to merge the two systems together. Therefore, the GNEs that connect airline host systems with travel agencies are repositioned as a support channel for GDSs instead of a substitute.

AACO has for long realized the importance of GDSs in the airlines' business. Arab airlines have signed long term distribution contracts since 1991, and they enjoyed one of the lowest distribution costs in the world for almost two decades. Moreover, AACO launched the collective negotiations in 2006, yielding a 10 year contract bringing together 13 Arab airlines with Amadeus as of 2009 – leveraging its experience in that domain, and responding to the Arab airlines need for wider outreach.

Electronic Ticketing and Interlining

Implementing electronic tickets

- The airline industry and service providers have strived for four years to implement IATA Simplifying the Business e-ticketing initiative that was launched in June 2004.
- May 31, 2008 was the IATA deadline to go 100% e-ticketing.
- AACO at the time put into place a detailed action plan to implement e-ticketing, as mandated by the AACO Executive Committee.
- During that period, a specialized team of Arab airlines, headed by the Secretary General of AACO, embarked on studying the requirements, and on collective negotiations. This team succeeded at obtaining joint proposals 30-60% cheaper than individual proposals.
- Arab airlines each adopted the preferred technology for its operations, and most Arab airlines currently issue e-tickets on their domestic and international routes.

Interline e-Ticketing Agreements

- Arab airlines, outside the global alliances, face some difficulties concluding the interline agreements that existed before the e-ticketing environment with particular airlines. This difficulty stems either from the e-ticketing service providers who are required to complete the technical connections, or by the other airlines that refuse to sign interline agreements with non-major interline partners.
- Using sector rates to issue interline tickets on "other airlines" would increase ticket prices, whereby airlines within alliances or major competing companies can grant sector connectivity at lower ticket prices.
- AACO members continue to sign interline agreements through the following channels:
  - Bilateral talks;
  - Within AACO Commercial Committee that organizes bilateral meetings for members;
  - Within Arabesk Project, and through expanding it by inviting non-Arab airlines to look into the possibility of signing interline agreements or codeshares;

It is worth mentioning that Arab airlines have agreed to accept paper tickets beyond 31 May 2008 for a period of six months.

Ground Services

Joint Cooperation at Outstations: joint project for 16 members launched in 1999.
Objective: reduce cost.

The joint cooperation project at outstations is on track in achieving service quality and cost savings estimated at 40% for project carriers, in addition to joint efforts between those carriers to face important challenges involving airport or airline operations at outstations. The ground handling steering board successfully pursues the agreements in Athens with Swissport, Istanbul with Havas, and Rome with Fight Care.

The Ground Handling Steering Board seeks to:

- Renew or sign new contract in Frankfurt, London, Paris, Madrid
- Expand the project into cooperation in ULDs and Cargo, in addition to joint purchase on operations of ground equipment.

TUNISIA

Arab Air Transport Database

AACO follows up closely on industry developments, and reflects them daily on its website, and through electronic and printed publications:

- "The Nashra" – Industry's Pulse & Arab Aviation: AACO's official monthly bulletin in English, distributed electronically to all air transport industry parties on the regional and international airline industry bodies.
- "AATS" – Arab Air Transport Statistics: Includes detailed statistics for Arab airlines operations, fleet, market size, capacity, and the overall economic trend and impacts on the air transport industry.
- "Weekly Web News": Distributed electronically and covers latest development and daily news in the aviation industry, featured on AACO website.
- "Safe & Level": A Bulletin on safety and security issues circulated monthly.
- "Quarterly Statistical Bulletin": Covers data statistics about the Arab air transport market.
- "Fuel Bulletin": covers all jet fuel issues and is circulated every six month.

External Representation and Regional Cooperation

AACO cooperates with regional and international organizations, governmental and non-governmental bodies, foreign airlines, manufacturers and service providers, offering a broad framework of cooperation for AACO members, protection of their interests, and support for better economic environment for their operations.

The coordination and cooperation at various levels includes the commercial, regulatory, legal, and operational aspects, through continuous communication with IATA, ICAO, ACAC, the European Commission, the U.S. Department of Transportation, and regional airline organizations around the world.

AACO also has a solid base of industry partners under the Industry Partnership program since 1998, and today brings together more than 50 partners of aircraft and engine manufacturers, IT companies and global distribution systems, fuel companies, engines and aircraft leasing companies, consulting firms, ground-handling companies, financial firms and others. The program creates a mutually beneficial environment where partners benefit from AACO events and activities to strengthen their relations with member airlines, while AACO benefits from partner support in the various training programs and numerous other benefits to member airlines.

AACO also capitalizes on its widespread relations with regional organizations to expand its members' networks through cooperation with foreign airlines with regional and international coverage in various regions of the world; AACO identifies points of joint-benefit to push for code-shares or prorate agreements for markets that are not served by AACO members. Joint work under AACO umbrella provides a heavier negotiation weight and a greater incentive for regional cooperation.

www.aaco.org

85 Anis Nsouli St.
P.O.Box: 13-5468
2044-1408 Beirut – Lebanon
Tel: +961 1 861 297/8/9
Fax: +961 1 863 168