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LEMON TREE FINDS ROOM FOR CHANGE

Behind the mid-market hotel chain's transformation into an asset-lite company

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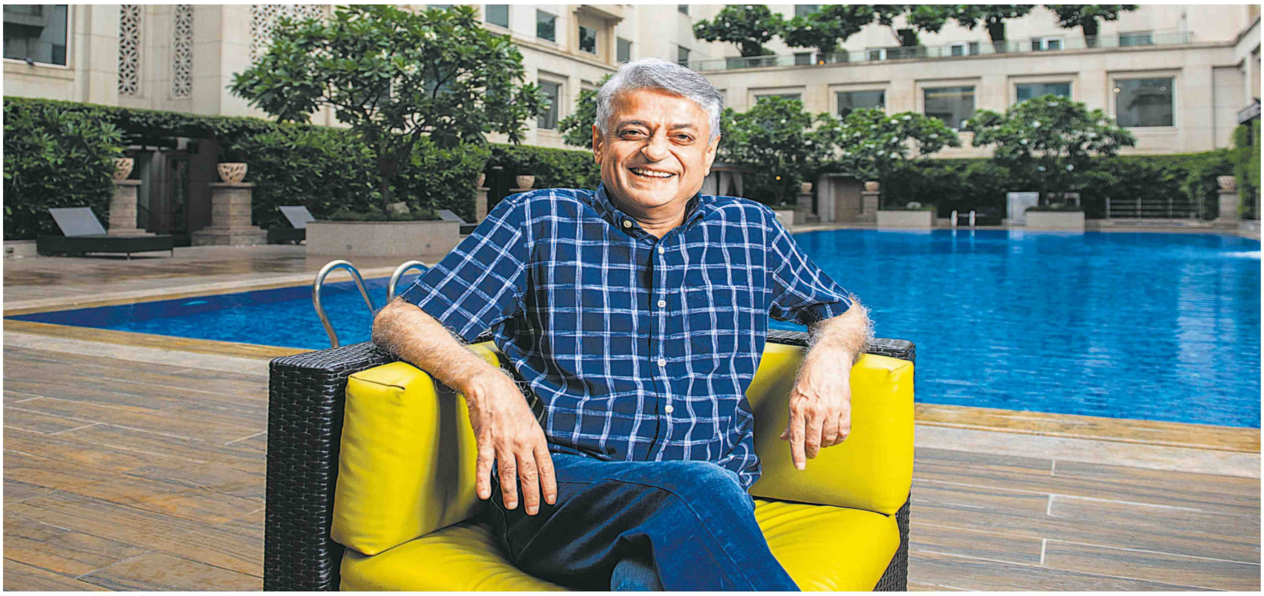

Patanjali Keswani, chairman of Lemon Tree Hotels.

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On a Friday evening, when most company heads usually unwind, Patanjali Keswani, chairman of Lemon Tree Hotels, is poring over floor plans for one of India's largest upcoming hotels.

Keswani has returned from a site where his company is building a 669-room hotel near the Mumbai International Airport. It's the third upscale hotel, after Udaipur and Coorg, under Lemon Tree's recently launched Aurika Hotels and Resorts brand. Two more are planned by 2025.

Over the past decade, Lemon Tree Hotels invested capital when few others did. "In the past eight years, we invested ₹3,000 crore. Accor, ITC and Chalet too deployed significant capital," says Keswani. But now, 20 years since its inception, the company is drawing up a new road map—a 2.0 asset-light version. Rather than plough back capital into asset creation, the company seeks to smarten up its digital presence, build on its management capabilities and monetise its brand, especially in smaller cities, via the management and franchise models. "In a sense, we have become far more risk-averse, which is a very good thing," says Keswani.

The moment of reckoning happened two years ago, when Patu, as Keswani is better known in industry circles, began charting the company's path for the next five years. "I realized we want to be dominant in the mid-market space with a strong presence in the upscale segment," says Keswani.

The company owns around 5,100 rooms of the 8,300 rooms in its portfolio currently. It now wants to operate 20,000 rooms in the next five years.

ASSET-LIGHT'S RIGHT?

The company owns around 5,100 rooms of the 8,300 rooms in its portfolio currently. It has now set itself an ambitious target of operating 20,000 rooms in the next five years, in line with Keswani's vision. With two more owned hotels in the pipeline, it will have 6,000 owned rooms in the next few years.

