

HENNESSY ADVISORS INC  
Form 10-Q  
August 04, 2011  
Table of Contents

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

**FORM 10-Q**

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

**For the Quarterly Period Ended June 30, 2011**

.. **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**

**HENNESSY ADVISORS, INC.**

**(Exact name of registrant as specified in its charter)**

Edgar Filing: HENNESSY ADVISORS INC - Form 10-Q

<b>California</b> (State or other jurisdiction of incorporation or organization)	<b>68-0176227</b> (IRS Employer Identification No.)
<b>7250 Redwood Blvd., Suite 200</b>	
<b>Novato, California</b> (Address of principal executive office)	<b>94945</b> (Zip Code)
<b>(415) 899-1555</b> (Issuer's telephone number)	

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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer <input type="checkbox"/>	Accelerated Filer <input type="checkbox"/>
Non-accelerated Filer <input type="checkbox"/>	Smaller Reporting Company <input checked="" type="checkbox"/>

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 15, 2011 there were 5,741,451 shares of common stock issued and outstanding.

**Table of Contents**

HENNESSY ADVISORS, INC.

INDEX

	Page Number
PART I. Financial Information	
Item 1. Unaudited Condensed Financial Statements	
<u>Balance Sheets as of June 30, 2011 (unaudited) and September 30, 2010</u>	3
<u>Statements of Operations for the three and nine months ended June 30, 2011 and 2010 (unaudited)</u>	4
<u>Statement of Changes in Stockholders' Equity for the nine months ended June 30, 2011 (unaudited)</u>	5
<u>Statements of Cash Flows for the nine months ended June 30, 2011 and 2010 (unaudited)</u>	6
<u>Notes to Unaudited Condensed Financial Statements</u>	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	17
Item 4. Controls and Procedures	30
PART II. Other Information	
Item 6. Exhibits	30
Signatures	31

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

(In thousands, except share and per share amounts)

	June 30, 2011 (Unaudited)	September 30, 2010
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 8,178	\$ 8,054
Investments in marketable securities, at fair value	6	5
Investment fee income receivable	614	619
Prepaid expenses	105	186
Deferred income tax asset	102	118
Other current assets	18	22
<b>Total current assets</b>	<b>9,023</b>	<b>9,004</b>
Property and equipment, net of accumulated depreciation of \$373 and \$383, respectively	149	180
Management contracts	22,284	22,284
Investment in the Hennessy Micro Cap Growth Fund, LLC, at fair value	447	364
Other assets, net of accumulated amortization of \$106 and \$101, respectively	63	67
<b>Total assets</b>	<b>\$ 31,966</b>	<b>\$ 31,899</b>
<b>Liabilities and Stockholders Equity</b>		
<b>Current liabilities:</b>		
Accrued liabilities and accounts payable	\$ 726	\$ 1,005
Income taxes payable	18	18
Current portion of deferred rent	37	50
Bank loan	625	573
<b>Total current liabilities</b>	<b>1,388</b>	<b>1,646</b>
Long-term debt	2,083	2,552
Long-term portion of deferred rent	24	24
Deferred income tax liability	3,683	3,177
<b>Total liabilities</b>	<b>7,154</b>	<b>7,399</b>
<b>Commitments and Contingencies (Note 9)</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: 5,741,451 shares issued and outstanding at June 30, 2011 and 5,709,839 at September 30, 2010	9,536	9,456
Accumulated other comprehensive loss	(65)	(148)
Retained earnings	15,341	15,192

Edgar Filing: HENNESSY ADVISORS INC - Form 10-Q

<b>Total stockholders equity</b>	24,812	24,500
<b>Total liabilities and stockholders equity</b>	<b>\$ 31,966</b>	<b>\$ 31,899</b>

See accompanying notes to unaudited condensed financial statements

- 3 -

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

	<b>Three Months ended June 30,</b>		<b>Nine Months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Revenue</b>				
Investment advisory fees	\$ 1,709	\$ 1,755	\$ 5,200	\$ 5,233
Shareholder service fees	214	204	646	615
Other		5	5	15
<b>Total revenue</b>	<b>1,923</b>	<b>1,964</b>	<b>5,851</b>	<b>5,863</b>
<b>Operating expenses</b>				
Compensation and benefits	574	710	1,731	2,085
General and administrative	393	393	1,385	1,411
Mutual fund distribution	163	161	497	505
Sub-advisor fees	152	178	487	529
Amortization and depreciation	24	33	78	93
<b>Total operating expenses</b>	<b>1,306</b>	<b>1,475</b>	<b>4,178</b>	<b>4,623</b>
<b>Operating income</b>	<b>617</b>	<b>489</b>	<b>1,673</b>	<b>1,240</b>
Interest expense	15	8	49	27
Other expense (income), net			(1)	5
<b>Income before income tax expense</b>	<b>602</b>	<b>481</b>	<b>1,625</b>	<b>1,208</b>
<b>Income tax expense</b>	<b>250</b>	<b>206</b>	<b>675</b>	<b>519</b>
<b>Net income</b>	<b>\$ 352</b>	<b>\$ 275</b>	<b>\$ 950</b>	<b>\$ 689</b>
<b>Earnings per share:</b>				
Basic	\$ 0.06	\$ 0.05	\$ 0.17	\$ 0.12
Diluted	\$ 0.06	\$ 0.05	\$ 0.17	\$ 0.12
<b>Weighted average shares outstanding:</b>				
Basic	5,688,901	5,708,043	5,726,633	5,706,021
Diluted	5,700,878	5,722,016	5,737,943	5,718,728

