

Chorus Aviation Inc.

Second Quarter 2022 Financial Results Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Chorus Aviation Inc. Second Quarter 2022 Financial Results Conference Call. At this time, all callers are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press star zero for the operator. This call is being recorded on Friday, August 5, 2022.

I would now like to turn the conference over to Tyrone Cotie, VP of Treasury and Investor Relations. Please go ahead.

Tyrone Cotie — Vice President, Treasury & Investor Relations, Chorus Aviation Inc.

Thank you, operator. Hello and thank you for joining us today for our second quarter 2022 conference call and audio webcast. With me today from Chorus are Joe Randell, President and Chief Executive Officer, and Gary Osborne, Chief Financial Officer. We'll start by giving a brief overview of the results and then go on to questions from the analyst community.

Because some of the discussion in this call may be forward-looking, I direct your attention to the caution regarding forward-looking statements and information, which are subject to various risks, uncertainties, and assumptions that are included or referenced in our Management's Discussion and Analysis of the results and operations of Chorus Aviation Inc. for the three months ended June 30, 2022 and the outlook section and other sections of our MD&A where such statements appear.

In addition, some of the following discussions involve certain non-GAAP financial measures, including references to EBITDA, adjusted EBITDA, adjusted EBT, and adjusted net income, and adjusted net income available to common shareholders. Please refer to our MD&A for a discussion related to the use of such non-GAAP measures.

I'll now turn the call over to Joe Randell.

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

Thank you, Tyrone, and good morning, everyone.

In the second quarter we completed the acquisition of the Falko business. We're very pleased to see Falko delivering the expected results and the integration of the business is going smoothly. We have both complementary and similar leadership styles and cultures. We clearly see the Falko asset management platform delivering more diversity and flexibility to Chorus. In June, we announced the addition of 35 turboprop aircraft in a servicing capacity on behalf of a syndicate of banks, further expanding our asset management business and demonstrating Falko's ability to continue broadening its customer base.

With the Falko acquisition, Chorus is now a market-leading regional aircraft asset manager and the world's largest aircraft lessor focused solely on the regional aircraft leasing space with an aircraft lease portfolio of 266 aircraft and a total fleet of 381. We have significantly advanced our growth and diversification strategy. We are now expecting to derive approximately 50% of our 2022 annual adjusted EBITDA from the regional aviation leasing, or RAL, segment of our business.

Finally, Fund III has been launched, the data room is open, discussions have commenced, and there is a robust level of activity. There has been some general market volatility in the public equity and debt markets, which has caused a slight delay on the planned closing date. We continue to target a minimum amount of US\$500 million in capital commitments and we are planning on closing this fund raise in the fourth quarter of 2022 as market conditions stabilize. Looking forward, we will continue to transition our leasing business to an asset light model, opportunistically exploring asset sales so as to create additional shareholder value through paying down debt and generating incremental cash flows.

I thought it would be useful to provide some observations on the current aviation and regional aviation industry in particular. As you know, there are many parties that play an essential role in the air transportation system. We are working closely with Air Canada, airport authorities, and government agencies to address the issues the industry is facing. We believe these issues to be temporary. In addition, it is important to note that, due to the nature of our CPA contract, disruptions have not impacted our financial results. In particular, our Jazz operations are fully staffed for our CPA commitments and in line with pre-COVID levels.

It is important to understand that we have been preparing ourselves for the issue of pilot scarcity since well before the pandemic began. We created our Pathways Program, which is the premier education and training pathway for pilots in Canada providing industry-leading education and experience and a clear career path to employment on the larger aircraft with Air Canada for these pilots. This program has been a differentiator for Chorus in recruiting pilots. Over the years, with our various programs and partnerships, we have proven to be an innovative leader in pilot recruitment and are currently working towards

enhancing our capabilities in this regard. We expect to have more to share in the coming weeks on our continuous efforts to improve pilot supply.

Looking at the global industry, our focus is on regional aircraft, which are largely deployed in domestic markets. These markets have proven themselves to be the most robust from a passenger demand standpoint, as evidenced by the bounce back in demand for flying in the US, Brazil, India, and European countries. The regional sector continues to be a resilient and indispensable component of the air transport industry and, with the changing competitive landscape and with our scale, we are well-positioned to capitalize on opportunities. As seen in the past, in a recessionary period, there is strong demand for regional aircraft. For example, we have seen strong interest in the Dash 8 aircraft that recently came out of the Jazz operation.

Before I turn it over to Gary I wanted to acknowledge that we did take a provision in relation to anticipated aircraft repossessions and lease restructuring on CACIL's aircraft portfolio. We believe this addresses the last of the lessees that struggled significantly from the impact of the pandemic.

