

HENNESSY ADVISORS INC  
Form 10-Q  
August 02, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

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

For the Quarterly Period Ended June 30, 2007

.. **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 000-49872

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**HENNESSY ADVISORS, INC.**

(Exact name of registrant as specified in its charter)

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California  
(State or other jurisdiction of  
incorporation or organization)

68-0176227  
(IRS Employer  
Identification No.)

7250 Redwood Blvd., Suite 200

Novato, California

94945

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(Address of principal executive office)

(Zip Code)

(415) 899-1555

(Issuer's telephone number)

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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 is a large accelerated filer, and accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check One):

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer

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 9, 2007 there were 5,701,415 shares of common stock issued and outstanding.

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**Table of Contents****Hennessy Advisors, Inc.****Condensed Balance Sheets**

(In thousands, except share and per share amounts)

|  | June 30,<br>2007<br>(Unaudited) | September 30,<br>2006 |
|--|---------------------------------|-----------------------|
| <b>Assets</b>  |                                 |                       |
| <b>Current assets:</b>   |                                 |                       |
| Cash and cash equivalents  | \$ 12,474                       | \$ 10,360             |
| Investments in marketable securities, at fair value  | 6                               | 5                     |
| Investment fee income receivable   | 1,306                           | 1,408                 |
| Prepaid expenses   | 257                             | 232                   |
| Deferred income tax asset  | 282                             | 259                   |
| Other current assets   | 18                              | 16                    |
| <b>Total current assets</b>  | <b>14,343</b>                   | <b>12,280</b>         |
| Property and equipment, net of accumulated depreciation of \$167 and \$106   | 340                             | 383                   |
| Management contracts, net of accumulated amortization of \$629   | 19,406                          | 19,406                |
| Non-compete agreement, net of accumulated amortization of \$1,077 and \$673  | 539                             | 943                   |
| Other assets   | 112                             | 95                    |
| <b>Total assets</b>  | <b>\$ 34,740</b>                | <b>\$ 33,107</b>      |
| <b>Liabilities and Stockholders Equity</b>   |                                 |                       |
| <b>Current liabilities:</b>  |                                 |                       |
| Accrued liabilities and accounts payable   | \$ 1,756                        | \$ 2,248              |
| Current portion of deferred rent   | 4                               |                       |
| Current portion of long-term debt  | 2,091                           | 2,091                 |
| <b>Total current liabilities</b>   | <b>3,851</b>                    | <b>4,339</b>          |
| Long-term debt   | 7,031                           | 8,599                 |
| Long-term portion of deferred rent   | 29                              |                       |
| Deferred income tax liability  | 1,512                           | 1,219                 |
| <b>Total liabilities</b>   | <b>12,423</b>                   | <b>14,157</b>         |
| <b>Commitments and Contingencies (Note 8)</b>  |                                 |                       |
| <b>Stockholders equity:</b>  |                                 |                       |
| Adjustable rate preferred stock, \$25 stated value, 5,000,000 shares authorized: zero shares issued and outstanding                                    |                                 |                       |
| Common stock, no par value, 15,000,000 shares authorized: 5,701,415 shares issued and outstanding at June 30, 2007 and 5,658,308 at September 30, 2006 | 7,903                           | 7,551                 |
| Additional paid-in capital   | 976                             | 652                   |
| Retained earnings  | 13,438                          | 10,747                |
| <b>Total stockholders equity</b>   | <b>22,317</b>                   | <b>18,950</b>         |

|  |           |           |
|--|-----------|-----------|
| <b>Total liabilities and stockholders equity</b> | \$ 34,740 | \$ 33,107 |
|--|-----------|-----------|

See accompanying notes to condensed financial statements

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

|   | <b>Three Months ended June 30,</b> |                 | <b>Nine Months ended June 30,</b> |                 |
|---|------------------------------------|-----------------|-----------------------------------|-----------------|
|   | <b>2007</b>                        | <b>2006</b>     | <b>2007</b>                       | <b>2006</b>     |
| <b>Revenue</b>                              |                                    |                 |                                   |                 |
| Investment advisory fees                    | \$ 3,537                           | \$ 4,157        | \$ 10,935                         | \$ 11,112       |
| Shareholder service fees                    | 454                                | 540             | 1,400                             | 1,439           |
| Other                                       |                                    | 5               | 11                                | 15              |
| <b>Total revenue</b>                        | <b>3,991</b>                       | <b>4,702</b>    | <b>12,346</b>                     | <b>12,566</b>   |
| <b>Operating expenses</b>                   |                                    |                 |                                   |                 |
| Compensation and benefits                   | 880                                | 928             | 2,650                             | 2,399           |
| General and administrative                  | 439                                | 364             | 1,339                             | 1,209           |
| Mutual fund distribution                    | 754                                | 934             | 2,390                             | 2,506           |
| Amortization and depreciation               | 164                                | 162             | 490                               | 471             |
| <b>Total operating expenses</b>             | <b>2,237</b>                       | <b>2,388</b>    | <b>6,869</b>                      | <b>6,585</b>    |
| Operating income                            | 1,754                              | 2,314           | 5,477                             | 5,981           |
| Interest expense                            | 172                                | 228             | 576                               | 672             |
| Other income                                | (138)                              | (88)            | (373)                             | (174)           |
| Income before income tax expense            | 1,720                              | 2,174           | 5,274                             | 5,483           |
| Income tax expense                          | 696                                | 867             | 2,120                             | 2,190           |
| <b>Net income</b>                           | <b>\$ 1,024</b>                    | <b>\$ 1,307</b> | <b>\$ 3,154</b>                   | <b>\$ 3,293</b> |
| <b>Earnings per share:</b>                  |                                    |                 |                                   |                 |
| Basic                                       | \$ 0.18                            | \$ 0.23         | \$ 0.56                           | \$ 0.59         |
| Diluted                                     | \$ 0.17                            | \$ 0.22         | \$ 0.53                           | \$ 0.55         |
| <b>Weighted average shares outstanding:</b> |                                    |                 |                                   |                 |
| Basic                                       | 5,649,823                          | 5,608,233       | 5,631,408                         | 5,592,234       |
| Diluted                                     | 5,959,184                          | 5,936,456       | 5,952,636                         | 5,941,445       |