See accompanying notes to unaudited condensed financial statements



**Table of Contents****Hennessy Advisors, Inc.****Statements of Changes in Stockholders Equity****Nine Months Ended June 30, 2011****(In thousands, except share data)****(Unaudited)**

	Common Shares	Common Stock	Retained Earnings	Other Comprehensive Loss	Total Stockholders Equity
Balance at September 30, 2010	5,709,839	\$ 9,456	\$ 15,192	\$ (148)	\$ 24,500
Net Income			950		950
Dividends paid			(801)		(801)
Unrealized gain on investment in Hennessy Micro Cap Growth Fund, LLC				83	83
Employee and director restricted stock vested	33,588	(5)			(5)
Repurchase of vested employee restricted stock for tax withholding	(1,976)				
Deferred restricted stock unit compensation		139			139
Tax effect of RSU vesting		(54)			(54)
Balance at June 30, 2011	5,741,451	\$ 9,536	\$ 15,341	\$ (65)	\$ 24,812

See accompanying notes to unaudited condensed financial statements



**Table of Contents****Hennessy Advisors, Inc.****Statements of Cash Flows****(Unaudited)**

	<b>Nine Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
<b>Cash flows from operating activities:</b>		
Net income	\$ 950	\$ 689
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	78	93
Deferred income taxes	522	554
Tax effect from restricted stock unit vesting	(54)	(160)
Restricted stock units vested	(5)	(22)
Deferred restricted stock unit compensation	139	319
Unrealized gain on marketable securities	(1)	
<b>(Increase) decrease in operating assets:</b>		
Investment fee income receivable	5	(48)
Prepaid expenses	81	580
Other current assets	4	(7)
Other assets	(1)	17
<b>Increase (decrease) in operating liabilities:</b>		
Accrued liabilities and accounts payable	(279)	(668)
Income taxes	(18)	42
Current portion of deferred rent	(13)	27
Long-term portion of deferred rent	(24)	33
<b>Net cash provided by operating activities</b>	<b>1,384</b>	<b>1,449</b>
<b>Cash flows used in investing activities:</b>		
Purchases of property and equipment	(42)	(49)
Payments related to acquisition of management contracts		(59)
<b>Net cash used in investing activities</b>	<b>(42)</b>	<b>(108)</b>
<b>Cash flows used in financing activities:</b>		
Principal payments on bank loan	(417)	(619)
Dividend payment	(801)	(522)
<b>Net cash used in financing activities</b>	<b>(1,218)</b>	<b>(1,141)</b>
<b>Net increase in cash and cash equivalents</b>	<b>124</b>	<b>200</b>
Cash and cash equivalents at the beginning of the period	8,054	5,747
<b>Cash and cash equivalents at the end of the period</b>	<b>\$ 8,178</b>	<b>\$ 5,947</b>
<b>Supplemental disclosures of cash flow information:</b>		
Unrealized gain (loss) on investment	\$ 83	\$ (27)

Edgar Filing: HENNESSY ADVISORS INC - Form 10-Q

Cash paid for:			
Income taxes	\$	230	\$ 29
Interest	\$	48	\$ 96

See accompanying notes to unaudited condensed financial statements

- 6 -

---

**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, 2010, which has been derived from audited financial statements, and the unaudited interim condensed financial statements as of June 30, 2011 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). Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial position at June 30, 2011, the operating results for the three and nine months ended June 30, 2011 and June 30, 2010, and the cash flows for the nine months ended June 30, 2011 and June 30, 2010. These financial statements and notes should be read in conjunction with the Company's audited financial statements and notes thereto for the year ended September 30, 2010, included in the Company's Form 10-K filed with the Securities and Exchange Commission.

The operating activities of the Company consist of providing investment advisory and shareholder services to ten open-end mutual funds (collectively the Hennessy Funds), seven of which also have institutional share classes; and investment advisory services to one non-registered private pooled investment fund, the Hennessy Micro Cap Growth Fund, LLC. The Company serves as investment advisor for all classes of the Hennessy Cornerstone Growth Fund, the Hennessy Cornerstone Growth Fund, Series II, the Hennessy Focus 30 Fund, the Hennessy Cornerstone Large Growth Fund, the Hennessy Cornerstone Value Fund, the Hennessy Select Large Value Fund, the Hennessy Select SPARX Japan Fund, the Hennessy Select SPARX Japan Smaller Companies Fund, the Hennessy Total Return Fund, the Hennessy Balanced Fund, and the Hennessy Micro Cap Growth Fund, LLC.

