

HENNESSY ADVISORS INC
Form 10-Q
August 01, 2018
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the Quarterly Period Ended June 30, 2018

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the Transition Period From _____ to _____

Commission File Number 001-36423

HENNESSY ADVISORS, INC.

(Exact name of registrant as specified in its charter)

California
(State or other jurisdiction of
incorporation or organization)

7250 Redwood Boulevard, Suite 200

Novato, California
(Address of principal executive office)

(415) 899-1555

(Registrant's telephone number)

68-0176227
(IRS Employer
Identification No.)

94945
(Zip Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 27, 2018, there were 7,808,527 shares of common stock issued and outstanding.

Table of Contents

HENNESSY ADVISORS, INC.

TABLE OF CONTENTS

PART I	<u>Financial Information</u>	
Item 1	<u>Unaudited Condensed Financial Statements</u>	3
	<u>Balance Sheets</u>	3
	<u>Statements of Income</u>	4
	<u>Statement of Changes in Stockholders' Equity</u>	5
	<u>Statements of Cash Flows</u>	6
	<u>Notes to Unaudited Condensed Financial Statements</u>	7
Item 2	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
Item 3	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	30
Item 4	<u>Controls and Procedures</u>	30
PART II	<u>Other Information</u>	
Item 6	<u>Exhibits</u>	31
	<u>Signatures</u>	32

Table of Contents**PART I: FINANCIAL INFORMATION****Item 1: Unaudited Condensed Financial Statements****Hennessy Advisors, Inc.****Balance Sheets****(In thousands, except share and per share amounts)**

	June 30, 2018 (Unaudited)	September 30, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 21,142	\$ 15,700
Investments in marketable securities, at fair value	8	8
Investment fee income receivable	4,457	4,325
Prepaid expenses	607	1,614
Other accounts receivable	484	584
Total current assets	26,698	22,231
Property and equipment, net of accumulated depreciation of \$1,088 and \$922, respectively	365	254
Management contracts	78,038	74,628
Other assets	188	145
Total assets	\$ 105,289	\$ 97,258
Liabilities and Stockholders Equity		
Current liabilities:		
Accrued liabilities and accounts payable	\$ 5,839	\$ 7,353
Income taxes payable	418	676
Deferred rent	177	202
Current portion of long-term debt, net of debt issuance costs	4,228	4,228
Total current liabilities	10,662	12,459
Long-term debt, net of debt issuance costs and current portion	18,557	21,728
Deferred income tax liability, net of deferred tax asset	8,055	11,541
Total liabilities	37,274	45,728

Commitments and Contingencies (Note 8)

Stockholders equity:

Edgar Filing: HENNESSY ADVISORS INC - Form 10-Q

Common stock, no par value, 22,500,000 shares authorized: 7,808,496 shares issued and outstanding at June 30, 2018, and 7,776,563 at September 30, 2017	16,672	14,943
Retained earnings	51,343	36,587
Total stockholders equity	68,015	51,530
Total liabilities and stockholders equity	\$ 105,289	\$ 97,258

See accompanying notes to unaudited condensed financial statements

Table of Contents**Hennessy Advisors, Inc.****Statements of Income****(In thousands, except share and per share amounts)****(Unaudited)**

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Revenue:				
Investment advisory fees	\$ 12,503	\$ 12,020	\$ 38,068	\$ 36,192
Shareholder service fees	1,064	1,158	3,318	3,516
Total revenue	13,567	13,178	41,386	39,708
Operating expenses:				
Compensation and benefits	3,219	3,124	9,872	9,613
General and administrative	1,357	1,332	4,302	4,122
Mutual fund distribution	140	80	383	213
Sub-advisor fees	2,662	2,281	7,842	6,862
Amortization and depreciation	98	91	276	275
Total operating expenses	7,476	6,908	22,675	21,085
Net operating income	6,091	6,270	18,711	18,623
Interest expense	279	281	808	825
Other income	(44)	(3)	(79)	(3)
Income before income tax expense	5,856	5,992	17,982	17,801
Income tax expense	1,638	2,032	1,022	6,217
Net income	\$ 4,218	\$ 3,960	\$ 16,960	\$ 11,584
Earnings per share:				
Basic	\$ 0.54	\$ 0.51	\$ 2.17	\$ 1.51
Diluted	\$ 0.53	\$ 0.51	\$ 2.15	\$ 1.49
Weighted average shares outstanding (prior periods restated for stock split, see Note 6):				
Basic	7,807,972	7,690,443	7,804,733	7,688,397
Diluted	7,924,510	7,788,456	7,883,733	7,785,536

See accompanying notes to unaudited condensed financial statements

Table of Contents**Hennessy Advisors, Inc.****Statement of Changes in Stockholders Equity****Nine Months Ended June 30, 2018****(In thousands, except share data)****(Unaudited)**

	Common Stock		Retained	Total
	Shares	Amount	Earnings	Stockholders
				Equity
Balance at September 30, 2017	7,776,563	\$ 14,943	\$ 36,587	\$ 51,530
Net income			16,960	16,960
Dividends paid			(2,147)	(2,147)
Employee and director restricted stock vested	38,700			
Repurchase of vested employee restricted stock for tax withholding	(9,316)	(94)	(57)	(151)
Shares issued for auto-investments pursuant to the 2015 and 2018 Dividend Reinvestment and Stock Purchase Plans	733	13		13
Shares issued for dividend reinvestment pursuant to the 2015 and 2018 Dividend Reinvestment and Stock Purchase Plans	1,816	33		33
Stock-based compensation		1,828		1,828
Employee restricted stock forfeiture		(51)		(51)
Balance at June 30, 2018	7,808,496	\$ 16,672	\$ 51,343	\$ 68,015