Going asset-light wasn't really a post-pandemic strategy, says company president Vikramjit Singh, adding, "It was always part of the plan which is why we created the joint venture, Carnation Hotels." Carnation is Lemon Tree's hotel management arm. A sentiment shared by an industry consultant, who said that Lemon Tree was on "a mad growth path" pre-covid and a lot of that was on the back of Carnation.

Yet, covid offered an opportunity, which the company was prescient enough to sense. It noticed a customer shift from unbranded to branded hotels primarily because of hygiene and standardization issues during the early days of Covid.

Earlier, people were not so fussy about staying in hygienic places. Covid became that differentiator and underlined the importance of branding. A lot of standalone hotel owners are now wising up to the need to tie up with brands.

"This shift in mindset is what our asset-light strategy is looking to capitalize on. The number of queries from first-time or standalone hotel owners is many times more than earlier," says Singh. A lot of the franchise queries are coming from tier II and III cities.

Franchising has, in the past, proved problematic for hotel owners. This is because in smaller cities, cash is still king and owners of smaller inventory hotels try to keep money off the books. But a large part of Lemon Tree's success with the asset-light model has been due to its consistent performance and deft management of the relationships with the hotel owners.

Take Rishikesh, where it started with one conversion in 2020 of the existing standalone Ganga Beach Resort to Lemon Tree Premier. Today, the company manages two converted hotels for the owner in Rishikesh and one newly built hotel in Neelkanth under different brands, and has signed two more to open in the coming years, including Aurika, Rishikesh. Conversions in Dehradun, Ahmedabad, Rishikesh and Goa have all taken place after the first wave of covid.

"In their tier III and IV story, there is absolutely no real worry about whether Lemon Tree has an adequate customer base or not. They definitely have a market. Today, most travellers earn enough credit card points to not worry about loyalty. They may not even need a loyalty programme since people just want that clean room at an affordable cost," says an industry consultant.

Over the years, the company has also been experimenting with multiple business models like own-and-operate, pure management or franchise as well as the hybrid manchise model. In the manchised route, the general manager is part of the brand while the rest of the employees are paid by the asset owner.

Competition is likely to be fierce for Lemon Tree, not just from domestic brands but also international operators that are slowly getting into the smaller inventory management business in the small towns. "But they may still have an advantage as many who live in these towns would have definitely heard of a Lemon Tree, Sarovar or a Taj," says Achin Khanna, managing partner at hospitality consulting firm Hotelivate and head of the firm's strategic advisory practice.

Lemon Tree's Singh believes compliance is king and the brand ensures several levels of audits. "Because we've just entered the space, we do find that it's a fast way to grow, because franchising requires us to give the brand and share standard operating procedures, which can be done quickly. We then conduct proper audits and ensure that brand standards are being adhered to," he says.

GOING DEBT-FREE

Of the 85 hotels in Lemon Tree's portfolio, 40 are owned or leased and the rest 45 are managed or franchised. On an estimate of about ₹3,000 crore of cash in the next five years, the company will invest an equity of about ₹450-550 crore in its Mumbai project leaving a net debt of ₹1,600 crore.

"We will be debt-free in five years and going forward, I don't see us deploying sizable capital in asset creation," says Keswani.

Being asset light is helping them, says an industry veteran. "It is a fully home-grown brand that invested in its own assets when nobody had thought of building hotels in the mid-market space in India," he says, adding, "The broad fundamentals of the company are sound. Patu (Keswani) is someone who has made a business strong enough to go public and subsequently make it asset light."

The company has come a long way, from a mid-market and economy hotel company that housed brands like Lemon Tree and Red Fox by Lemon Tree Hotels, to upper midscale hotels under its Lemon Tree Premier brand. Its first upscale hotel in Udaipur was launched just before the pandemic, in October 2019.

"A few fundamental things have happened since the pandemic. We have become super-efficient in our cost structures," says Keswani, an IIT Delhi and IIM Kolkata alumnus, who cut his teeth with the Tata group and rose up the ranks. Before he left to later promote Lemon Tree, he was the senior vice-president and COO of the Taj Group of Hotels.