(2) Management Contracts

As of June 30, 2011, Hennessy Advisors 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 all classes of the Hennessy Cornerstone Growth Fund, the Hennessy Cornerstone Value Fund, and the Hennessy Focus 30 Fund; with Hennessy Funds Trust for all classes of the Hennessy Cornerstone Growth Fund, Series II, the Hennessy Cornerstone Large Growth Fund, and the Hennessy Select Large Value Fund; and with Hennessy SPARX Funds Trust for all classes of the Hennessy Select SPARX Japan Fund and the Hennessy Select SPARX Japan Smaller Companies Fund.

The management agreements for the Hennessy Funds are renewed annually by (1) the board of directors or trustees of the applicable investment company or by a majority vote of the outstanding shares of the applicable fund and (2) by the vote of a majority of the directors or trustees of the applicable investment company who are not parties to the management agreement and are disinterested directors or trustees. These management agreements were renewed by the Board of Directors of Hennessy Funds, Inc. and Hennessy Mutual Funds, Inc. and by the Board of Trustees of Hennessy Funds Trust and Hennessy SPARX Funds Trust on March 2, 2011 for a period of one year.

## **Table of Contents**

Other than non-renewal, two other circumstances might lead to termination of the management agreements: (1) the assignment of a management agreement to another advisor automatically terminates the agreement (assignment includes an indirect assignment by transferring a controlling block of our common stock); and (2) the termination of the agreement by the Company or by one of the Hennessy Funds investment companies 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 Hennessy Funds.

The Company waives its investment advisory fees to comply with contractual expense ratio limitations for the Hennessy Funds institutional class shares. The fee waivers are calculated daily by our fund accountants and are expensed monthly by the Company as an offset to revenue. The fees are deducted from the management fee income, and are deducted from the funds received from our fund accountants in the subsequent month.

In the past, fees have only been waived based on contractual obligations. However, the Company regularly analyzes the fees and has the right to waive fees at its discretion to compete with other mutual funds with lower expense ratios. Any decision to waive fees would not apply to previous periods, but would apply on a going forward basis.

Hennessy Advisors is also the Managing Member of the Hennessy Micro Cap Growth Fund, LLC (the Micro Cap Fund). Hennessy Advisors will serve as the Managing Member until its resignation or removal. The Managing Member may voluntarily resign with 30 days prior written notice to the other members or 60 days prior written notice if there is not then a remaining Managing Member. At any time, the Managing Member may designate an additional Managing Member or designate a successor Managing Member with no further consent or approval required from the other members. The Managing Member may be removed at any time, with or without cause, by the vote of the other members owning a majority-in-interest of the capital accounts of the Disinterested Members, defined as members other than members who are the Managing Member or affiliates of the Managing Member.

Under the terms of the management agreement for the Micro Cap Fund, the Managing Member bears all organizational expenses (defined as expenses incurred in connection with and directly related to the formation, qualification and funding of the Micro Cap Fund), but the Micro Cap Fund bears all of its operating, investment and other expenses. However, the Managing Member is responsible for the ordinary and extraordinary costs of administering the Micro Cap Fund, including any placement fees incurred in connection with the offering of interests in the Micro Cap Fund.

Hennessy Advisors, as the Managing Member of the Micro Cap Fund, has the right to reduce or waive the management fee or incentive allocation (as defined in Note 5) chargeable to any member's account without the consent of or notice to any other member.

---

**Table of Contents**

As of June 30, 2011, no events or changes in circumstances occurred that indicated potential impairment of the management contracts.

(3) Investment in the Hennessy Micro Cap Growth Fund, LLC

On October 30, 2007, Hennessy Advisors invested \$0.5 million in the Micro Cap Fund. The investment currently represents approximately 24.4% of the total subscriptions in the Micro Cap Fund. The Micro Cap Fund is a limited liability company for which Hennessy Advisors is the Managing Member.

The investment is classified as an available-for-sale security, and is included on the balance sheet at fair market value. The fair market value of the investment at June 30, 2011 was \$0.4 million.

The accounting method the Company uses for its equity investments is generally dependent upon the influence the Company has over the investee. If there are investments where the Company can exert control over the financial and operating policies of the investee, which generally exists if there is a 50% or greater voting interest (the Company's ownership in the Micro Cap Fund is approximately 24.4%), the investee will be consolidated into the Company's financial statements. Further, as managing member of an investee, the Company is generally presumed to control the investee (and should consolidate the investee into the Company's financial statements) unless this presumption is overcome because members of the investee other than the Company and its affiliates have the substantive ability to dissolve the investee or otherwise remove the Company as the managing member without cause. After considering the above with respect to the investment in the Micro Cap Fund and the Financial Accounting Standards Board's (FASB) guidance on investment in equity and variable interests, the Company determined that the Micro Cap Fund should not be consolidated because the Company's investment is less than 50% of the total investment, the Company can be removed from its position as Managing Member at any time, with or without cause, by the vote of the other members owning a majority-in-interest of the capital accounts of the Disinterested Members, and the Company does not have a controlling financial interest in the Micro Cap Fund as the Company has no obligation to absorb gains or losses.