See accompanying notes to condensed financial statements

**Table of Contents****Hennessy Advisors, Inc.****Condensed Statement of Changes in Stockholders Equity****Nine Months Ended June 30, 2007****(In thousands, except share data)****(Unaudited)**

|  | <b>Common<br/>Shares</b> | <b>Common<br/>Stock</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Retained<br/>Earnings</b> | <b>Total<br/>Stockholders<br/>Equity</b> |
|--|--------------------------|-------------------------|---|------------------------------|--|
| Balance as of September 30, 2006                                   | 5,658,308                | \$ 7,551                | \$ 652                                    | \$ 10,747                    | \$ 18,950                                |
| Net income for nine months ended June 30, 2007                     |                          |                         |   | 3,154                        | 3,154                                    |
| Dividends paid   |                          |                         |   | (456)                        | (456)                                    |
| Employee and director stock options exercised                      | 29,500                   | 183                     |   |                              | 183                                      |
| Employee and director restricted stock vested                      | 14,625                   | 179                     | (179)                                     |                              |  |
| Repurchase of vested employee restricted stock for tax withholding | (918)                    | (10)                    |   | (5)                          | (15)                                     |
| Employee and director restricted stock compensation                |                          |                         | 245                                       |                              | 245                                      |
| Tax benefit of RSU vesting and stock option exercises              |                          |                         | 258                                       |                              | 258                                      |
| Adjustment for fractional shares paid in cash                      | (100)                    |                         |   | (2)                          | (2)                                      |
| Balance as of June 30, 2007  | 5,701,415                | \$ 7,903                | \$ 976                                    | \$ 13,438                    | \$ 22,317                                |

See accompanying notes to condensed financial statements.

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

|  | <b>Nine Months Ended June 30,</b> |                 |
|--|-----------------------------------|-----------------|
|  | <b>2007</b>                       | <b>2006</b>     |
|  | <b>(In thousands)</b>             |                 |
| <b>Cash flows from operating activities:</b>   |                                   |                 |
| Net income   | \$ 3,154                          | \$ 3,293        |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                                   |                 |
| Depreciation and amortization  | 490                               | 471             |
| Loss on asset disposal   |                                   | 32              |
| Deferred income taxes  | 270                               | 220             |
| Tax benefit from options exercised and restricted stock vested                           | 258                               | 346             |
| Tax benefit from restricted stock unit compensation                                      |                                   | 105             |
| Restricted stock units vested  | (15)                              |                 |
| Deferred restricted stock unit compensation  | 245                               |                 |
| Unrealized gain on marketable securities   | (1)                               |                 |
| Deferred rent  | 33                                |                 |
| <b>(Increase) decrease in operating assets:</b>  |                                   |                 |
| Investment fee income receivable   | 102                               | (231)           |
| Prepaid expenses   | (25)                              | 73              |
| Other current assets   | (2)                               | 81              |
| Other assets   | (30)                              | 8               |
| <b>Increase (decrease) in operating liabilities:</b>                                     |                                   |                 |
| Accrued liabilities and accounts payable   | (492)                             | (69)            |
| <b>Net cash provided by operating activities</b>   | <b>3,987</b>                      | <b>4,329</b>    |
| <b>Cash flows used in investing activities:</b>  |                                   |                 |
| Purchases of property and equipment  | (30)                              | (365)           |
| <b>Net cash used in investing activities</b>   | <b>(30)</b>                       | <b>(365)</b>    |
| <b>Cash flows used in financing activities:</b>  |                                   |                 |
| Principal payments on long-term debt   | (1,568)                           | (1,568)         |
| Proceeds from exercise of employee and director stock options                            | 183                               | 516             |
| Proceeds from short swing return of profit   |                                   | 5               |
| Dividend payment   | (456)                             | (318)           |
| Cash paid for fractional shares  | (2)                               |                 |
| <b>Net cash used in financing activities</b>   | <b>(1,843)</b>                    | <b>(1,365)</b>  |
| <b>Net increase in cash and cash equivalents</b>   | <b>2,114</b>                      | <b>2,599</b>    |
| Cash and cash equivalents at the beginning of the period                                 | 10,360                            | 6,291           |
| <b>Cash and cash equivalents at the end of the period</b>                                | <b>\$ 12,474</b>                  | <b>\$ 8,890</b> |



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Supplemental disclosures of cash flow information:

Cash paid for:

|              |    |       |    |       |
|--------------|----|-------|----|-------|
| Income taxes | \$ | 1,689 | \$ | 1,540 |
| Interest     | \$ | 591   | \$ | 670   |

See accompanying notes to condensed financial statements.

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Hennessy Advisors, Inc.