See accompanying notes to unaudited condensed financial statements

Table of Contents

Hennessy Advisors, Inc.
Statements of Cash Flows
(In thousands)
(Unaudited)

	Nine Months Ended June 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$ 16,960	\$ 11,584
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and depreciation	276	275
Deferred income taxes	(3,486)	1,349
Stock-based compensation	1,828	1,585
Amortization of debt issuance costs	(110)	(110)
Employee restricted stock forfeiture	(51)	
Change in operating assets and liabilities:		
Investment fee income receivable	(132)	(130)
Prepaid expenses	1,007	548
Other accounts receivable	100	26
Other assets	(43)	3
Accrued liabilities and accounts payable	(1,514)	(877)
Income taxes payable	(258)	(383)
Deferred rent	(25)	178
Net cash provided by operating activities	14,552	14,048
Cash flows from investing activities:		
Purchases of property and equipment	(277)	(112)
Payments related to management contracts	(3,410)	(165)
Net cash used in investing activities	(3,687)	(277)
Cash flows from financing activities:		
Principal payments on bank loan	(3,171)	(3,171)
Restricted stock units repurchased for employee tax withholding	(151)	(168)
Proceeds from shares issued pursuant to the 2015 and 2018 Dividend Reinvestment and Stock Repurchase Plans	46	3
Dividend payments	(2,147)	(1,642)
Cash paid for fractional shares		(1)
Net cash used in financing activities	(5,423)	(4,979)
Net increase in cash and cash equivalents	5,442	8,792

Edgar Filing: HENNESSY ADVISORS INC - Form 10-Q

Cash and cash equivalents at the beginning of the period	15,700	3,535
Cash and cash equivalents at the end of the period	\$ 21,142	\$ 12,327
Supplemental disclosures of cash flow information:		
Cash paid for:		
Income taxes	\$ 3,698	\$ 4,643
Interest	\$ 810	\$ 822

See accompanying notes to unaudited condensed financial statements

Table of Contents

HENNESSY ADVISORS, INC.

NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS

(1) Basis of Financial Statement Presentation

The accompanying condensed balance sheet as of September 30, 2017, which has been derived from audited financial statements, and the unaudited interim condensed financial statements as of and for the three and nine months ended June 30, 2018 and 2017, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission and include the accounts of Hennessy Advisors, Inc. (the Company, we, us, or our). Certain information and footnote disclosures in these unaudited interim condensed financial statements, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, have been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission for Quarterly Reports on Form 10-Q. In the opinion of management, the unaudited interim condensed financial statements reflect all adjustments necessary for a fair presentation of the Company's financial position at June 30, 2018, the Company's operating results for the three and nine months ended June 30, 2018 and 2017, and the Company's cash flows for the nine months ended June 30, 2018 and 2017. These unaudited interim condensed financial statements and notes should be read in conjunction with the Company's audited financial statements and notes thereto for fiscal year 2017, which are included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2017.

The preparation of financial statements requires management to make estimates and assumptions. Making estimates requires management to exercise significant judgment. Accordingly, the actual results could differ substantially from those estimates.

The Company's operating activities consist primarily of providing investment advisory services to 14 open-end mutual funds branded as the Hennessy Funds. The Company serves as the investment advisor to all classes of the Hennessy Cornerstone Growth Fund, the Hennessy Focus Fund, the Hennessy Cornerstone Mid Cap 30 Fund, the Hennessy Cornerstone Large Growth Fund, the Hennessy Cornerstone Value Fund, the Hennessy Total Return Fund, the Hennessy Equity and Income Fund, the Hennessy Balanced Fund, the Hennessy Gas Utility Fund, the Hennessy Small Cap Financial Fund, the Hennessy Large Cap Financial Fund, the Hennessy Technology Fund, the Hennessy Japan Fund, and the Hennessy Japan Small Cap Fund. The Company also provides shareholder services to the entire family of the Hennessy Funds.

The Company's operating revenues consist of contractual investment advisory and shareholder service fees paid to it by the Hennessy Funds. The Company earns investment advisory fees from each Hennessy Fund by, among other things:

acting as portfolio manager for the fund or overseeing the sub-advisor acting as portfolio manager for the fund, which includes managing the composition of the fund's portfolio (including the purchase, retention, and disposition of portfolio securities in accordance with the fund's investment objectives, policies, and restrictions), seeking best execution for the fund's portfolio, managing the use of soft dollars for the fund, and managing proxy voting for the fund;