(4) Bank Loan

On March 11, 2004, Hennessy Advisors 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. 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. An additional \$2.0 million was loaned to the Company on September 27, 2010, and the loan was amended to require 60 monthly payments in the amount of \$52,083 plus interest at the bank's prime rate (currently 3.25%, in effect since December 17, 2008) less one percent (effective interest rate of 2.25%) and is secured by the Company's assets. The final installment of the then outstanding principal and its interest are due September 30, 2015. The loan agreement includes certain reporting requirements and loan covenants requiring the maintenance of certain financial ratios. The Company is in compliance as of June 30, 2011.

In connection with securing the financing discussed above, Hennessy Advisors incurred loan costs in the amount of \$31,250. These costs are included in other assets and the unamortized balance of \$31,250 (as of the loan amendment date of September 27, 2010) is being amortized on a straight-line basis over 60 months.

**Table of Contents**

(5) Investment Advisory and Shareholder Service Fee Revenue

Investment advisory and shareholder services, which are the Company's 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, the Hennessy Cornerstone Growth Fund, Series II, the Hennessy Focus 30 Fund, the Hennessy Cornerstone Large Growth Fund, and the Hennessy Cornerstone Value Fund; at an annual rate of 0.85% of the average daily net assets of the Hennessy Select Large Value Fund; at an annual rate of 1.00% of the Hennessy Select SPARX Japan Fund; and at an annual rate of 1.20% of the Hennessy Select SPARX Japan Smaller Companies Fund. The annual advisory fee for the Hennessy Balanced Fund and the Hennessy Total Return Fund is 0.60%, and the annual advisory fee for the Micro Cap Fund is 2.0% of the aggregate capital accounts of the members, but no management fee is charged to the capital account of the Company.

The Company has delegated the day-to-day portfolio management of the Hennessy Select Large Value Fund, the Hennessy Select SPARX Japan Fund and the Hennessy Select SPARX Japan Smaller Companies Fund (the Select Funds) to sub-advisors. Hennessy Advisors pays RBC Global Asset Management (U.S.) Inc. at an annual rate of 0.35% of the average daily net assets of the Hennessy Select Large Value Fund; and Hennessy Advisors pays SPARX Asset Management Co., Ltd. at an annual rate of 0.35% of the average daily net assets of the Hennessy Select SPARX Japan Fund and of 0.20% of the average daily net assets of the Hennessy Select SPARX Japan Smaller Companies Fund.

Fees are earned for shareholder support services provided for each of the original class shares of the ten Hennessy Funds. The shareholder service fees are charged at an annual rate of 0.1% of average daily net assets.

In the Micro Cap Fund, an additional incentive allocation can potentially be earned on any member's balance, other than the Company's balance. The allocation is determined at the end of each calendar quarter as 20% of the amount by which net profits (defined as the amount by which the net asset value on the last day of a period exceeds the net asset value on the commencement of the same period), if any, exceed the positive balance, if any, of a member's loss carryforward (defined as a memorandum account kept for each member having an initial balance of zero that is increased by the net loss, if any, allocated to each member for each calendar period). The incentive fee is calculated and earned on the last day of the quarter, at which point it would be recognized in accordance with FASB guidance on revenue recognition, which specifies that the following criteria must be met for revenue recognition: persuasive evidence of an arrangement exists, delivery has occurred or the service has been rendered, the fee is fixed and determinable, and collectability is probable. The incentive income is not subject to any clawback provisions that would require us to return fees to investors. There was no incentive fee earned in the nine months ended June 30, 2011 and 2010.

**Table of Contents**

## (6) Income Taxes

The following is our tax position at June 30, 2011 and 2010:

The provision for income taxes comprised of the following for the nine months ended June 30, 2011 and 2010:

	6/30/2011	6/30/2010
<b>Current</b>		
Federal	\$ 165,000	\$ 124,100
State	42,500	800
	207,500	124,900
<b>Deferred</b>		
Federal	410,900	330,900
State	56,200	63,100
	467,100	394,000
<b>Total</b>	<b>\$ 674,600</b>	<b>\$ 518,900</b>

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities as of June 30, 2011 and 2010 are presented below:

	6/30/2011	6/30/2010
<b>Current deferred tax assets:</b>		
Accrued compensation	\$ 45,900	\$ 64,400
Deferred rent	14,400	34,000
State taxes	14,500	300
Net operating loss		44,500
Other	27,500	11,100
<b>Total deferred tax assets</b>	<b>102,300</b>	<b>154,300</b>
<b>Noncurrent deferred tax liabilities:</b>		
Net operating loss	42,000	
Property and equipment	(7,900)	(5,300)
Management contracts	(3,717,200)	(3,069,100)
<b>Total deferred tax liabilities</b>	<b>(3,683,100)</b>	<b>(3,074,400)</b>
<b>Net deferred tax liabilities</b>	<b>\$ (3,580,800)</b>	<b>\$ (2,920,100)</b>

The Company files U.S. federal and state tax returns and has determined that its major tax jurisdictions are the United States and California. The tax years ended in 2006 through 2009 remain open and subject to examination by the appropriate governmental agencies in the U.S., and the 2003 through 2009 tax years remain open in California.

## Edgar Filing: HENNESSY ADVISORS INC - Form 10-Q

The Company's effective tax rates for the nine months ended June 30, 2011 and 2010, were 41.5% and 43.0%, respectively, and differ from the federal statutory rate of 34% primarily due to the effects of state income taxes.