Notes to Condensed Financial Statements

(1) Basis of Financial Statement Presentation

The accompanying condensed financial statements of Hennessy Advisors, Inc. (the Company) are unaudited, but in the opinion of management, such financial statements have been presented on the same basis as the audited financial statements and include all adjustments consisting of only normal recurring adjustments necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented. The condensed financial statements were prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Operating results for the three and nine months ended June 30, 2007, are not necessarily indicative of results which may be expected for the fiscal year ending September 30, 2007. For additional information, refer to the financial statements for the fiscal year ended September 30, 2006, which are included in the Company's annual report on Form 10-KSB, filed with the Securities and Exchange Commission on December 8, 2006.

The operating activities of the Company consist primarily of providing investment management services to nine open-end mutual funds (the Hennessy Funds). The Company serves as investment advisor of the Hennessy Cornerstone Growth Fund, Hennessy Cornerstone Growth Fund-Series II, Hennessy Focus 30 Fund, Hennessy Cornerstone Value Fund, Hennessy Total Return Fund and Hennessy Balanced Fund.

(2) Management Contracts

As of June 30, 2007, Hennessy Advisors, Inc. had contractual management agreements with Hennessy Funds, Inc. for the Hennessy Balanced Fund and the Hennessy Total Return Fund; with Hennessy Mutual Funds, Inc. for the Hennessy Cornerstone Growth Fund, the Hennessy Cornerstone Value Fund and the Hennessy Focus 30 Fund; and with Hennessy Funds Trust for the Hennessy Cornerstone Growth Fund-Series II.

The management agreements were renewed by the Board of Directors of Hennessy Funds, Inc., Hennessy Mutual Funds, Inc. and Hennessy Funds Trust, at their meeting on March 6, 2007 for a period of one year. The agreements may be renewed from year to year, as long as continuance is specifically approved at least annually in accordance with the requirements of the 1940 Act. Each management agreement will terminate in the event of its assignment, or it may be terminated by Hennessy Funds, Inc., Hennessy Mutual Funds, Inc., Hennessy Funds Trust (either by the Board of Directors or by vote of a majority of the outstanding voting securities of each Fund), or by Hennessy Advisors, upon 60 days' prior written notice.

Under the terms of the management agreements, each Fund bears all expenses incurred in its operation that are not specifically assumed by Hennessy Advisors, the administrator or the distributor. Hennessy Advisors bears the expense of providing office space, shareholder servicing, fulfillment, clerical and bookkeeping services and maintaining books and records of the Funds. Hennessy Advisors has, from time to time, had contractual obligations to waive all or part of its management fees for the Funds it manages, but such agreements are now expired. Hennessy Advisors may still choose to voluntarily waive part of its management fees in order to maintain competitive expense ratios for its funds.

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(3) Long-term Debt

On March 11, 2004, Hennessy Advisors, Inc. secured financing from US Bank National Association to acquire the management contracts for certain Lindner funds. The loan agreement required fifty-nine (59) monthly payments in the amount of \$94,060 plus interest at the bank's prime rate less one percent, as amended on February 1, 2007. The prime rate may change from time to time (currently 8.25%, in effect since June 29, 2006) and the loan is secured by the Company's assets. On July 1, 2005, the loan was amended to provide an additional \$6.7 million to fund acquisition of the management contract for the Henlopen Fund. The amended loan after payment of an installment of \$94,060 on July 10, 2005, requires 64 monthly payments in the amount of \$174,210 plus interest at the bank's prime rate (currently 8.25%), less one percent (effectively 7.25%) per a loan amendment dated February 1, 2007. The loan is secured by the Company's assets. The final installment of the then outstanding principal and interest is due September 30, 2010.

In connection with securing the financing discussed above, Hennessy Advisors, Inc. incurred loan costs in the amount of \$101,110. These costs are included in other assets and the unamortized balance of \$85,289 (as of the loan amendment date of July 1, 2005) is being amortized on a straight-line basis over 64 months.

(4) Investment Advisor and Shareholder Service Fee Revenue

Investment Advisory and Shareholder Service fees, which are the primary sources of revenue, are recorded when earned. The Company receives investment advisory fees monthly at an annual rate of 0.74% of the average daily net assets of the Hennessy Cornerstone Growth Fund, Hennessy Cornerstone Growth Fund Series II, Hennessy Focus 30 Fund, and Hennessy Cornerstone Value Fund. The annual advisory fee for the Hennessy Balanced Fund and Hennessy Total Return Fund is 0.60%.

Fees for shareholder support services provided to the Hennessy Cornerstone Growth Fund, Hennessy Cornerstone Growth Fund Series II, Hennessy Focus 30 Fund, and Hennessy Cornerstone Value Fund, are charged at an annual rate of 0.1% of average daily net assets.

Effective July 1, 2007, fees for shareholder support services provided to the Hennessy Balanced Fund and the Hennessy Total Return Fund will be charged at an annual rate of 0.1% of average daily net assets. The fees were approved by the Board of Directors of Hennessy Funds, Inc. on June 5, 2007.

(5) Income Taxes

Income taxes are accounted for under the asset and liability method, in accordance with the provisions of FASB Statement No. 109 Accounting For Income Taxes .

Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those differences are expected to be recovered or settled. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

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A valuation allowance is then established to reduce that deferred tax asset to the level at which it is more likely than not that the tax benefits will be realized. Realization of tax benefits of deductible temporary differences and operating losses or credit carryforwards depends on having sufficient taxable income of an appropriate character within the carryforward periods. Sources of taxable income that may allow for the realization of tax benefits include income that will result from future operations.