Table of Contents

performing a daily reconciliation of portfolio positions and cash for the fund;

monitoring the fund's compliance with its investment objectives and restrictions and federal securities laws;

performing activities such as maintaining a compliance program, conducting ongoing reviews of the compliance programs of the fund's service providers (including its sub-advisor, as applicable), conducting on-site visits to the fund's service providers (including its sub-advisor, as applicable), monitoring incidents of abusive trading practices, reviewing fund expense accruals, payments, and fixed expense ratios, evaluating insurance providers for fidelity bond, D&O/E&O, and cybersecurity insurance coverage, conducting employee compliance training, reviewing reports provided by service providers, maintaining books and records, and preparing an annual compliance report for the Board of Trustees of Hennessy Funds Trust (the Funds' Board of Trustees);

overseeing the selection and continued employment of the fund's sub-advisor, if applicable, reviewing the fund's investment performance, and monitoring such sub-advisor's adherence to the fund's investment objectives, policies, and restrictions;

overseeing service providers that provide accounting, administration, distribution, transfer agency, custodial, sales, marketing, public relations, audit, information technology, and legal services to the fund;

maintaining in-house marketing and distribution departments on behalf of the fund;

being actively involved with preparing all regulatory filings for the fund, including writing and annually updating the fund's prospectus and related documents;

preparing or reviewing a written summary of the fund's performance for the most recent 12-month period for each annual report of the fund;

monitoring and overseeing the accessibility of the fund on third party platforms;

paying the incentive compensation of the fund's compliance officers and employing other staff such as legal, marketing, national accounts, distribution, sales, administrative, and trading oversight personnel, as well as management executives;

providing a quarterly compliance certification to Hennessy Funds Trust; and

Table of Contents

preparing or reviewing materials for the Funds Board of Trustees, presenting or leading discussions to or with the Funds Board of Trustees, preparing or reviewing meeting minutes, and arranging for training and education of the Funds Board of Trustees.

The Company earns shareholder service fees from Investor Class shares of the Hennessy Funds by, among other things, maintaining a toll-free number that the current investors of the Hennessy Funds may call to ask questions about the Hennessy Funds or their accounts, or to get help with processing exchange and redemption requests or changing account options. These fee revenues are earned and calculated daily by the Hennessy Funds accountants at U.S. Bancorp Fund Services, LLC and are subsequently reviewed by management. The fees are computed and billed monthly, at which time they are recognized in accordance with Accounting Standard Codification 605 Revenue Recognition.

Effective February 28, 2017, the Company waives fees with respect to the Hennessy Technology Fund to comply with a contractual expense ratio limitation. The fee waiver is calculated daily by the Hennessy Funds accountants at U.S. Bancorp Fund Services, LLC, is subsequently reviewed by management, and is then charged to expense monthly by the Company as an offset to revenue. The waived fee is deducted from investment advisory fee income and reduces the aggregate amount of advisory fees received by the Company in the subsequent month. To date, the Company has only waived fees based on contractual obligations, but the Company has the ability to waive fees at its discretion. If the Company elects to voluntarily waive fees, the decision to waive fees would not apply to previous periods, but would only apply on a going forward basis.

The Company's contractual agreements for investment advisory and shareholder services provide persuasive evidence that an arrangement exists with fixed and determinable fees, and the services are rendered daily. The collectability is deemed probable as the fees are received from the Hennessy Funds in the month subsequent to the month in which the services are provided.

(2) Management Contracts Purchased

Throughout its history, the Company has completed nine purchases of assets related to the management of 28 different mutual funds, some of which were reorganized into already existing Hennessy Funds. In accordance with guidance issued by the Financial Accounting Standards Board (FASB), the Company periodically reviews the carrying value of its purchased management contracts to determine if any impairment has occurred. The fair value of management contracts are based on management estimates and assumptions, including third party valuations that utilize appropriate valuation techniques. The fair value of the management contracts was estimated by applying the income approach. It is the opinion of the Company's management that there was no impairment as of June 30, 2018, or September 30, 2017.

Under the FASB guidance on Intangibles Goodwill and Other, intangible assets that have indefinite useful lives are not amortized but are tested at least annually for impairment. The Company reviews the life of the management contracts each reporting period to determine if they continue to have an indefinite useful life. The Company considers the mutual fund management contracts to be intangible assets with an indefinite useful life and are not impaired as of June 30, 2018, or September 30, 2017.

Table of Contents

Most recently, the Company purchased the assets related to the management of the Rainier Large Cap Equity Fund, the Rainier Mid Cap Equity Fund, and the Rainier Small/Mid Cap Equity Fund (collectively, the Rainier U.S. Funds). In the aggregate, the Company paid \$3.1 million for approximately \$375 million of assets related to management of the Rainier U.S. Funds. The transaction, which was completed in two stages, was consummated in accordance with the terms and conditions of the Transaction Agreement, dated as of May 10, 2017, as amended, between the Company, Manning & Napier Group, LLC, and Rainier Investment Management, LLC.

The details of the first stage of the transaction, which closed on December 1, 2017, are as follows:

The Company purchased the assets related to the management of (i) the Rainier Large Cap Equity Fund, which were reorganized into the Hennessy Cornerstone Large Growth Fund, and (ii) the Rainier Mid Cap Equity Fund, which were reorganized into the Hennessy Cornerstone Mid Cap 30 Fund.

The purchase price of \$1.0 million was funded with available cash and was based on the total net assets under management of the Rainier Large Cap Equity Fund and the Rainier Mid Cap Equity Fund as measured at the close of business on November 30, 2017.

The amount of the purchased assets under management as of the closing date was approximately \$122 million.

The details of the second stage of the transaction, which closed on January 12, 2018, are as follows:

The Company purchased the assets related to the management of the Rainier Small/Mid Cap Equity Fund and reorganized them into the Hennessy Cornerstone Mid Cap 30 Fund.

