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Royal Enfield sales rev up to support valuation at Eicher Motors

At ₹21,164, Eicher Motors Ltd's share price is steep. The one-year estimated price-to-earnings (P-E) ratio as per Bloomberg's consensus is 44, making it the highest among peers. The S&P BSE Auto index trades at a P-E of 15 times.

What justifies Eicher Motors' premium valuation? A strong product line with premium pricing, robust operating performance and, most importantly, a scorching pace of profit growth. Analysts estimate a 60% compound annual growth rate until fiscal 2017 (fiscal 2016 will be an 18-month accounting period).

Of course, the forecasts hinge on the stellar sales of its premium motorcycle unit—Royal Enfield. The motorcycle brand has a waiting period of around four months. According to the management, its recent online bookings for a limited edition closed within 26 minutes.

Royal Enfield's sales volume for the June quarter was 44% higher than a year ago. The unit posted a 37.8% year-on-year growth in net profit at ₹183.6 crore, accounting for about 82% of Eicher Motors' consolidated profit. This made it the best quarterly performance ever in terms of sales and profits.

Meanwhile, Eicher Motors is gaining ground in the commercial vehicles segment. A 6% rise in volumes along with a 14% growth in realizations during the June quarter helped the company's overall performance, too.

For the June quarter, the operating margin was a tad lower than forecast as employee costs were higher than expected. This could be the reason why the stock ebbed in Wednesday's trading session. Still, at 26.4% it was nearly 150 basis points higher than the year-ago period. Such high profitability in the auto universe is rare and backs the strong stock valuation.

POWERING AHEAD

Shares of Eicher Motors have outperformed the broader market by a huge margin in the last one year.



SARVESH SHARMA/MINT

Along with the commercial vehicles business, Eicher Motors' consolidated operating margin met the Street's expectation at 14.8%, higher than a year back by 215 basis points. Again, with Royal Enfield spewing out strong cash flows, Eicher Motors posted a consolidated operating profit of ₹431 crore, which was a solid 52% jump from the year-ago period.

The post-results management commentary only reinforced the analysts' forecast of stellar growth in the forthcoming quarters. With motorcycle sales expanding into developed markets overseas and with sales volumes expected to double by fiscal 2017 from current levels, there is little doubt about profitability being maintained.

With hardly any downside to earnings growth in the next two years, any improvement in the commercial vehicles business will only fuel Eicher Motors' sales and profitability.