The Company's effective tax rate for the three and nine months ended June 30, 2007, was 40.5% and 40.2%, respectively, and differs from the federal statutory rate of 34% primarily due to the effects of state income taxes.

### **(6) Earnings 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 the weighted average number of shares of common stock outstanding adjusted for the dilutive effect of common stock equivalents.

On January 25, 2007, our Board of Directors declared a three-for-two stock split which was implemented on March 7, 2007 for shareholders of record as of February 14, 2007. All disclosures in this report relating to shares of common stock, stock options, restricted share units and per share data have been adjusted to reflect this stock split.

### **(7) Stock-Based Compensation**

On May 2, 2001, the Company established an incentive plan (the Plan) providing for the issuance of options, stock appreciation rights, restricted stock, performance awards, and stock loans for the purpose of attracting and retaining executive officers and key employees. The maximum number of shares which may be issued under the Plan is 25% of the outstanding common stock of the Company, subject to adjustment by the compensation committee of the Board of Directors. The 25% limitation shall not invalidate any awards made prior to a decrease in the number of outstanding shares, even though such awards have resulted or may result in shares constituting more than 25% of the outstanding shares being available for issuance under the Plan. Shares available under the Plan which are not awarded in one particular year may be awarded in subsequent years. The compensation committee of the Board of Directors has the authority to determine the awards granted under the Plan, including among other things, the individuals who receive the awards, the times when they receive them, vesting schedules, performance goals, whether an option is an incentive or nonqualified option and the number of shares to be subject to each award. However, no participant may receive options or stock appreciation rights under the Plan for an aggregate of more than 75,000 shares in any calendar year. The exercise price and term of each option or stock appreciation right will be fixed by the compensation committee except that the exercise price for each stock option which is intended to qualify as an incentive stock option must be at least equal to the fair market value of the stock on the date of grant and the term of the option cannot exceed 10 years. In the case of an incentive stock option granted to a 10% shareholder, the exercise price must be at least 110% of the fair market value on the date of grant and cannot exceed five years. Incentive stock options may be granted only within ten years from the date of adoption of the Plan. The aggregate fair market value (determined at the time the option is granted) of shares with respect to which incentive stock options may be granted to any one individual, which stock options are exercisable for the first time during any calendar year, may not exceed \$100,000. An optionee may, with the consent of the compensation committee, elect to pay for the shares to be received upon exercise of their options in cash or shares of common stock or any combination thereof.

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As the exercise prices of all options granted under the Plan were equal to the market price of the underlying common stock on the grant date, no stock-based employee compensation cost was recognized in net income. There were no options granted during the three and nine month periods ended June 30, 2007 and 2006.

During the nine months ended June 30, 2007, the Company issued restricted stock units ( RSU ) under its 2001 Omnibus Plan. Under the Company s 2001 Omnibus Plan, participants may be granted RSU s, representing an unfunded, unsecured right to receive a Company common share on the date specified in the recipient s award. The Company issues new shares for shares delivered for RSU recipients. The RSU granted under this plan vests over four years, at a rate of 25 percent per year. The Company recognizes compensation expense on a straight-line basis over the four-year vesting term of each award. RSU activity for the nine months ended June 30, 2007 was as follows:

|  | <b>Restricted Stock Unit Activity</b>  |                                 |
|--|--|---------------------------------|
|  | <b>Nine Months Ended June 30, 2007</b> |                                 |
|  | <b>Number of Restricted</b>            | <b>Weighted Avg.</b>            |
|  | <b>Share Units</b>                     | <b>Fair Value at Grant Date</b> |
| Non-vested Balance at September 30, 2006 | 52,386                                 | \$ 12.49                        |
| Granted                                  | 44,925                                 | \$ 16.94                        |
| Vested                                   | (18,058)                               | \$ 13.88                        |
| Forfeited                                |  |                                 |
| Non-vested Balance at June 30, 2007      | 79,253                                 | \$ 14.76                        |

**Restricted Stock Unit Compensation****Nine Months Ended June 30, 2007**

|   | <b>(In Thousands)</b> |
|---|-----------------------|
| Total expected compensation expense related to Restricted Stock Units | \$ 1,611              |
| Compensation Expense recognized as of June 30, 2007                   | (441)                 |
| Unrecognized compensation expense related to RSU s at June 30, 2007   | \$ 1,170              |

As of June 30, 2007, there was \$1.2 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 3.0 years.

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### (8) Commitments and Contingencies

The Company's headquarters is located in leased office space under a single non-cancelable operating lease at 7250 Redwood Blvd., Suite 200, in Novato, California. The initial lease expires October 31, 2010 with one five-year extension available thereafter.

The Company's portfolio trading operation is located in leased office space under a non-cancelable lease at One Landmark Square, Suite 424, in Stamford, Connecticut. The lease expires September 30, 2008.

As of June 30, 2007, there were no material changes in leasing arrangements that would have a significant effect on future minimum lease payments reported in our Annual Report on Form 10-KSB for the fiscal year ended September 30, 2006.

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

Certain statements in this report are forward-looking within the meaning of the federal securities laws. Although management believes that the expectations reflected in the forward-looking statements are reasonable, future levels of activity, performance or achievements cannot be guaranteed. Additionally, management does not assume responsibility for the accuracy or completeness of these 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 redemptions by mutual fund shareholders, general economic and financial conditions, movement of interest rates, competitive conditions, industry regulation, and others, many of which are beyond the control of our management. Statements regarding the following subjects are forward-looking by their nature:

our business strategy, including our ability to identify and complete future acquisitions;

market trends and risks;

our estimates for future performance;

our estimates regarding anticipated revenues and operating expenses; and

our ability to retain the mutual fund assets we currently manage.

