Diary of a Private Investor **Renishaw** **Colm Fagan 4 October 2015**

The experts advise against getting attached to an individual share, that it can damage your financial health. I think they're wrong.

Renishaw is a FTSE 250 company, which means it's one of the 350 leading quoted companies in the UK but ranks below the elite FTSE 100. It was founded over 40 years ago by a Dubliner, David (now Sir David) McMurtry and his colleague John Deer. Sir David is still the company's chairman and chief executive - at a sprightly 75.

I bought my first Renishaw shares in 1998 at just over £4 a share. At the time, the yearly dividend was 11.44p, equivalent to an "interest rate" of 2.8% on my money. A pre-tax return of 2.8% was less than I could have got (net) from the Post Office at the time, but I was confident that Renishaw's dividends would increase in future.

My confidence was fully justified. The dividend has increased more than fourfold, to its current 46.5p a share, equivalent to an "interest rate" of more than 11% on my original investment.

As I write, the share price is £20, almost five times the cost in 1998. Not bad, considering also the steady flow of dividends in the meantime. No wonder I'm attached to the share.

The problem with getting so attached to it is that I consistently think it's worth more than the value placed on it by the market. Every time the price dips - and it fluctuates quite violently at times – I am tempted to increase my holding. The result is that I now have far more exposure to Renishaw than the experts, who worship at the altar of diversification, think is reasonable. They advise me to sell some of my shares to reduce my exposure.

Should I take the experts' advice? Let's do the sums. I have learned the hard way (see last month's column) not to buy or sell a share without first checking the numbers.

Most importantly, Renishaw's future looks bright. It is a world leader in designing and making sophisticated measuring instruments for manufacturers. Increased complexity in all areas of manufacturing helps to ensure a strong demand for its metrology products. It also has exciting technologies in healthcare and 3-D printing.

Through good times and bad, Renishaw invests around 15% of its revenues in engineering and research and development (R&D). Published accounts must show R&D expenditure as money down the drain, but in truth it is the best possible protection against obsolescence.

Renishaw has no debt and millions in the bank. It owns many of the premises it occupies, from Swords to Shanghai. Another positive is that the two founder directors own more than 50% of the business between them, so their interests are aligned to mine.

The company refuses all requests for 'nod and a wink' meetings with analysts. The analysts don't like this, but it means that I, as a private investor, know as much about the company as they do.

Renishaw normally aims to pay around 50% of its profits in dividends. It also aims for a smooth progression of dividends from one year to the next. In recent years, dividend growth hasn't kept pace with the fast growth in profits, so the dividend payout ratio has fallen below the targeted 50%.

In the year to 30 June last, Renishaw's earnings were £1.675 per share, but 2015 was exceptional. Profits were more than double their 2014 level, because of once-off orders from the Far East. The company projects middle- of-the-range earnings for 2016 of around £1.12 a share, down 33% on 2015.

In assuming virtually no repeat of last year's once-off orders, I believe the company is over-cautious in its forecast for the current year. Despite the downturn in China - which in any event should have a greater impact on companies selling to consumers than on companies like Renishaw that sell to manufacturers - I expect earnings of the order of £1.30 a share in 2016, still a hefty 22% down on 2015.

Over the last 15 years, Renishaw's earnings per share have grown by over 10% per annum on average. I expect growth of similar order from 2017, fuelled by the company's unswerving commitment to R&D and its increasing focus on systems solutions rather than on product sales. Systems solutions create long-term relationships and generate dependable recurring revenues.

Given Renishaw's growth prospects, I'll be happy with an earnings yield of 5% in the current year (which implies a dividend yield of less than 2.5%). On my assumption of £1.30 earnings per share for 2016, I therefore value the company at £26 a share (£1.30 is 5% of £26). In other words, my valuation of Renishaw is 30% greater than the current £20 share price.

I have no intention of selling at such a large discount to Renishaw's fair value – *my* assessment of fair value, of course. I also believe that the experts are wrong about diversification: it is a false god that will not shield me from the vagaries of the market. My experience tells me that I am better off investing in fewer than a dozen companies, ideally in un-correlated sectors, which offer the prospect of good long-term returns and limited downside risk. At its current price, Renishaw qualifies as one of those companies.