I'll now turn the call over to Gary to take you through some highlights of our second quarter financial results.

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Thank you, Joe, and good morning.

In the second quarter of 2022, Chorus reported adjusted EBITDA of \$104.9 million, an increase of \$28 million over the second quarter of 2021, with the main reason for the increase being the RAL

segment's increase in adjusted EBITDA of \$25.4 million due to the inclusion of two months of Falko's adjusted EBITDA of \$20.8 million; increased lease revenue from re-leased aircraft in CACIL's aircraft portfolio and the RAS segment's adjusted EBITDA increasing by \$2.6 million, primarily due to an increase in other revenue due to an increase in part sales and contract flying, partially offset by a decrease in third-party MRO activity; an increase in capitalization of major maintenance overhauls on owned aircraft; and an increase in aircraft leasing revenue under the CPA due to a higher US dollar exchange rate, offset by an increase in general and administrative expenses.

Adjusted net income was \$27.6 million, an increase of \$16.2 million over the second quarter of 2021, largely due to the increase in adjusted EBITDA of \$28 million just described, an increase in depreciation expense of \$9.3 million primarily attributable to the Falko business, and an increase in net interest costs of \$1.1 million primarily related to interest on long-term debt assumed as part of the Falko acquisition.

Adjusted net income available to common shareholders, or adjusted net income less minority interest and preferred share dividends, was \$21.7 million or \$0.11 per common share, a \$0.05 increase over the same period in 2021.

Net loss was \$40.4 million, a quarter-over-quarter decrease in income of \$61.9 million, primarily due to anticipated aircraft repossessions and lease restructurings resulting in provisions of \$45.6 million on the CACIL aircraft portfolio. It is important to note that all our other remaining customers are operating in compliance with lease arrangements and this provision does not impact our positive long-term outlook for the business. In addition, the following items impacted the quarter: an unrealized foreign exchange

loss of \$34.3 million and strategic advisory fees of \$5.7 million, offset by an increase in adjusted net income of \$16.2 million.

Now turning to liquidity, as of June 30, 2022, Chorus's liquidity was \$148.6 million, including cash of \$70.7 million and \$77.9 million of available room on its operating facilities. Our liquidity decreased in the quarter, primarily due to the investment related to the Falko acquisition, offset partially by strong cash flows from operations. In July 2022, Chorus securitized the beneficial interest in five aircraft trusts and, as a result, was able to remove restrictions on US\$27.6 million of cash that had been held as security for a loan in the Falko business. We anticipate having total liquidity in excess of \$100 million for the remainder of 2022. This will provide Chorus with sufficient liquidity to fund ongoing operations, planned capital expenditures, and principal and interest payments related to long-term borrowings.

And now on to our outlook. Chorus's forecast for the year ended December 31, 2022 has been updated from the first quarter 2022 forecast for the impact of anticipated aircraft repossessions and lease restructurings in the CACIL portfolio, the initial closing of the new Falko-managed fund moving from Q2 to Q4 2022, and US dollar to Canadian dollar exchange rate of \$1.28. With these changes, Chorus expects that the 2022 adjusted net income available to common shareholders to be between \$88,000 and \$103,000 and adjusted EPS available to common shareholders to be between \$0.45 and \$0.53. We expect to see our net debt to adjusted EBITDA for the end of 2022 to be in the 4.7% to 5.0% range as we continue to pay down our amortizing debt and we built in eight months of earnings from Falko. Other key elements of our guidance for 2022 are contained in the outlook section of the MD&A.

Before turning the call back to Joe, I would like to acknowledge the dedication of our teams at Jazz, Voyageur, CAC Chorus, and our newly acquired Falko. We wouldn't have been able to do this without their tireless work and dedication.

So, with that, I'll turn the call back to Joe.

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

Thanks, Gary.

And finally, again, I'd just like to express again this quarter my sincerest appreciation to our employees, who remain focused and committed to safety first and operational integrity through this challenging time, especially our frontline people who continue to put customers first.

Overall, the entire Chorus organization remains energized and excited about the opportunities we see moving ahead and look forward to delivering additional value to all our stakeholders. So, thank you for listening and, operator, we can now open the call to questions.

Q & A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the star followed by the one on your touchtone phone. You will hear a three-tone prompt acknowledging your request and your questions will be polled in the order they are received.

Should you wish to decline from the polling process, please press the star followed by the two. One moment please for your first question.

Your first question comes from Konark Gupta from Scotiabank. Please go ahead.