Although we seek to maintain cost controls, a significant portion of our expenses are fixed and do not vary greatly. As a result, substantial fluctuations in our revenue can directly impact our net income from period to period.

### Overview

We derive our operating revenue from management fees and shareholder servicing fees paid to us by the Hennessy Funds. These fees are calculated as a percentage of the average daily net assets in each of our mutual funds and vary

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from fund to fund. The fees we receive fluctuate with changes in the total net asset value of the assets in our mutual funds, which are affected by our investment performance, redemptions, completed acquisitions of management agreements, market conditions and the success of our marketing efforts. Total assets under management were \$1.91 billion as of June 30, 2007.

The assets we manage in total have decreased since June 30, 2006 as a result of increasing redemptions and decreasing inflows. The following table illustrates the changes in assets under management from June 30, 2006 through June 30, 2007:

|                                    | <b>Assets Under Management</b>                                  |                  |                   |                  |                  |
|------------------------------------|---|------------------|-------------------|------------------|------------------|
|                                    | <b>At Each Quarter End, June 30, 2006 through June 30, 2007</b> |                  |                   |                  |                  |
|                                    | <b>6/30/2006</b>  | <b>9/30/2006</b> | <b>12/31/2006</b> | <b>3/31/2007</b> | <b>6/30/2007</b> |
|                                    | <b>(In Thousands)</b>   |                  |                   |                  |                  |
| Beginning assets under management  | \$ 2,249,995  | \$ 2,182,580     | \$ 2,056,253      | \$ 2,032,736     | \$ 1,899,944     |
| Organic inflows                    | 268,615   | 165,112          | 102,584           | 84,162           | 78,320           |
| Redemptions                        | (173,620)   | (196,412)        | (296,568)         | (259,026)        | (200,095)        |
| Market appreciation (depreciation) | (162,410)   | (95,027)         | 170,467           | 42,072           | 135,701          |
| Ending assets under management     | \$ 2,182,580  | \$ 2,056,253     | \$ 2,032,736      | \$ 1,899,944     | \$ 1,913,870     |

The principal asset on our balance sheet, management contracts net of accumulated amortization, represents the capitalized costs incurred in connection with the acquisition of management agreements. As of June 30, 2007, this asset had a net balance of \$19.4 million.

The principal liability on our balance sheet is the long-term bank debt incurred in connection with the acquisition of the management agreements for the Lindner Funds and the Henlopen Fund. As of June 30, 2007, this liability, including the current portion of long-term debt, had a balance of \$9.1 million.

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## Results of Operations

The following table displays items in the statements of income as dollar amounts and as percentages of total revenue for the three months ended June 30, 2007 and 2006:

|                                  | 2007            | Three Months Ended June 30,<br>2006 |                 |              |
|----------------------------------|-----------------|-------------------------------------|-----------------|--------------|
|                                  |                 | (In thousands, except percentages)  |                 |              |
|                                  | Percent         | Percent                             |                 |              |
|                                  | of Total        |                                     | of Total        |              |
|                                  | Amounts         | Revenue                             | Amounts         | Revenue      |
| <b>Revenue:</b>                  |                 |                                     |                 |              |
| Investment advisory fees         | \$ 3,537        | 88.6%                               | \$ 4,157        | 88.4%        |
| Shareholder service fees         | 454             | 11.4                                | 540             | 11.5         |
| Other                            |                 |                                     | 5               | 0.1          |
| <b>Total revenue</b>             | <b>3,991</b>    | <b>100.0</b>                        | <b>4,702</b>    | <b>100.0</b> |
| <b>Operating expenses:</b>       |                 |                                     |                 |              |
| Compensation and benefits        | 880             | 22.1                                | 928             | 19.7         |
| General and administrative       | 439             | 11.0                                | 364             | 7.8          |
| Mutual fund distribution         | 754             | 18.9                                | 934             | 19.8         |
| Amortization and depreciation    | 164             | 4.1                                 | 162             | 3.5          |
| <b>Total operating expenses</b>  | <b>2,237</b>    | <b>56.1</b>                         | <b>2,388</b>    | <b>50.8</b>  |
| Operating income                 | 1,754           | 43.9                                | 2,314           | 49.2         |
| Interest expense                 | 172             | 4.3                                 | 228             | 4.8          |
| Other income                     | (138)           | (3.5)                               | (88)            | (1.9)        |
| Income before income tax expense | 1,720           | 43.1                                | 2,174           | 46.3         |
| Income tax expense               | 696             | 17.4                                | 867             | 18.5         |
| <b>Net income</b>                | <b>\$ 1,024</b> | <b>25.7%</b>                        | <b>\$ 1,307</b> | <b>27.8%</b> |

**Revenues:** Total revenue decreased by \$0.7 million or 15.1%, in the three months ended June 30, 2007, from \$4.7 million in the prior comparable period, primarily due to decreased average assets under management. Investment management fees decreased by \$0.6 million, or 14.9%, in the three months ended June 30, 2007, from \$4.2 million in the prior comparable period, and shareholder service fees decreased by \$0.09 million, or 15.9%, in the three months ended June 30, 2007 from \$0.5 million in the prior comparable period. These decreases resulted from decreases in the average daily net assets of our mutual funds, which can differ considerably from total net assets of our mutual funds at the end of an accounting period. Total net assets in our mutual funds decreased by \$268.7 million, or 12.3%, as of June 30, 2007, from \$2.183 billion as of the end of the prior comparable period. The \$268.7 million decrease in net mutual funds assets is attributable to redemptions of \$952.1 million, partly offset by organic inflows of \$430.2 million and market appreciation of \$253.2 million. Redemptions as a percentage of assets under management increased from an average of 2.5% per month to 3.5% per month during the same period.