The purchase price of \$2.1 million was funded with available cash and was based on the total net assets under management of the Rainier Small/Mid Cap Equity Fund as measured at the close of business on January 11, 2018.

The amount of the purchased assets under management as of the closing date was approximately \$253 million.

(3) Investment Advisory Agreements

The Company has management contracts with Hennessy Funds Trust, under which it provides investment advisory services to all classes of the 14 Hennessy Funds.

The management contracts must be renewed annually (except in limited circumstances) by (i) the Funds Board of Trustees or the vote of a majority of the outstanding shares of the applicable Hennessy Fund and (ii) the vote of a majority of the trustees of Hennessy Funds Trust who are not interested persons of the Hennessy Funds. If the management contracts are not renewed annually as described above, they will terminate automatically. There are two additional circumstances in which the management contracts would terminate. First, the management contracts would

automatically terminate if the Company assigned them to another advisor (assignment includes indirect assignment, which is the transfer of the Company's common stock in sufficient quantities deemed to constitute a controlling block). Second, each management contract may be terminated prior to its expiration upon 60 days' notice by either the Company or the applicable Hennessy Fund.

Table of Contents

As provided in the management contracts with the 14 Hennessy Funds, the Company receives investment advisory fees monthly based on a percentage of the respective fund's average daily net assets.

The Company has entered into sub-advisory agreements for the Hennessy Focus Fund, the Hennessy Equity and Income Fund, the Hennessy Japan Fund, and the Hennessy Japan Small Cap Fund. Under each of these sub-advisory agreements, the sub-advisor is responsible for the investment of the assets of the applicable Hennessy Fund in accordance with the terms of such agreement and the applicable Hennessy Fund's Prospectus and Statement of Additional Information. The sub-advisors are subject to the direction, supervision, and control of the Company and the Funds' Board of Trustees. The sub-advisory agreements must be renewed annually (except in limited circumstances) in the same manner as, and are subject to the same termination provisions as, the management contracts.

In exchange for the sub-advisory services, the Company (not the Hennessy Funds) pays sub-advisory fees to the sub-advisors out of its own assets. Sub-advisory fees are calculated as a percentage of the applicable sub-advised fund's average daily net asset value.

(4) Bank Loan

The Company has an outstanding bank loan with U.S. Bank National Association (U.S. Bank), as administrative agent and as a lender, and California Bank & Trust, as syndication agent and as a lender. On September 17, 2015, in connection with the repurchase of up to 1,500,000 shares of the Company's common stock pursuant to its self-tender offer, the Company and its lenders entered into a term loan agreement with an original principal amount of \$35.0 million (consisting of a \$20.0 million promissory note to U.S. Bank and a \$15.0 million promissory note to California Bank & Trust). Then, on September 19, 2016, the Company and its lenders entered into an amendment to the term loan agreement to allow the Company to purchase the assets related to the management of the Westport Fund and the Westport Select Cap Fund (each of which merged into the Hennessy Cornerstone Mid Cap 30 Fund). On November 16, 2017, the Company and its lenders entered into an amendment to the term loan agreement to revise the excess cash flow prepayment requirements. On November 30, 2017, the Company and its lenders entered into an amendment to the term loan agreement to allow the Company to purchase the assets related to the management of the Rainier U.S. Funds.

The term loan agreement requires 48 monthly payments in the amount of \$364,583 plus interest calculated based on one of the following, at the Company's option:

(1) *the sum of* (a) a margin that ranges from 2.75% to 3.25%, depending on the Company's ratio of consolidated debt to consolidated earnings before interest, taxes, depreciation and amortization (excluding, among other things, certain non-cash gains and losses) (EBITDA), *plus* (b) the LIBOR rate; or

Table of Contents

(2) *the sum of* (a) a margin that ranges from 0.25% to 0.75%, depending on the Company's ratio of consolidated debt to consolidated EBITDA *plus* (b) the highest rate out of the following three rates: (i) the prime rate set by U.S. Bank from time to time, (ii) the Federal Funds Rate plus 0.50%, or (iii) the one-month LIBOR rate plus 1.00%.

The Company currently uses a one-month LIBOR rate contract, which must be renewed monthly. As of June 30, 2018, the effective rate is 4.732%, which is comprised of the one-month LIBOR rate of 1.982% as of June 1, 2018, plus a margin of 2.75% based on the Company's ratio of consolidated debt to consolidated EBITDA as of March 31, 2018. The Company intends to continue renewing the LIBOR rate contract on a monthly basis provided that the LIBOR-based interest rate remains favorable to the prime rate-based interest rate.

All borrowings under the term loan agreement are secured by substantially all of the Company's assets. The final installment of the then-outstanding principal plus accrued interest is due September 17, 2019. As of June 30, 2018, the Company had \$23.0 million outstanding under its term loan (\$22.8 million net of debt issuance costs).

The term loan agreement includes certain reporting requirements and loan covenants requiring the maintenance of certain financial ratios. The Company was in compliance for the periods ended June 30, 2018 and 2017.