Konark Gupta — Analyst, Scotiabank

Thank you. Good morning, everyone. I just have a couple of questions here. First, on the organic CAC business, it seems like the revenue and EBITDA were down sequentially from Q1. I'm just wondering if there were any changes. You pointed out on repossession of aircraft, but was there anything in that second quarter that impacted the revenue versus the previous quarter in Q1? Or is there like any other kind of benefits that you had in Q1 maybe that you didn't see in Q2?

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Yes. Sorry, it's Gary here. There was nothing on the ordinary in the quarter. We had, as you recall, if you go back through our disclosures, we've renegotiated lease amendments over the course of time that would have been reflected, but when you look at the quarter there was nothing out of the ordinary outside of the expected repossession provision.

Konark Gupta — Analyst, Scotiabank

Okay. Thanks, Gary. And then with respect to your outlook commentary and the guidance change, I think one of the factors for guidance, slight reduction in guidance, is probably the anticipated aircraft

repossessions in the organic business on the third-party leasing side. Where specifically are you seeing that repossession potential? Like which part of your customer group?

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

Yeah, we do not comment on individual or specific customers, Konark, so we really can't share that with you at this time.

Konark Gupta — Analyst, Scotiabank

Okay. That's okay, Joe, but I was just kind of curious as to, you know, like I think most of your customers have already either renegotiated or they have come to some sort of terms before, so I'm just kind of curious, this last remaining repossession, how meaningful is this? Like is it like a few aircraft you're talking here or are you talking about like maybe half a dozen or something?

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

Well, there are a number of aircraft and, again, I can't be specific on which ones or which operator. Generally speaking, we did negotiate and have renegotiated a lot of the agreements that were in the CACIL portfolio and, generally speaking, customers are living to these revised terms and agreements. And these are lingering issues that have been struggling and we anticipate repossessing certain aircraft over the next little while, but we're not really free to say which carriers or which aircraft at this time.

Konark Gupta — Analyst, Scotiabank

Okay. So, just to be clear, the repossession that you anticipate, it's going to impact Q3 and Q4? It didn't impact Q3 yet.

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Q2 it did not impact outside of the provisions. Going forward it's reflected in our guidance, Konark, so we do expect to take them back here in the next number of weeks or months.

Konark Gupta — Analyst, Scotiabank

That's it for me. I'll turn it over. Thank you.

Operator

Thank you. And your next question comes from Matthew Lee, Canaccord Genuity. Please go ahead.

Matthew Lee — Analyst, Canaccord Genuity

Hi, guys. I was just hoping to get your opinion on the ability for Falko to raise funds in the current economic conditions. I know you kind of mentioned a slight change in appetite, but are you seeing any meaningful shifts on that front?

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

We've not seen any meaningful shift away from the interest in the fund. Obviously, during the quarter there was significant stock market volatility as some of the investors rebalanced their investments, et cetera, which we see settling now. So we see it as being just a delay rather than it being any real indication of a lack of interest. And that interest comes from existing investors, because those are the ones that you initially speak to. So, you know, I think we're still optimistic, it's just that this past few months, from a stock market point of view, it's a lot of volatility in interest rates. We see some of this settling out now and I think that that is shared by others, that view, so that will enable us to move forward.

Matthew Lee — Analyst, Canaccord Genuity

Great colour. And then maybe in terms of management fee, it looks like \$3.7 million recognized in the quarter. If I do the math, that translates to just over \$22 million per year. If I think about Falko's AUM as roughly C\$1.5 billion, it seems like that's an annual management fee of around 1.5%. Is that the right way to think about it or are there other kind of puts and takes that we should consider?

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Hi. It's Gary here. When you look at Falko's management fee, we had \$3.6 million in the quarter. There would have been a little bit of a one-time fee with onboarding of the 35 aircraft, so you could adjust a little bit out of it, but it is a fair run rate for how we see that business moving ahead.

Matthew Lee — Analyst, Canaccord Genuity

Okay, great. And just lastly, if I think about the new turboprops, the 35 new aircraft, can you help me just understand the economics of that deal? Are you leasing those aircraft on behalf of the banks and collecting a fee or is their (inaudible) kind of beyond that?

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

No, those are aircraft that we are managing for the bank, for the syndicate of banks, and so we have no risk on those aircraft, et cetera, we're simply managing it and helping them with that portfolio in recovering value. So that is the role of Falko as an asset manager with those airplanes.

Matthew Lee — Analyst, Canaccord Genuity

Okay. Thanks so much. Bye-bye.

Operator

Thank you. And your next question comes from Tim James from TD Securities. Please go ahead.

