

Lemon Tree born on a dream, built on demand

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Lemon Tree Hotels was created in 2002 when founder Patu Keswani saw the potential in India's mid-market. Now the company counts an upscale and economy brand in its portfolio as well.

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NEW DELHI, India— The Lemon Tree Hotel Company, founded in 2002 by Patu Keswani, was molded by a group of dedicated professionals with experience and an entrepreneurial dream.

Over the past 12 years, the company has grown into a nimble hotel chain in a country where hotel business typically is dominated by either corporate groups or business families with deep pockets and presence in India's real estate scene.

But Keswani foresaw a potential in the budget segment of hotels, which was the catalyst to form the company. The original six-person team, which is still intact at the company, had all worked with Keswani in the past.

"Lemon Tree was created by Patu Keswani to cater to the dormant demand for mid-market hotel accommodation in India," said Rahul Pandit, the company's president and executive director, who had worked with Keswani at Taj Hotels Resorts & Palaces.

"Patu's vision was to pioneer and institutionalize the mid-market and economy hotel segment in the country, meeting both customer and equity expectations," he said. "Traditionally, the bulk of the branded supply in India had been luxury and the rest was disparate inventory, not linked to the above two objectives."

The first hotel launched in 2004 at a cost of 9 crore rupees (\$1.5 million) made up substantially by promoter's equity. The second hotel came up at a cost of 14 crore rupees (\$2.3 million). Both properties delivered double-digit return on capital employed as they were launched at a time when the industry was delivering at its peak.

The chain has since expanded, adapting to the market environment and able to seize opportunities. Essentially started as a mid-market brand, customer feedback drove the evolution toward the upscale Lemon Tree Premier and economy Red Fox Hotels brands were started—thus marking a presence as a group across price points.

The company counts three hotel brands and two resorts brands in its portfolio: Lemon Tree Premier; Lemon Tree Hotels; Red Fox; and resorts Lemon Tree Amarante and Lemon Tree Vembanad. It has 24 properties open, according to the company's website.

"We are presently the third-largest owner and operator of hotel rooms in India and own 2% of the organized inventory in the country," Pandit said.

What has pioneered the growth is the investments from Warburg (plus Kotak Realty and Shinsei Bank) and APG. The innovative approach of the management and the ability to deliver returns has attracted such investors to the chain.

Core strengths and looking forward

The core strength in operation has been the use of ingenious methods to proverbially stretch the rupee. Executives strive to combine quality and value with a cost paranoia.

"Our cost paranoia is reflected in our design, (capital expenditure) and (operating expense) ratios. We research the occupancy and demand of each location by bed type and create multiple bays of varying area to deliver space efficiencies. We would pay a premium in our CapEx to collapse the project (performance evaluation & review technique)," Pandit said.

"You will never see a pizza on our menu as the energy cost of the oven scares us, within a low volume hotel environment. Our manpower and energy ratios are typically half of the industry average. So, our costs are typically half of the industry and earnings two-thirds, thereby we deliver a three-times return versus our peers on every rupee invested," he said.

The company is betting on counter cyclical and has bought an operating asset (with a negative carry) in Bangalore and with active development in Mumbai, Gurgaon, Hyderabad, Kolkatta, Pune, Bhuvaneshwar, Udaipur, Shimla, Coimbatore, Trivandrum, Kovalam and Coorg.

Speaking of the future Pandit said, "This will grow to 4% of the organized and 10% of the mid-market inventory in India by 2017-18. We have also started our management arm to rapidly grow asset-light. The target over the next 10 years is to operate 50,000 rooms, split equally between owned and managed assets."

Several marketing initiatives have been launched, including the loyalty program Lemon Tree Smiles with more than 200,000 users. The company has incorporated a beyond profit initiative.

"Lemon Tree has defined the goal as mainstreaming 'Opportunity Deprived Indians' into its workforce. Today 10% of group employees (261 people) are Employees With Disabilities. The group plans to increase this number to 350 people by 31 March 2015," Pandit said.