In connection with securing the financings discussed above, the Company incurred loan costs in the amount of \$0.41 million. These costs were reclassified to offset debt liability per Accounting Standards Update (ASU) 2015-03 as of March 31, 2017, and the balance is being amortized on a straight-line basis, which approximates the effective interest basis, over 48 months. Amortization expense during the nine months ended June 30, 2018 and 2017, was \$0.1 million for each period. The unamortized balance of the loan fees was \$0.2 million as of June 30, 2018. The following is a reconciliation of the reclassification:

	Gross Debt at at June 30, 2018	Debt Issuance Cost (In thousands)	Debt, Net of Issuance Cost, at June 30, 2018
Current portion of debt	\$ 4,375	\$ (147)	\$ 4,228
Long-term portion of debt	18,594	(37)	18,557
Total Debt	\$ 22,969	\$ (184)	\$ 22,785

	Gross Debt at September 30, 2017	Debt Issuance Cost (In thousands)	Debt, Net of Issuance Cost, at September 30, 2017
Current portion of debt	\$ 4,375	\$ (147)	\$ 4,228
Long-term portion of debt	21,875	(147)	21,728
Total Debt	\$ 26,250	\$ (294)	\$ 25,956

(5) Income Taxes

On December 22, 2017, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 (SAB 118), which permits companies a period of one year from the enactment date of the Tax Cuts and Jobs Act of 2017 (the 2017 Tax Act) to account for the resulting tax effects. Any required adjustment would be included in net earnings from continuing operations as an adjustment to income tax expense in the reporting period during which such adjustment is identified. In our first quarter, based on available information, we estimated the impact of the reduced corporate tax rate and re-measured our deferred tax liability. This resulted in a reduction to income tax expense of approximately \$4 million.

Table of Contents

The Company's effective income tax rates for the three months ended June 30, 2018 and 2017, were 28.0% and 33.9%, respectively. The effective income tax rate was lower for the three months ended June 30, 2018, due to the reduced federal tax rate resulting from the 2017 Tax Act, offset partially by state taxes.

The Company's effective income tax rates for the nine months ended June 30, 2018 and 2017, were 5.7% and 34.9%, respectively. The effective income tax rate was lower for the nine months ended June 30, 2018, due to the 2017 Tax Act, with a slight offset due to state taxes and increased income before income tax expense. For the three months ended December 31, 2017, the Company was required to record a one-time, non-cash benefit to income taxes of approximately \$4 million for the accounting re-measurement of its deferred tax liability to account for the future impact of a lower federal corporate income tax rate.

We are subject to income tax in the U.S. federal jurisdiction and multiple state jurisdictions. Our U.S. federal tax returns for 2015 and subsequent years remain open to examination. Generally, we are no longer subject to state examinations by tax authorities for years prior to fiscal year 2014. For state tax jurisdictions with unfiled tax returns, the statute of limitations will remain open indefinitely.

(6) Earnings per Share and Dividends per Share

Basic earnings per share is determined by dividing net earnings by the weighted average number of shares of common stock outstanding, while diluted earnings per share is determined by dividing net earnings by the weighted average number of shares of common stock outstanding adjusted for the dilutive effect of common stock equivalents, which consist of restricted stock units (RSUs).

All common stock equivalents were dilutive and therefore included in the diluted earnings per share calculation for the three and nine months ended June 30, 2018 and 2017.

On January 26, 2017, the Company's Board of Directors declared a 3-for-2 stock split, which was effected on March 6, 2017, for shareholders of record as of February 10, 2017. All disclosures in this report relating to shares of common stock, RSUs, and per share data have been adjusted to reflect this stock split.

The Company paid quarterly cash dividends of \$0.075, \$0.10, and \$0.10 per share, respectively, on December 8, 2017, to shareholders of record as of November 15, 2017; on March 5, 2018, to shareholders of record as of February 9, 2018; and on June 11, 2018, to shareholders of record as of May 17, 2018.

Table of Contents**(7) Equity****Amended and Restated 2013 Omnibus Incentive Plan**

The Company has adopted, and the Company's shareholders have approved, the Amended and Restated 2013 Omnibus Incentive Plan (the "Omnibus Plan"). Under the Omnibus Plan, participants may be granted RSUs, representing an unfunded, unsecured right to receive a share of the Company's common stock on the date specified in the recipient's award. The Company issues new shares of its common stock when it is required to deliver shares to an RSU recipient. The RSUs granted under the Omnibus Plan vest over four years, at a rate of 25% per year. The Company recognizes stock-based compensation expense on a straight-line basis over the four-year vesting term of each award. There were no RSUs granted under the Omnibus Plan during the nine months ended June 30, 2018 or 2017. RSU activity for the nine months ended June 30, 2018, was as follows:

	RSU Activity	
	Nine Months Ended June 30, 2018	
	Number of RSUs	Weighted Avg. Fair Value Per Share at Each Date
Non-vested balance at September 30, 2017	358,291	\$ 16.48
Granted		
Vested (1)	(112,676)	15.77
Forfeited	(11,367)	16.62
Non-vested balance at June 30, 2018	234,248	\$ 16.77

- (1) The number of vested RSUs includes partially vested shares. Shares of common stock have not been issued for the partially vested shares, but the related compensation expense has been recognized. There were 29,384 net shares of common stock issued for vested and issued RSUs in the nine months ended June 30, 2018.