- 11 -



**Table of Contents**

(7) Earnings per Share and Dividends per Share

Basic earnings per share are determined by dividing net earnings by the weighted average number of shares of common stock outstanding, while diluted earnings per share are 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.

There were 653,175 common stock equivalents, consisting of unexercised options and unvested restricted stock units (RSUs), excluded from the per share calculation for the nine months ended June 30, 2011 because they were anti-dilutive. There were 697,388 common stock equivalents, consisting of unexercised options and unvested RSUs, excluded from the per share calculation for the nine months ended June 30, 2010 because they were anti-dilutive.

A cash dividend of \$0.09 per share was paid on November 18, 2010 to shareholders of record as of October 27, 2010. Additionally, quarterly cash dividends of \$0.025 per share, respectively, were paid on March 4, 2011 to shareholders of record as of February 9, 2011 and on June 9, 2011 to shareholders of record as of May 19, 2011.

(8) Stock-Based Compensation

On May 2, 2001, the Company established an omnibus 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 does 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 is 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.

**Table of Contents**

As the exercise price of all options granted under the Plan was equal to the market price of the underlying common stock on the grant date and all options were granted and fully vested prior to the adoption of the revised FASB guidance on Stock Compensation, no stock-based employee compensation cost related to options granted was recognized in net income. There were no options granted during the nine months ended June 30, 2011 and 2010.

Under the Plan, participants may be granted RSUs, 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 RSUs granted under the Plan vest 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. There were no RSUs granted during the nine months ended June 30, 2011 and 2010. RSU activity for the nine months ended June 30, 2011 was as follows:

	Restricted Stock Unit Activity Nine Months Ended June 30, 2011	
	<u>Number of Restricted</u>	<u>Weighted Avg.</u>
	<u>Share</u>	<u>Fair Value</u>
	<u>Units</u>	<u>Per Share at</u>
		<u>Each Date</u>
Non-vested Balance at September 30, 2010	43,528	\$ 7.65
Granted		
Vested (1)	(18,860)	\$ 7.36
Forfeited	(3,350)	\$ 4.80
Non-vested Balance at June 30, 2011	21,318	\$ 4.93

- (1) The restricted stock units vested includes partially vested shares. Shares of common stock have not been issued for the partially vested shares, but the related compensation costs have been expensed. Additionally, some of the shares issued in the current year were partially vested (and expensed) in the prior fiscal year. There were 31,612 shares of common stock issued for restricted stock units vested (net of shares repurchased for tax withholding) in the nine months ended June 30, 2011.

**Table of Contents**

## Restricted Stock Unit Compensation

Nine Months Ended June 30, 2011

	(In Thousands)
Total expected compensation expense related to Restricted Stock Units	\$ 2,181
Compensation Expense recognized as of June 30, 2011	(2,065)
<b>Unrecognized compensation expense related to RSU s at June 30, 2011</b>	<b>\$ 116</b>

As of June 30, 2011, there was \$0.1 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 1.2 years.

## (9) 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. On April 1, 2010, the Company signed an amended lease agreement for the Novato office space extending the term through June 30, 2012 with an option for an additional three years thereafter.

The Company's primary portfolio trading operation was located in leased office space under a non-cancelable lease at One Landmark Square, Suite 424, in Stamford, Connecticut. In January, 2011, all trading operations were consolidated to the Company's headquarters in Novato, California, but the lease is non-cancelable and will continue to be paid until August, 2011.

As of June 30, 2011, there were no material changes in the leasing arrangements that would have a significant effect on future minimum lease payments reported in our Annual Report on Form 10-K for the fiscal year ended September 30, 2010.

## (10) Fair Value Measurements

In September, 2006, the FASB issued new standard Fair Value Measurements, which was effective for our fiscal year 2009. In February, 2008, the FASB issued a new standard which delayed the effective date for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, to the fiscal year beginning after November 15, 2008 (our fiscal year 2010). The Company adopted the fair value measurement for all financial and non-financial assets and liabilities as of October 1, 2009. Based on the scope of the new accounting guidance, all of the non-financial assets and non-financial liabilities on the Company's balance sheet are excluded from the new accounting guidance. 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 quoted market prices in active markets for identical assets or liabilities that are accessible at the measurement date.

**Table of Contents**

Level 2 from other than quoted market prices that are observable for the asset or liability, either directly or indirectly (namely, similar assets or from markets that are not active).

Level 3 unobservable and shall be used to measure fair value to the extent that observable inputs are not available (namely, reflecting an entity's own assumptions).