Tim James — Analyst, TD Securities

Okay. Good morning. Thanks very much. I guess my first question, just want to confirm kind of the mechanics of the impact from the difference in timing of the launch of the fund versus the closing. Maybe if you can kind of walk us through that and the timing of kind of revenue and various other puts and takes there from an accounting perspective.

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

Right. Well, of course, the first part of the arrangement in the process in launching a fund is to put it out there for people to consider in terms of its structure, its goals, et cetera, which has been done in the past with the funds that are there on an existing basis. Then these funds have to be evaluated by investors in terms of their interests and, you know, you generally go through an order. And of course you offer folks that have previously invested sort of first opportunity, et cetera. And so there's a broad list of potentials after that. And then the fund we're looking to close, as I said, in the fourth quarter, and the goal is US\$500 million, and at that time we plan on having folks, and Chorus itself, you know, we've said that we would invest up to 15% in these funds ourselves. So that's the process.

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

And Tim, it's Gary here. Just on the accounting for it, until the fund closes and you have the commitments of investments, there would be no fees earned, but as soon as you start to close the fund you can start the fees to get earned.

Tim James — Analyst, TD Securities

And so, and do the fees kind of, you hit the ground running on the fees? Or is there some sort of a ramp-up timeframe? Or how does that work from sort of day one onwards?

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Without getting into specifics, there are some fees associated with the fund itself as you close and then from there it can ramp up as the fund gets bigger.

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

Generally there are fees related to the committed capital and there are also transactional fees as well upon certain transactions in terms of things like acquisitions of a portfolio or a number of aircraft.

Tim James — Analyst, TD Securities

Okay. I see. Thank you. My other questions have been answered, so thank you very much.

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Thanks, Tim.

Operator

Thank you. And your next question comes from Cameron Doerksen from National Bank Financial. Please go ahead.

Cameron Doerksen — Analyst, National Bank Financial

Thanks. Good morning. Just to follow up on Tim's question just on the new fund, I mean what's the kind of timeline for deploying the capital? I mean presumably, you know, at close would there like sort of be aircraft in the fund very shortly after close or is this something that's going to take a number of quarters to fully deploy the capital?

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

It's really difficult to predict. You could have a large transaction of a number of aircraft. In the past when funds have been launched by Falko, there has been a large portfolio that was actually acquired in the fund. And this was specifically a few years ago, a number of years ago, the Avolon portfolio. So you could have a small number of airplanes with like certain operators or you could have a portfolio. So it is difficult to say. There are opportunities out there in both regards. I think you've seen where NAC is focusing on narrow-body aircraft. AerCap has the GECAS regional portfolio, which is not core to their business, et cetera. So, there are opportunities for portfolios. There are also opportunities to do deals with operators. So, in terms of the rate and the size of the deployment, it could be variable.

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

It's Gary here, Cam. You look at the funds themselves, usually over a two- to three-year period the capital gets deployed or committed, so that's what you could expect.

Cameron Doerksen — Analyst, National Bank Financial

Okay. And on the management fees, I'm just wondering what, I guess, the profitability here. I guess what services are you providing? I mean I'm just trying to get a sense of whether that's a very high profit margins on the fees. So just anything you can sort of describe around, I guess, maybe the cost to you on those management fees for those aircraft that you're managing.

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

It's Gary here again. When you look at the service fees, we have those, you know, those come right on to the revenue line, and what we have against it is our SG&A, which is the general administration expenses. Anything that's direct to the aircraft goes into the fund and we're left with the general administrative piece. So, when you look at the way the fees play out, particularly in our current situation, we have SG&A in place today that can handle a new fund. This new fund is essentially, you know, the revenue, less a reasonable amount of fees or costs, will make its way to Chorus' bottom line.

Cameron Doerksen — Analyst, National Bank Financial

What does the, I guess, the airline that's paying you for the management fee get in return? Like why would they outsource that to you if they could do it in-house?

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

So, it isn't the airline that pays the fee. It comes out of the funds that have been raised amongst the investors, including the LPs. So, it's the investors for which we are managing this portfolio that pay the fees. So, this does not affect any lessee if they're leasing these aircraft from a fund just like they would lease them from any other lessor.

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Cam, it's Gary here. So, if you look at the fund model, the reason you're paid a fee is to hit a targeted rate of return, and that's part of what Jeremy and the Falko team do, they achieve that and then hopefully better. So part of the fee is for that expected return that they receive. In the case of the 35 aircraft I think Joe alluded to earlier, that's a little bit different. That's for managing the assets on behalf

of somebody, so it's different. But when you look at the Fund III or this new fund that we're trying to kick out here, it is for managing the assets but producing a rate of return for your investors that they're able to achieve. So that's why.