**Operating Expenses:** Total operating expenses decreased by \$.02 million, or 6.3%, in the three months ended June 30, 2007, from \$2.4 million in the prior comparable period. The decrease resulted from decreases in compensation and benefits, and mutual fund distribution expense, partly offset by increased general and administrative expense. As a percentage of total revenue, total operating expenses increased by 5.3% to 56.1% in the three months ended June 30, 2007, as compared to 50.8% in the prior comparable period.





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**Compensation and Benefits:** Compensation and benefits decreased by \$0.05 million, or 5.2%, in the three months ended June 30, 2007, from \$0.9 million in the prior comparable period. The decrease resulted primarily due to decreased bonus accruals in the current year. As a percentage of total revenue, compensation and benefits increased by 2.4% to 22.1% for the three months ended June 30, 2007, compared to 19.7% in the prior comparable period.

**General and Administrative Expenses:** General and administrative expense increased by \$0.08 million, or 20.6%, in the three months ended June 30, 2007, from \$0.4 million in the prior comparable period, primarily due to increases in business insurance, director RSU expense for new awards granted in the current year, and travel and entertainment expenses. As a percentage of total revenue, general and administrative expense increased by 3.2% to 11.0% in the three months ended June 30, 2007, from 7.8% in the prior comparable period.

**Mutual Fund Distribution Expenses:** Distribution expenses decreased by \$0.2 million, or 19.3%, in the three months ended June 30, 2007, from \$0.9 million in the prior comparable period. As a percentage of total revenue, distribution expenses decreased by 0.9% to 18.9% for the three months ended June 30, 2007, compared to 19.8% in the prior comparable period. The decreased costs are due to decreased assets held through mutual fund supermarkets such as Charles Schwab, Fidelity and TD Ameritrade.

**Amortization and Depreciation Expense:** Amortization and depreciation expense increased by \$0.002 million, or 1.2%, in the three months ended June 30, 2007, from \$0.2 million in the prior comparable period. The increase is related to a larger fixed asset balance being depreciated in the current period. As a percentage of total revenue, amortization and depreciation expenses increased by 0.6% to 4.1% for the three months ended June 30, 2007, compared to 3.5% in the prior comparable period.

**Interest Expense:** Interest expense decreased by \$0.06 million from the prior comparable period due to a loan amendment decreasing the interest rate to prime less one percent effective February 1, 2007. Additionally, the principal balance has decreased \$2.1 million since the prior period due to monthly payments. As a percentage of total revenue, interest expense decreased by 0.5% to 4.3% for the three months ended June 30, 2007, compared to 4.8% in the prior comparable period.

**Other Income:** Other income increased by \$0.05 million from the prior comparable period due to a higher cash balance earning interest. As a percentage of total revenue, other income increased by 1.6% to 3.5% for the three months ended June 30, 2007, compared to 1.9% in the prior comparable period.

**Income Taxes:** The provision for income taxes decreased by \$0.2 million, or 19.7%, in the three months ended June 30, 2007, from \$0.9 million in the prior comparable period.

**Net Income:** Net income decreased by \$0.3 million, or 21.7%, in the three months ended June 30, 2007, compared to \$1.3 million in the prior comparable period, as a result of the factors discussed above.

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The following table displays items in the statements of income as dollar amounts and as percentages of total revenue for the nine months ended June 30, 2007 and 2006:

|                                  | Nine Months Ended June 30,         |              |                 |              |
|----------------------------------|------------------------------------|--------------|-----------------|--------------|
|                                  | 2007                               | 2006         |                 |              |
|                                  | (In thousands, except percentages) |              |                 |              |
|                                  | Percent                            |              | Percent         |              |
|                                  | of Total                           |              | of Total        |              |
|                                  | Amounts                            | Revenue      | Amounts         | Revenue      |
| <b>Revenue:</b>                  |                                    |              |                 |              |
| Investment advisory fees         | \$ 10,935                          | 88.6%        | \$ 11,112       | 88.4%        |
| Shareholder service fees         | 1,400                              | 11.3         | 1,439           | 11.5         |
| Other                            | 11                                 | 0.1          | 15              | 0.1          |
| <b>Total revenue</b>             | <b>12,346</b>                      | <b>100.0</b> | <b>12,566</b>   | <b>100.0</b> |
| <b>Operating expenses:</b>       |                                    |              |                 |              |
| Compensation and benefits        | 2,650                              | 21.5         | 2,399           | 19.1         |
| General and administrative       | 1,339                              | 10.8         | 1,209           | 9.6          |
| Mutual fund distribution         | 2,390                              | 19.4         | 2,506           | 19.9         |
| Amortization and depreciation    | 490                                | 3.9          | 471             | 3.8          |
| <b>Total operating expenses</b>  | <b>6,869</b>                       | <b>55.6</b>  | <b>6,585</b>    | <b>52.4</b>  |
| Operating income                 | 5,477                              | 44.4         | 5,981           | 47.6         |
| Interest expense                 | 576                                | 4.7          | 672             | 5.3          |
| Other income                     | (373)                              | (3.0)        | (174)           | (1.3)        |
| Income before income tax expense | 5,274                              | 42.7         | 5,483           | 43.6         |
| Income tax expense               | 2,120                              | 17.2         | 2,190           | 17.4         |
| <b>Net income</b>                | <b>\$ 3,154</b>                    | <b>25.5%</b> | <b>\$ 3,293</b> | <b>26.2%</b> |