Table of Contents**RSU Compensation****Nine Months Ended June 30, 2018**

	(In thousands)
Total expected compensation expense related to RSUs	\$ 12,289
Compensation expense recognized at reporting date	(8,360)
 Unrecognized compensation expense related to RSUs at reporting date	 \$ 3,929

As of June 30, 2018, there was \$3.9 million of total RSU compensation expense related to non-vested awards not yet recognized, which is expected to be recognized over a weighted-average vesting period of 2.4 years.

Dividend Reinvestment and Stock Purchase Plan

In January 2018, the Company adopted an updated Dividend Reinvestment and Stock Purchase Plan (the "DRSPP"), replacing the previous Dividend Reinvestment and Stock Purchase Plan established in March 2015, to provide shareholders and new investors with a convenient and economical means of purchasing shares of the Company's common stock and reinvesting cash dividends paid on the Company's common stock. Under the DRSPP and its predecessor, the Company issued 2,549 and 1,533 shares of common stock during the nine months ended June 30, 2018 and 2017, respectively.

Stock Buyback Program

In August 2010, the Company adopted a stock buyback program. The program provides that the Company may repurchase up to 1,500,000 shares of its common stock and has no expiration date. Share repurchases may be made in the open market, in privately negotiated transactions, or otherwise. The Company did not repurchase any shares pursuant to the stock buyback program during the nine months ended June 30, 2018 or 2017.

(8) Commitments and Contingencies

The Company's headquarters is located in leased office space under a single non-cancelable operating lease at 7250 Redwood Boulevard, Suite 200, Novato, California 94945. The lease expires June 30, 2021, with one five-year extension available thereafter.

The Company also has office space under a single non-cancelable operating lease at 101 Federal Street, Suite 1900, Boston, Massachusetts 02110. The initial term of the lease expired on November 30, 2015, but automatically renews for successive one-year periods unless either party terminates the lease by providing at least three months' notice of termination to the other party prior to the next renewal date.

The Company also has office space under a single non-cancelable operating lease at 1340 Environ Way, #305, Chapel Hill, North Carolina 27517. The initial term of the lease expired on November 30, 2014, but automatically renews for successive three-month periods unless either party terminates the lease by providing at least two months' notice of termination to the other party prior to the next renewal date.

Table of Contents

The Company also has office space under a single, non-cancelable operating sub-lease at 4800 Bee Caves Road, Suite 100, Austin, Texas 78746, where it occupies approximately 600 square feet and has the right to use all common areas. The term of the sub-lease commenced on January 4, 2018, and expires on December 31, 2018, but will automatically renew for successive six-month periods unless either party gives at least 60 days' notice of termination to the other party prior to the renewal date.

Total rent expense for the three and nine months ended June 30, 2018, were \$0.1 million and \$0.4 million, respectively. As of June 30, 2018, there were no material changes in the leasing arrangements that would have a significant effect on future minimum lease payments reported in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2017.

(9) Fair Value Measurements

The Company applies the FASB standard "Fair Value Measurements" for all financial assets and liabilities, which establishes a framework for measuring fair value and expands disclosures about fair value measurements. The standard defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." It also establishes a fair value hierarchy consisting of the following three levels that prioritize the inputs to the valuation techniques used to measure fair value:

Level 1 Unadjusted, quoted prices in active markets for identical assets or liabilities that an entity has the ability to access at the measurement date.

Level 2 Other significant observable inputs (including, but not limited to, quoted prices in active markets for similar assets or liabilities, quoted prices in markets that are not active for identical or similar assets or liabilities, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets).

Level 3 Significant unobservable inputs (including the entity's own assumptions about what market participants would use to price the asset or liability based on the best available information) when observable inputs are not available.

Table of Contents

Based on the definitions, the following table represents the Company's assets categorized in the Level 1 to 3 hierarchies as of June 30, 2018, and September 30, 2017:

	Fair Value Measurements at June 30, 2018			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Money market fund deposits	\$ 19,913	\$	\$	\$ 19,913
Mutual fund investments	8			8
Total	\$ 19,921	\$	\$	\$ 19,921
Amounts included in:				
Cash and cash equivalents	\$ 19,913	\$	\$	\$ 19,913
Investments in marketable securities	8			8
Total	\$ 19,921	\$	\$	\$ 19,921

	Fair Value Measurements at September 30, 2017			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Money market fund deposits	\$ 13,832	\$	\$	\$ 13,832
Mutual fund investments	8			8
Total	\$ 13,840	\$	\$	\$ 13,840
Amounts included in:				
Cash and cash equivalents	\$ 13,832	\$	\$	\$ 13,832
Investments in marketable securities	8			8
Total	\$ 13,840	\$	\$	\$ 13,840

There were no transfers between levels during the nine months ended June 30, 2018, or the year ended September 30, 2017.

(10) New Accounting Standards

In January 2017, the FASB issued ASU 2017-04 Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The update eliminates a step from impairment testing to simplify the process, particularly for entities with a zero or negative carrying amount for an intangible asset. This update is effective for annual reporting periods beginning after December 15, 2019 (our fiscal year 2021). The adoption of this update is not expected to have a material impact on our financial condition, results of operations, or cash flows.

In June 2018, the FASB issued ASU 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which allows companies to account for nonemployee awards in the same manner as employee awards. The guidance is effective for fiscal years beginning after December 15, 2018, and

interim periods within those annual periods (our fiscal year 2019). The adoption of this update is not expected to have a material impact on our financial condition, results of operations, or cash flows.

