Diary of a Private Investor **Renishaw** **Colm Fagan 7 February 2016**

Owning shares is not for the fainthearted. That was proved to me once again by recent gyrations in the share price of Renishaw, a British engineering company that is my largest individual investment, accounting for over 25% of my portfolio. In the past four months, the share price has fluctuated from a high of £20.50 to a low of £16, a difference of 28%. This volatility is despite the fact that there have been no price-sensitive developments of note for the company in the period, with the results for the half-year to December 31, 2015 confirming guidance given for the full year to June 30, 2016. God knows what would have happened to the price if the company had made a big announcement. This is the sort of volatility shareholders must live with.

Short-term price fluctuations don't concern me unduly - what matters is the long-term. In the long-term, Renishaw has delivered. I bought my first shares in the company over 17 years ago at a dividend yield of slightly more than 2.5%. The dividend has grown by an average of more than 8.5% a year since. The dividend yield is once again slightly over 2.5%, which is close to the average for the entire period. This means an average return of more than 11% a year over the 17 years, comfortably beating inflation, which averaged 2% a year. Nice.

My target return for the future is inflation plus 6% a year. I will get this return if the dividend yield stays around 2.5% and dividends grow by an average of inflation plus 3.5% a year - 2.5% dividend plus 3.5% real growth in dividends equates to my target 6% real return. The company aims to pay around 50% of profits in dividends, and to reinvest the other half in the business, so the question becomes: will profits grow on average by the same 3.5% a year in real terms in future?

There are a number of drivers for Renishaw's success. One is the strength of the commitment at the top. The joint founder and chairman, Dubliner Sir David McMurtry, owns more than a third of the company; his shares are worth approximately £460 million at the current price of £17.43 a share. It's good to know that his interests are aligned with mine.

Another success driver is the company's unswerving long-term focus on a set of core competencies, centred round metrology, the science of measurement. From this core competence, Renishaw has branched out, with an appropriate degree of caution, into specialised areas of healthcare and additive manufacturing, more colloquially known as 3-D printing.

The company eschews mergers and acquisitions, other than small bolt-on acquisitions aimed at enhancing its competencies in key areas. It prefers to grow organically. This is in tune with my own philosophy. I believe that organic growth is best, and that mergers and acquisitions generally fail to deliver long-term value for the acquiring company.

It also helps that the company's strengths are in a specialised and obscure area of business, where there is likely to be less intense competition. It is said that, during the Californian gold rush, the only guaranteed winners were the merchants in the unglamorous business of selling picks and shovels - not the prospectors who used them. Renishaw is a modern-day equivalent of those merchants. Manufacturers of electronic consumer products, modern-day equivalents of the Californian prospectors, are among its biggest customers. Let them have their occasional bonanzas; I'm happy to stick with the company that generates a steady income.

The most important driver for Renishaw's success to date, however, is the strength of its commitment to research and development (R&D). Year after year, through good times and bad, it invests around 15% of revenues in R&D. The chairman firmly believes that there is a strong correlation between the proportion of revenues invested in R&D and the rate of growth in profits. If he's right, and I have no reason to doubt him, then my target return of inflation plus 6% per annum is safe.

Of course there are risks, lots of them: demand could fall, particularly in China; margins could be hit by competition; the supply chain could fail, causing the company to be unable to meet customer deliveries; R&D could be misdirected. My biggest concern is the need to ensure a successful transition of the management team to the next generation: the chairman and chief executive is 75; his deputy is 76; the finance director is 66. I love to see fellow senior citizens doing well, but we can have too much of a good thing. Nevertheless, I am confident that the board will be able to oversee a successful transition to a new management team when McMurtry and his colleagues at the top eventually decide to call it a day.

While I may reduce my holding slightly to keep my New Year's resolution of reducing risk by diversifying my portfolio, I still believe that Renishaw will deliver the target long-term return.