**Revenues:** Total revenue decreased by \$0.2 million or 1.8%, in the nine months ended June 30, 2007, from \$12.6 million in the prior comparable period, primarily due to lower fees earned on decreased average assets under management. Investment management fees decreased by \$0.2 million, or 1.6%, in the nine months ended June 30, 2007, from \$11.1 million in the prior comparable period, and shareholder service fees decreased by \$0.04 million, or 2.7%, in the nine months ended June 30, 2007 from \$1.4 million in the prior comparable period. These decreases resulted from decreases in the average daily net assets of our mutual funds, which can differ considerably from total net assets of our mutual funds at the end of an accounting period. Total net assets in our mutual funds decreased by \$268.7 million, or 12.3%, as of June 30, 2007, from \$2.183 billion as of the end of the prior comparable period. The \$268.7 million decrease in net mutual funds assets is attributable to redemptions of \$952.1 million, partly offset by organic inflows of \$430.2 million and market appreciation of \$253.2 million. Redemptions as a percentage of assets under management increased from an average of 2.5% per month to 3.5% per month during the same period.

**Operating Expenses:** Total operating expenses increased by \$0.3 million, or 4.3%, in the nine months ended June 30, 2007, from \$6.6 million in the prior comparable period. The increase resulted from increases in compensation and benefits, several components of general and administrative expense, and increased depreciation expense, partly offset by lower mutual fund distribution expense. As a percentage of total revenue, total operating expenses increased by 3.2% to 55.6% in the nine months ended June 30, 2007, as compared to 52.4% in the prior comparable period.



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**Compensation and Benefits:** Compensation and benefits increased by \$0.3 million, or 10.5%, in the nine months ended June 30, 2007, from \$2.4 million in the prior comparable period. The increase is primarily due to increased bonus accruals, increased officer salaries, greater compensation expense related to restricted stock awards granted in the current period, and increased costs related to employee health insurance benefits. As a percentage of total revenue, compensation and benefits increased by 2.4% to 21.5% for the nine months ended June 30, 2007, compared to 19.1% in the prior comparable period.

**General and Administrative Expenses:** General and administrative expense increased by \$0.1 million, or 10.8%, in the nine months ended June 30, 2007, from \$1.2 million in the prior comparable period, primarily due to increases in office rental, business insurance expenses, and director RSU expense for new awards granted in the current year. As a percentage of total revenue, general and administrative expense increased by 1.2% to 10.8% in the nine months ended June 30, 2007, from 9.6% in the prior comparable period.

**Mutual Fund Distribution Expenses:** Distribution expenses decreased by \$0.1 million, or 4.6%, in the nine months ended June 30, 2007, from \$2.5 million in the prior comparable period. As a percentage of total revenue, distribution expenses decreased by 0.5% to 19.4% for the nine months ended June 30, 2007, compared to 19.9% in the prior comparable period. The decreased costs are due to decreased assets held through mutual fund supermarkets such as Charles Schwab, Fidelity and TD Ameritrade.

**Amortization and Depreciation Expense:** Amortization and depreciation expense increased by \$0.02 million, or 4.0%, in the nine months ended June 30, 2007, from \$0.5 million in the prior comparable period. The increase is related to a larger fixed asset balance being depreciated in the current period. As a percentage of total revenue, amortization and depreciation expense increased by 0.1% to 3.9% for the nine months ended June 30, 2007, compared to 3.8% in the prior comparable period.

**Interest Expense:** Interest expense decreased by \$0.1 million from the prior comparable period due to a loan amendment decreasing the interest rate to prime less one percent effective February 1, 2007. Additionally, the principal balance has decreased \$2.1 million since the prior period due to monthly payments. As a percentage of total revenue, interest expense decreased by 0.6% to 4.7% for the nine months ended June 30, 2007, compared to 5.3% in the prior comparable period.

**Other Income:** Other income increased by \$0.2 million from the prior comparable period due to a higher cash balance earning interest. As a percentage of total revenue, other income increased by 1.7% to 3.0% for the nine months ended June 30, 2007, compared to 1.3% in the prior comparable period.

**Income Taxes:** The provision for income taxes decreased by \$0.07 million, or 3.2%, in the nine months ended June 30, 2007, from \$2.2 million in the prior comparable period.

**Net Income:** Net income decreased by \$0.14 million, or 4.2%, in the nine months ended June 30, 2007, compared to \$3.3 million in the prior comparable period, as a result of the factors discussed above.

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### Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board issued FASB Statement No. 123R, *Share-Based Payment*, which amended the provisions of FASB Statement No. 123 *Accounting for Stock-Based Compensation*. FASB Statement No. 123R requires public companies to recognize as an expense the fair value of stock-based payment arrangements at the date of grant, including stock options and employee stock purchase plans. The statement eliminates proforma accounting for share-based payments using the intrinsic value method previously allowed under the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*.

Effective October 1, 2005, we adopted the fair value recognition of FASB Statement No. 123R under the *Modified Perspective* method in accordance with the transition and disclosure provisions of FASB Statement No. 148, *Accounting for Stock-based Compensation Transition and Disclosure*. All compensation costs related to restricted stock units vested during the three and nine months ended June 30, 2007 and 2006 have been recognized in our financial statements.