Based on the definitions, the following table represents the Company's assets categorized in the level 1 to 3 hierarchies as of June 30, 2011:

	Fair Value Measurements at Reporting Date (amounts in thousands)			
	Level 1	Level 2	Level 3	Total
Money market fund deposits	\$ 7,770	\$	\$	\$ 7,770
Mutual fund investments	6			6
Investment in domestic equities		447		447
<b>Total</b>	<b>\$ 7,776</b>	<b>\$ 447</b>	<b>\$</b>	<b>\$ 8,223</b>
<b>Amounts included in:</b>				
Cash and cash equivalents	\$ 7,770	\$	\$	\$ 7,770
Investments in marketable securities	6			6
Investment in the Hennessy Micro Cap Fund		447		447
<b>Total</b>	<b>\$ 7,776</b>	<b>\$ 447</b>	<b>\$</b>	<b>\$ 8,223</b>

**(11) New Accounting Pronouncements**

In June, 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-17, Consolidation of Variable Interest Entities (ASC 810-10). The update requires ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity. It also eliminates the quantitative approach previously required for determining the primary beneficiary of a variable interest entity. The update is effective for annual and interim reporting periods in fiscal years beginning after December 15, 2009 (the Company's fiscal year 2011). The adoption of this update has had no effect on our financial statements or results of operations.

In January, 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-06, Improving Disclosure about Fair Value Measurements (ASC 820-10). This ASU will add new requirements for disclosures into and out of Levels 1 and 2 fair value measurements and information on purchases, sales, issuances and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. It also clarifies existing fair value disclosures about the level of disaggregation, inputs and valuation techniques. The guidance in the ASU is effective for annual and interim reporting periods in fiscal years

**Table of Contents**

beginning after December 15, 2010 (the Company's fiscal year 2012). We do not anticipate that the adoption of the new guidance will have any effect on our financial statements or results of operations.

There have been no other significant changes in the Company's critical accounting policies and estimates during the nine months ended June 30, 2011 as compared to what was previously disclosed in the Company's Form 10-K for the year ended September 30, 2010 as filed with the SEC on December 3, 2010.

## (12) Comprehensive Income

Comprehensive income includes all changes in equity during a period except those that resulted from investments by or distributions to the Company's stockholders. Other comprehensive income (loss) refers to revenues, expenses, gains and losses that, under GAAP, are included in comprehensive income, but excluded from net income as these amounts are recorded directly as an adjustment to stockholders' equity. The Company's other comprehensive loss is composed of unrealized gains (losses) on its investment in the Micro Cap Fund. The components of comprehensive income consisted of the following (in thousands):

	<b>Nine Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Net income attributable to stockholders	\$ 950	\$ 689
Other comprehensive gain (loss)		
Unrealized gain (loss) on investment	83	(27)
Total other comprehensive gain (loss)	83	(27)
Total comprehensive income	\$ 1,033	\$ 662

**Table of Contents**

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, without limitation, redemptions by mutual fund shareholders, general economic and financial conditions, movement of interest rates, competitive conditions, industry regulation, fluctuation in the stock market, 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 assumptions about changes in the market place, especially with the extreme volatility in the global and US financial markets;

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 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 our mutual funds and vary 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. Average assets under management were \$904.3 million and \$920.9 million for the nine months ended June 30, 2011 and 2010, respectively.

**Table of Contents**

Total assets under management were \$882.6 million as of June 30, 2011. Our total assets under management have increased since June 30, 2010, due to market appreciation and inflows, partly offset by redemptions. The following table illustrates the changes in assets under management from June 30, 2010 through June 30, 2011:

	Assets Under Management				
	At Each Quarter End, June 30, 2010 through June 30, 2011				
	6/30/2010	9/30/2010	12/31/2010	3/31/2011	6/30/2011
	(In Thousands)				
Beginning assets under management	\$ 960,816	\$ 812,595	\$ 892,465	\$ 885,354	\$ 915,830
Organic inflows	16,185	41,125	23,894	80,559	19,221
Redemptions	(74,029)	(47,706)	(100,443)	(109,999)	(53,860)
Market appreciation (depreciation)	(90,377)	86,451	69,438	59,916	1,406
Ending assets under management	\$ 812,595	\$ 892,465	\$ 885,354	\$ 915,830	\$ 882,597

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, 2011, this asset had a net balance of \$22.3 million.

The principal liability on our balance sheet is the bank debt incurred in connection with the acquisition of management agreements. As of June 30, 2011, this liability had a balance of \$2.7 million.

**Table of Contents**

## Results of Operations

The following table displays items in the statements of operations as dollar amounts and as percentages of total revenue for the three months ended June 30, 2011 and 2010:

	Three Months Ended June 30,			
	2011		2010	
	(In thousands, except percentages)			
	Amounts	Percent of Total Revenue	Amounts	Percent of Total Revenue
<b>Revenue:</b>				
Investment advisory fees	\$ 1,709	88.9%	\$ 1,755	89.4%
Shareholder service fees	214	11.1	204	10.4
Other			5	0.2
<b>Total revenue</b>	<b>1,923</b>	<b>100.0</b>	<b>1,964</b>	<b>100.0</b>
<b>Operating expenses:</b>				
Compensation and benefits	574	29.8	710	36.2
General and administrative	393	20.4	393	20.0
Mutual fund distribution	163	8.5	161	8.2
Sub-advisor fees	152	7.9	178	9.1
Amortization and depreciation	24	1.3	33	1.6
<b>Total operating expenses</b>	<b>1,306</b>	<b>67.9</b>	<b>1,475</b>	<b>75.1</b>
<b>Operating income</b>	<b>617</b>	<b>32.1</b>	<b>489</b>	<b>24.9</b>
Interest expense	15	0.8	8	0.4
Other income				
<b>Income before income tax expense</b>	<b>602</b>	<b>31.3</b>	<b>481</b>	<b>24.5</b>
<b>Income tax expense</b>	<b>250</b>	<b>13.0</b>	<b>206</b>	<b>10.5</b>
<b>Net income</b>	<b>\$ 352</b>	<b>18.3%</b>	<b>\$ 275</b>	<b>14.0%</b>