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

Which generally has a targeted rate of return and if you do better than that then there's a (inaudible) that's associated with the fund as well. That is an additional incentive to make the fund as productive as possible.

Cameron Doerksen — Analyst, National Bank Financial

Okay, no, that makes sense. And if your rate of return ends up being below what's promised, what's, I guess, the risk to Chorus?

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

There is no penalty, but of course it's not something that we would strive to do, because we see this fund and this asset management business as being core to us moving ahead in the leasing side. So, obviously, performance is very important, but there would be no financial penalty per se.

Cameron Doerksen — Analyst, National Bank Financial

Okay. No, that's helpful. Okay, that was all I had. Thanks very much.

Operator

Ladies and gentlemen, just as a friendly reminder, if you do have a question, please press the star followed by the one on your touchtone phone.

Your next question comes from Kevin Chiang at CIBC. Please go ahead.

Kevin Chiang — Analyst, CIBC Capital Markets

Thanks for taking my question. I apologize; I jumped on late here, so if you answered these earlier, I do apologize again. Just looking at your guidance revision within RAL, are you able to split what percentage of the revision or how you would bucket the revision between, I guess, some of the repossession costs and issues in the CACIL portfolio versus the delay in the Falko-managed fund?

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Kevin, it's Gary here. I would say the primary reason for the revision is more of the delay in the fund. Back to the comment I made earlier, those fees, we have the SG&A in place less a reasonable amount of transactional costs, are revenues that will flow essentially to the bottom line. So that's the biggest piece of it and then, obviously, the expected lease repossessions, but the primary would be the...

Kevin Chiang — Analyst, CIBC Capital Markets

Okay. That makes sense. And I guess, just a follow up on that, I appreciate kind of timeline to deploy capital is tough to predict, but it doesn't sound like you're making some sort of big assumption this year within your guidance just given the fact that the fund doesn't launch until Q4.

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Yeah, it plays no significant part.

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

The important thing to us, Kevin, is that, you know, it's a go-forward business, which we think we're on the right track as the industry recovers. Like we're seeing robust demand out there despite the fact that there were a couple, you know, some airlines that were damaged almost irreparably through COVID. But we're seeing a very strong recovery, no lack of demand in the world, and we're very excited about the segment and believe that this asset light approach is the right one. No question about it. And I think during this whole pandemic it was clearly demonstrated that the regional business and regional aircraft are very resilient and so we're very pleased. It's unfortunate this quarter we have something that we now have to deal with, but our optimism remains very, very high, so we're excited about the future.

Kevin Chiang — Analyst, CIBC Capital Markets

Okay. No, that makes a ton of sense. Maybe just on, ah, you talked about the targeted return as you manage these funds or as you and Falko manage these funds. I guess does that change as we move into this higher rate environment? I know historically you've talked about, from an asset perspective, wanting to get 15% or mid-teens ROE. Does that type of return profile makes sense when the tenure is at three or when inflation is at current levels or does that 15% need to move up as well?

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Hi. It's Gary here. The mid-teens is certainly still the target and remains the target. We have moved off (inaudible) of our Falko division, so it still remains the target. And as far as the returns go, right now, a little early, but we haven't seen any real change.

Joe Randell — President & Chief Executive Officer, Chorus Aviation Inc.

We feel that the interest rate tide raises all related items, so we certainly still target the same returns in the leasing segment.

Kevin Chiang — Analyst, CIBC Capital Markets

Okay. That makes sense. And just last one for me. I see your lease recovery rate, it's been hovering on 90% now, I guess, year to date. Do you think you kind of just hover around here until, I guess, we get a full recovery in aviation? Is this kind of where you're stuck at until we're back to kind of pre-pandemic flying? Or can this continue to, I know it took a step back this quarter, but do you think this can grind higher in this current environment?

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

It's possible, Kevin. One thing that I'd note there is it's a percentage of revenue recognized in the quarter. So we have billing arrangements that are a little bit different in the (inaudible) and was meant to give some consistency for the analyst community so they knew how much cash roughly was coming off of that revenue number. So it will grind, it could grind a little bit higher, but it may not ever achieve 100 in that particular measure, but yet we'll have our lessees executing on their agreements and then as time goes on it may go above 100.

Kevin Chiang — Analyst, CIBC Capital Markets

Okay. That's it for me. Thank you very much.

Operator

At this time we had no further questions. Please proceed with closing remarks.

Tyrone Cotie — Vice President, Treasury & Investor Relations, Chorus Aviation Inc.

Okay. Well, thank you all. We'll conclude the call now.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines. Have a good day.