Table of Contents

(11) Subsequent Events

On July 10, 2018, the Company announced that it has signed a definitive agreement with BP Capital Fund Advisors, LLC (BP Capital) to purchase the assets related to the management of the BP Capital TwinLine Energy Fund and the BP Capital TwinLine MLP Fund (the BP Funds). The Company filed a Current Report on Form 8-K regarding this transaction on July 11, 2018.

The definitive agreement includes customary representations, warranties, and covenants of the Company and BP Capital. It provides for payment by the Company to be made in two parts: (1) a payment upon closing equal to (A) \$100,000 plus (B) 0.75% of the aggregate current net asset value of the BP Funds measured as of the close of business on the trading day immediately preceding the closing date of the transaction, and (2) a payment on the one-year anniversary of the closing date equal to 0.75% of the aggregate current net asset value of the successor funds to the BP Funds measured as of the close of business on the trading day immediately preceding the one-year anniversary of the closing date of the transaction. The Company expects to complete the transaction in the fourth calendar quarter of 2018.

Upon completion of the transaction, the assets related to the BP Capital TwinLine Energy Fund will be reorganized into a new series of Hennessy Funds Trust called the Hennessy BP Energy Fund, and the assets related to the BP Capital TwinLine MLP Fund will be reorganized into a new series of Hennessy Funds Trust called the Hennessy BP Midstream Fund (together with the Hennessy BP Energy Fund, the Hennessy BP Funds). The Company will become the investment advisor of the Hennessy BP Funds, and BP Capital will become the sub-advisor to the Hennessy BP Funds.

The transaction is subject to customary closing conditions, including the approval of the BP Funds shareholders.

The Company has evaluated subsequent events through the date these financial statements were issued and has concluded that no other material subsequent events occurred during this period that would require recognition or disclosure.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations **Forward-Looking Statements**

This report contains forward-looking statements within the meaning of the securities laws, for which we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. In some cases, forward-looking statements can be identified by terminology such as expect, anticipate, intend, may, plan, will, should, could, would, assume, believe, estimate, predict, potential, similar expressions, as well as statements in the future tense. We have based these forward-looking statements on our current expectations and projections about future events, based on information currently available to us. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or means by, which such performance or results will be achieved.

Table of Contents

Forward-looking statements are subject to risks, uncertainties, and assumptions, including those described in the section entitled **Risk Factors** and elsewhere in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017, filed with the Securities and Exchange Commission. Unforeseen developments could cause actual performance or results to differ substantially from those expressed in or suggested by the forward-looking statements. Management does not assume responsibility for the accuracy or completeness of these forward-looking statements. There is no regulation requiring an update of any of the forward-looking statements after the date of this report to conform these statements to actual results or to changes in our expectations.

Our business activities are affected by many factors, including, without limitation, redemptions by mutual fund shareholders, taxes, general economic and financial conditions, movement of interest rates, competitive conditions, industry regulation, and fluctuations in the stock market, many of which are beyond the control of our management. Further, the business and regulatory environments in which we operate remain complex, uncertain, and subject to change. We expect that regulatory requirements and developments will cause us to incur additional administrative and compliance costs. In addition, while domestic economic conditions currently are relatively favorable, further increases in short-term interest rates, policy changes from the administration in Washington, D.C., and developments in international financial markets could influence economic and financial conditions significantly. Notwithstanding the variability in our economic and regulatory environments, we remain focused on the investment performance of the Hennessy Funds and on providing high-quality customer service to investors.

Our business strategy centers on (i) the identification, completion, and integration of future acquisitions and (ii) organic growth, through both the retention of the mutual fund assets we currently manage and the generation of inflows into the mutual funds we manage. The success of our business strategy may be influenced by the factors discussed in the section entitled **Risk Factors** in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017. All statements regarding our business strategy, as well as statements regarding market trends and risks and assumptions about changes in the marketplace, are forward-looking by their nature.

Overview

Our primary operating activity is providing investment advisory services to 14 open-end mutual funds branded as the Hennessy Funds. With respect to four of the funds, sub-advisors act as portfolio managers, subject to our oversight. We oversee the selection and continued employment of each sub-advisor, review each sub-advisor's investment performance, and monitor each sub-advisor's adherence to the applicable fund's investment objectives, policies, and restrictions. In addition, we conduct ongoing reviews of the compliance programs of sub-advisors and make on-site visits to sub-advisors. Our secondary operating activity is providing shareholder services to Investor Class shares of each of the Hennessy Funds.

Table of Contents

We derive our operating revenues from investment advisory fees and shareholder service fees paid to us by the Hennessy Funds. These fees are calculated as a percentage of the average daily net assets in each of the Hennessy Funds. The percentage amount of the investment advisory fees varies from fund to fund, but the percentage amount of the shareholder service fees is consistent across all funds. The dollar amount of the fees we receive fluctuates with changes in the average net asset value of each of the Hennessy Funds, which is affected by each fund's investment performance, purchases and redemptions of shares, general market conditions and the success of our marketing, sales, and public relations efforts.