**Revenues:** Total revenue decreased 2.1% to \$1.9 million in the three months ended June 30, 2011, due to decreased average assets under management. Investment advisory fees decreased 2.6% to \$1.7 million in the three months ended June 30, 2011, and shareholder service fees increased 4.9% to \$0.2 million in the three months ended June 30, 2011. The decrease in investment advisory fees is due to decreases in the average daily net assets of our mutual funds. The increase in shareholder service fees is due to the implementation of a shareholder service fee on the original class shares of the Hennessy SPARX Japan Fund and the Hennessy SPARX Japan Smaller Companies Fund as of June 1, 2010.

Average daily net assets in our mutual funds for the three months ended June 30, 2011 decreased by \$13.1 million, or 1.4%, to \$893.5 million from \$906.6 million in the prior comparable period. The decrease in average daily net assets is attributable to net outflows, partly offset by market appreciation in some of the Hennessy Funds. The largest net outflows were from the Hennessy Cornerstone Growth Fund (\$50.2 million) and the Hennessy SPARX Japan Fund (\$36.6 million). The decrease is partly offset by market appreciation, particularly in the Hennessy Focus 30 Fund (\$56.3 million) and the Hennessy Cornerstone Growth Fund (\$55.8 million).



## **Table of Contents**

About 22.8% of the total average daily net assets (\$203.6 million) for the period are concentrated in the Hennessy Cornerstone Growth Fund. All of the largest funds generate revenue at a rate of 0.84% of daily average assets, except for the Hennessy Select Large Value Fund, which generates revenue at a rate of 0.95% of daily average assets. However, the Company pays a sub-advisor fee of 0.35% of daily average assets of the Hennessy Select Large Value Fund, which reduces the net income generated by the fund for the Company.

Total net assets in our mutual funds increased by \$70.0 million, or 8.6%, as of June 30, 2011, from \$812.6 million as of the end of the prior comparable period. The \$70.0 million increase in net mutual funds assets is attributable to market appreciation of \$217.2 million, partly offset by net outflows of \$147.2 million. Redemptions as a percentage of assets under management decreased from an average of 2.6% per month to 2.0% per month during the same period due to decreased net outflows.

The net outflows are due to investors remaining apprehensive of the equity markets. Despite investor fear, there has been market appreciation since the prior period, which has offset the net outflows.

The market appreciation was due, among other factors, to the following:

During the most recent economic downturn, many public companies reduced their expenses, such as their number of employees, creating leaner, more profitable companies. The increased corporate profits have created an upturn in the stock market.

Even though the markets remain volatile, some investors are gradually returning to the equity markets.

The U.S. economy continues to show signs of strengthening, which has encouraged appreciation in the stock market. Redemptions from the funds were due, among other factors, to the following:

The economic environment is improving, but many investors are still drawing down liquid investments, such as investments in mutual funds, to pay for daily living expenses.

The equity markets are still quite volatile, and the fear created by that volatility continues to send many mutual fund investors from equity mutual funds to other types of investment products.

While all ten funds had positive performance for the calendar year-to-date ended June 30, 2011, only six out of the ten funds outperformed their relative benchmarks, and shareholders are performance sensitive. Current shareholders may feel uneasy and may be liquidating their equity investments while prospective investors are either investing their money in fixed income or other types of investment vehicles or remaining on the sidelines.

In the past, the Company has been obligated to waive fees to comply with contractual expense ratio limitations for all classes of shares, but now only has contractual expense ratio limitations for institutional class shares. The Company does not normally waive fees (other than for

## **Table of Contents**

institutional class shares), nor does it anticipate waiving fees, on a voluntary basis. The increase is due to the recoupment of expenses previously waived for the Hennessy Cornerstone Large Growth Fund. The contractual waiver on the Hennessy Cornerstone Large Growth Fund expired on March 31, 2010.

Although the Company may earn incentive income on the Micro Cap Fund, the Company did not earn incentive income for the three months ended June 30, 2011 and 2010.

**Operating Expenses:** Total operating expenses decreased 11.5% to \$1.3 million in the three months ended June 30, 2011, from \$1.5 million in the prior comparable period. The decrease is mainly due to decreased compensation and benefit expense and decreased sub-advisor fee expense. As a percentage of total revenue, total operating expenses decreased by 7.2% to 67.9% in the three months ended June 30, 2011, as compared to 75.1% in the prior comparable period.

**Compensation and Benefits:** Compensation and benefits decreased 19.2% to \$0.6 million in the three months ended June 30, 2011, from \$0.7 million in the prior comparable period. The decrease resulted primarily from the elimination of a position in January, 2010, a retirement in June, 2010 and the consolidation of a position in January, 2011. As a percentage of total revenue, compensation and benefits decreased by 6.4% to 29.8% for the three months ended June 30, 2011, compared to 36.2% in the prior comparable period.