"I am of the view that most five-star hotels in India have very high cost structures with Ebitda margins of 30%. We think we can massively increase margins when running this category of hotels. If we look at our Q1 this fiscal, we showed a net group Ebitda margin of 48% and at the hotel level it's much higher," Keswani says. Ebitda is an acronym for "earnings before interest, taxes, depreciation and amortization" and a widely used measure for corporate profitability.

Keswani has often inspired confidence in his investors and has brought on a number of marquee business owners and heads onto the company's board from the very beginning. The company is now in talks with a global consulting firm to take the company through its digital transformation process. This will include bionic revenue management, next generation sales processes, cost control towers and a revamped loyalty programme. Simply put, the company will use big data from customers and its own operations to improve its revenue and profits by selling better, and more than it already does.

"We are also focused on increasing our retail mix, that is, customers booking directly with us and reducing our dependence on large corporate accounts," says Keswani.

The core offering of cost efficiency or revenue optimization is all there, adds Hotelivate's Khanna. "The company still operates quite efficiently and its hotels are significantly more profitable than its peers in this space and their gross operating margins too have remained high," he says.

RECOVERY MODE

It also helps that the company, which went public in 2018, has recovered from its pandemic lows. Lemon Tree's stock had hit a high of about ₹85.9 around March 2019 following which it nosedived to as low as ₹15.85 in May 2020 when the lockdown came into full swing. Last month, following its annual results announcements, the stock recovered to ₹77.

"The company's Q1/Q2 targets are ambitious and that formed the basis on why it had listed in the stock exchanges. It has certainly seen a slowdown in their management arm and that could be due to a high-level exit at the top," says an industry consultant, alluding to the amicable exit of long-timer Rattan Keswani, the company's former deputy managing director.

The success of its asset-light model has been mainly due to its consistent performance and deft management of the relationships with hotel owners.

In January this year, when Goldman Sachs Singapore made a block deal with the company to pick up 3 million of its shares, the company's stock performance soared 10%. Right now, fund analysts have had a buy position on Lemon Tree till a target of at least ₹85 a share. On 22 September, the shares hit ₹87.

The outlook is positive overall for the industry too. The pandemic may have changed how people travel but the sector is still attracting investment. A lot of companies are riding on the back of a strong sectoral recovery. What's heartening for the entire hospitality sector has been its almost zero dependency on international travel trade for business and that has helped many chains like Lemon Tree bounce back, even though rates are still a bit of a challenge in some locations.

In August, Tata-owned Indian Hotels reported its best ever quarter with nearly four times increase in revenue. Overall, the demand across the sector soared during the first quarter of FY23 primarily driven by weddings, MICE (meetings, incentives, conferences and exhibitions), and business travel, says a new report from consultancy firm JLL.

Corporate MICE demand also witnessed a recovery in the form of corporate off-sites, team meetings, training sessions, and so on. "With exponential growth across all performance indicators in business and leisure destinations, Q1 of FY23 marks the revival of investor interest and stakeholder profitability in the hotel industry," says Jaideep Dang, MD, hotels and hospitality group, South Asia, JLL.

Domestic leisure was high too, driven by the pent-up demand of travellers who had not experienced a summer vacation for the past two years, the consultancy added. "We expect this momentum to continue over the next few quarters on the back of long weekends, festivals, weddings, events, and business travel evenly contributing to this growth story," adds Dang.

Keswani, too, is buoyed by the momentum but has concerns about the industry's future at large. As big tech giants like Google and Meta look at entering the hotel room distribution and marketing space globally, there is a worry over not just losing business and loyalty to online tour operators but also to tech behemoths.

"The biggest threat to the future of the hotel sector is likely to come from trillion-dollar companies like Google, Amazon or Facebook getting into the hotel discovery/reservation business and disintermediating hotel brands and OTA's (online travel agents) with their billions of users," he adds. In Dickensian terms, Keswani would agree that it's perennially the best of times and the worst of times for the hospitality industry.

mint SHORT STORY

WHAT

The Lemon Tree Hotels is drawing up a new roadmap. The company is monetising its brand, especially in smaller cities, via the management and franchise models

WHY

The company is cashing on a covid-led customer shift from unbranded to branded hotels. A lot of standalone hotel owners in tier II and III cities are interested in the Lemon Tree brand.

SO

The company claims to have cut costs and become leaner. Its hotels are significantly more profitable, say experts, and their gross operating margins too have remained high.

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