In July, 2006, the FASB issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109 ( *FIN 48* ), which is a change in accounting for income taxes. FIN 48 provides guidance on the threshold for recognizing the financial statement effects of a tax position. This interpretation is effective for fiscal years beginning after December 15, 2006. We do not expect the adoption of FIN 48 to have a material effect on our financial statements or results of operations.

In October, 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( *FAS 157* ). This standard defines fair value, establishes a framework for measuring fair value and expands disclosures about the use of fair value to measure assets and liabilities. FAS 157 is effective for fiscal years beginning after November 15, 2007. We do not expect the adoption of FAS 157 to have a material effect on our financial statements or results of operations.

### Critical Accounting Policies

In June 2001, the Financial Accounting Standards Board issued FASB Statement No. 142, *Goodwill and Other Intangible Assets*. FASB No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB No. 17, *Intangible Assets*. Under FASB Statement No. 142, goodwill and intangible assets that have indefinite useful lives are not amortized, but are tested at least annually for impairment. We consider the management agreements acquired to be intangible assets with an indefinite life. We fully implemented the provisions of FASB Statement No. 142 on October 1, 2002, at which time we ceased amortization of these intangible assets. Impairment analysis is conducted quarterly and coincides with our quarterly and annual financial reporting. Based on our detailed assessment of current fair market value, the value of the management agreements acquired has not been impaired. If future valuations in the marketplace decline significantly, the valuation of management agreements acquired may become impaired and net earnings would be negatively impacted by the resulting impairment adjustment.

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Liquidity and Capital Resources

We continually review our capital requirements to ensure that we have sufficient funding available to support our growth strategies. Management anticipates that cash and other liquid assets on hand as of June 30, 2007 will be sufficient to meet our short-term capital requirements. To the extent that liquid resources and cash provided by operations are not adequate to meet long-term capital requirements, management plans to raise additional capital through debt or equity markets. There can be no assurance that we will be able to borrow funds or raise additional equity.

Total assets under management as of June 30, 2007 were \$1.914 billion, which was a decrease of \$142.4 million, or 6.9%, from September 30, 2006. Property and equipment, management agreements, and non-compete agreement acquired totaled \$20.3 million as of June 30, 2007. Our remaining assets are very liquid, consisting primarily of cash and receivables derived from mutual fund asset management activities. As of June 30, 2007, we had cash and cash equivalents of \$12.5 million.

**Our Bank Loan:** We have an outstanding bank loan with U.S. Bank National Association. We incurred \$7.9 million of indebtedness in connection with acquiring the management agreements for the Lindner Funds and an additional \$6.7 million of indebtedness in connection with acquiring the management agreement for The Henlopen Fund (now known as the Hennessy Cornerstone Growth Fund Series II). The indebtedness we incurred to acquire the management agreement of The Henlopen Fund was rolled into a single loan with the indebtedness we incurred to acquire the management agreements of the Lindner Funds. We currently have \$9.1 million of principal outstanding under our bank loan, which bears interest at U.S. Bank National Association's prime rate, as set by U.S. Bank National Association from time to time (currently 8.25%, in effect since June 29, 2006), less one percent (effectively 7.25%) per a loan amendment dated February 1, 2007. The loan agreement requires us to make 64 monthly payments in the approximate amount of \$0.2 million, plus interest, with the final installment of the then outstanding principal and interest due on September 30, 2010.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We derive all of our operating revenues from management and shareholder service fees paid to us by the mutual funds we manage. These fees are calculated as a percentage of the average daily net assets of our mutual funds and vary from fund to fund. The securities markets are inherently volatile and may be affected by factors beyond our control, including global economic conditions, interest rate fluctuations, inflation rate increases and other factors that are difficult to predict. Volatility in the securities markets, and the equity markets in particular, could reduce the net assets of our mutual funds and consequently reduce our revenues. In addition to declines in the equity markets, failure of these markets to sustain prior levels of growth or continued short-term volatility in these markets could result in investors withdrawing their investments from our mutual funds or decreasing their rate of investment, either of which would likely adversely affect our revenues. Risk factors are described in more detail under the heading "Risk Relating to Our Business" in the Company's Annual Report, filed on Form 10-KSB with the U.S. Securities and Exchange Commission on December 8, 2006.

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Item 4. Controls and Procedures

Under the supervision and with the participation of the Company's management, including the Company's principal executive officer and principal financial officer, the Company conducted an evaluation of its disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on such evaluation, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures are effective.

There has been no significant change in our internal controls over financial reporting identified in connection with the foregoing evaluation that occurred during the last quarter and that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

Part II. OTHER INFORMATION

There were no reportable events for items 1 through 5.

Item 6. Exhibits

- 31.1 Rule 13a-14a Certification of the Chief Executive Officer
- 31.2 Rule 13a-14a Certification of the Chief Financial Officer
- 32.1 Written Statement of the Chief Executive Officer, Pursuant to 18 U.S.C. § 1350
- 32.2 Written Statement of the Chief Financial Officer, Pursuant to 18 U.S.C. § 1350



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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized:

Date: August 2, 2007

HENNESSY ADVISORS, INC.

By: /s/ Teresa M. Nilsen  
Teresa M. Nilsen,  
Executive Vice President, Chief Financial  
Officer and Secretary

EXHIBIT INDEX

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