U.S. equity markets rose over the nine months ended June 30, 2018. U.S. equities rallied principally in response to the positive impact on earnings from the significantly lower corporate tax rates established by the 2017 Tax Act. Investors were also encouraged by reports of economic strength domestically, including three consecutive quarters of real GDP growth close to 3% and robust job growth. However, equity prices came under pressure over the period in reaction to the imposition by the U.S. administration of barriers to trade on certain of its major trading partners. Fears of retaliatory tariffs and of the potential for an escalating trade war weighed on equity prices. The U.S. Federal Reserve, which appeared to continue to feel confident about the strength of the economy and mindful of a tight labor market and the possibility of a slight acceleration in inflation in 2018, raised short-term interest rates three times, by a quarter point each time, in December 2017, March 2018, and June 2018.

Long-term U.S. bond yields rose modestly over the nine months ended June 30, 2018. Bond yields rose sharply over the first half of the period as indications of an acceleration in domestic economic activity, together with signals from the Federal Reserve that the pace of interest rate increases would be nudged higher, combined to send bond prices lower. Prices recovered in the latter half of the period as concerns that a trade war could dampen growth and evidence that wage growth remained moderate boosted demand for fixed income securities.

The Japanese equity market rose modestly in local currency terms over the nine months ended June 30, 2018. Equities rallied higher in the first half of the period, boosted by evidence of continued strong economic growth, an acceleration in inflation, and healthy corporate profits growth. However, equity prices dropped sharply in the second half of the period as the imposition of trade tariffs by the U.S. set off fears of an international trade war. Reports of weaker economic growth in the first quarter of 2018 also contributed to the decline in equities.

We seek to provide positive annualized returns to investors in the Hennessy Funds over a market cycle and to generate inflows into the Hennessy Funds through our marketing and sales efforts. We use a database containing over 100,000 Registered Investment Advisors and Registered Representatives (Advisors) nationwide to whom we strategically target and regularly market, and approximately 19,400 of these Advisors currently use the Hennessy Funds for their clients. More than one in five of those Advisors owns two or more of the Hennessy Funds. We continually seek to expand our sales and distribution efforts, to serve our community of Advisors, and to provide high-quality and personalized services to our over 320,000 mutual fund accounts across the country. In addition, we have an active public relations effort with the Hennessy brand name appearing on television, radio, print, or online media on average once every two to three days.

Each of the 14 Hennessy Funds achieved positive annualized returns for the one-year, three-year, five-year, 10-year, and since inception periods ended June 30, 2018.

Table of Contents

Total assets under management as of June 30, 2018, was \$6.40 billion, a decrease of 2.0%, or \$132 million, from \$6.53 billion as of June 30, 2017. The decrease in total assets from June 30, 2017, to June 30, 2018, was attributable to net outflows from the Hennessy Funds, offset by market appreciation and the purchase of assets related to the management of the Rainier U.S. Funds.

The following table illustrates the changes quarter by quarter in our assets under management since June 30, 2017:

	Total Assets Under Management				
	At Each Quarter End, June 30, 2017, through June 30, 2018				
	6/30/2017	9/30/2017	12/31/2017	3/31/2018	6/30/2018
	(In thousands)				
Beginning assets under management	\$ 6,635,802	\$ 6,526,756	\$ 6,612,812	\$ 6,923,993	\$ 6,577,379
Acquisition inflows			121,831	252,530	
Organic inflows	249,043	197,671	324,132	460,948	214,236
Redemptions	(496,768)	(393,988)	(480,832)	(700,679)	(694,271)
Market appreciation (depreciation)	138,679	282,373	346,050	(359,413)	297,873
Ending assets under management	\$ 6,526,756	\$ 6,612,812	\$ 6,923,993	\$ 6,577,379	\$ 6,395,217

The principal asset on our balance sheet, management contracts, represents the capitalized costs incurred in connection with the purchase of assets related to the management of mutual funds. As of June 30, 2018, this asset had a net balance of \$78.0 million, compared to \$74.6 million as of September 30, 2017. The current period increase was mainly due to the purchase of assets related to the management of the Rainier U.S. Funds.

The principal liability on our balance sheet is the bank debt incurred in connection with the purchase of assets related to the management of mutual funds and the repurchase of 1,500,000 shares of the Company's common stock pursuant to the completion of its self-tender offer in September 2015. As of June 30, 2018, this liability had a gross balance of \$23.0 million, compared to \$26.3 million as of September 30, 2017. The decrease was the result of making monthly loan payments on our bank debt.

2017 Corporate Tax Reform

On December 22, 2017, the 2017 Tax Act was enacted into law, which changed various corporate income tax provisions within the existing Internal Revenue Code. The law was required to be accounted for in the period of enactment, which was our first fiscal quarter of 2018. As a result, we recorded a one-time, non-cash benefit to income taxes of approximately \$4 million for the accounting re-measurement of our deferred tax liability based on the lower federal corporate income tax rate.

Table of Contents

Beginning January 1, 2018, the 2017 Tax Act reduced our corporate federal income tax rate, favorably impacting our net income, earnings per share, and cash flows for our second and third fiscal quarters of 2018.

Results of Operations

The following tables set forth items in the statements of income as dollar amounts and as percentages of total revenue for the three and nine months ended June 30, 2018 and 2017:

	Three Months Ended June 30, 2018		2017	
	Amounts	Percent of Total Revenue	Amounts	Percent of Total Revenue
(In thousands, except percentages)				
Revenue:				
Investment advisory fees	\$ 12,503	92.2%	\$ 12,020	91.2%
Shareholder service fees	1,064	7.8	1,158	8.8
Total revenue	13,567	100.0	13,178	100.0

&n