**General and Administrative Expenses:** General and administrative expense remained constant at \$0.4 million in the three months ended June 30, 2011 as compared to the prior comparable period. As a percentage of total revenue, general and administrative expense increased by 0.4% to 20.4% in the three months ended June 30, 2011, from 20.0% in the prior comparable period.

**Mutual Fund Distribution Expenses:** Distribution expense increased 1.2% to \$0.163 million in the three months ended June 30, 2011, from \$0.161 million in the prior comparable period. As a percentage of total revenue, distribution expense increased by 0.3% to 8.5% for the three months ended June 30, 2011, compared to 8.2% in the prior comparable period.

The mutual fund distribution expense consists of fees paid for our mutual funds to be offered on various financial platforms. The platforms allow consumers to purchase shares from numerous mutual fund companies through a single location, which provides those customers with a single statement of investments and a single source for mutual fund information and customer service. When our funds are purchased through one of these platforms, such as Charles Schwab, Fidelity, TD Ameritrade or Morgan Stanley Smith Barney, the platform typically charges us an asset based fee which is recorded in mutual fund distribution expense in our statement of operations. The fees increase or decrease in line with the value of the funds held on the platforms, which can be affected by inflows, outflows and market impact.

The increased costs in the current period are due to an increase in the value of average assets held through mutual fund platforms such as Charles Schwab, Fidelity and TD Ameritrade. For the three months ended June 30, 2011, the value of the mutual funds held on Fidelity (the platform to which we pay about one-third of our total mutual fund distribution fees) increased by about 30% from the prior comparable period.

**Table of Contents**

The incremental assets purchased through the mutual fund platforms are not as profitable as those purchased in direct shareholder accounts due to the participation fees paid on assets held in the various mutual fund platforms. All of our funds are impacted by activity on the financial platforms as they are all available on several platforms.

**Sub-advisor Fee Expense:** Sub-advisor fee expense decreased 14.6% to \$0.15 million in the three months ended June 30, 2011, from \$0.18 million in the prior comparable period. The decrease is a result of a decrease in sub-advised assets in the current period, mainly due to net outflows. As a percentage of total revenue, sub-advisor fee expense decreased by 1.2% to 7.9% for the three months ended June 30, 2011, compared to 9.1% in the prior comparable period.

**Amortization and Depreciation Expense:** Amortization and depreciation decreased 27.3% to \$0.02 million in the three months ended June 30, 2011, from \$0.03 million in the prior comparable period. As a percentage of total revenue, amortization and depreciation expense decreased by 0.3% to 1.3% for the three months ended June 30, 2011, compared to 1.6% in the prior comparable period.

**Interest Expense:** Interest expense increased by 87.5% from the prior comparable period due to an amendment to the loan providing an additional \$2.0 million of principal on September 27, 2010. Monthly principal payments of \$0.05 million began in November, 2010. As a percentage of total revenue, interest expense increased by 0.4% to 0.8% for the three months ended June 30, 2011, compared to 0.4% in the prior comparable period.

**Income Taxes:** The provision for income taxes increased 21.4% to \$0.25 million in the three months ended June 30, 2011, from \$0.21 million in the prior comparable period. The change is due to increased income before tax in the current period.

**Net Income:** Net income increased by 28.0% to a net income of \$0.35 million in the three months ended June 30, 2011, from \$0.28 million in the prior comparable period, as a result of the factors discussed above.

**Table of Contents**

The following table displays items in the statements of operations as dollar amounts and as percentages of total revenue for the nine months ended June 30, 2011 and 2010:

	Nine Months Ended June 30,			
	2011		2010	
	(In thousands, except percentages)			
	Amounts	Percent of Total Revenue	Amounts	Percent of Total Revenue
<b>Revenue:</b>				
Investment advisory fees	\$ 5,200	88.9%	\$ 5,233	89.3%
Shareholder service fees	646	11.0	615	10.5
Other	5	0.1	15	0.2
<b>Total revenue</b>	<b>5,851</b>	<b>100.0</b>	<b>5,863</b>	<b>100.0</b>
<b>Operating expenses:</b>				
Compensation and benefits	1,731	29.6	2,085	35.6
General and administrative	1,385	23.7	1,411	24.1
Mutual fund distribution	497	8.5	505	8.6
Sub-advisor fees	487	8.3	529	9.0
Amortization and depreciation	78	1.3	93	1.6
<b>Total operating expenses</b>	<b>4,178</b>	<b>71.4</b>	<b>4,623</b>	<b>78.9</b>
<b>Operating income</b>	<b>1,673</b>	<b>28.6</b>	<b>1,240</b>	<b>21.1</b>
Interest expense	49	0.9	27	0.5
Other expense (income)	(1)	(0.0)	5	(0.0)
<b>Income before income tax expense</b>	<b>1,625</b>	<b>27.7</b>	<b>1,208</b>	<b>20.6</b>
<b>Income tax expense</b>	<b>675</b>	<b>11.5</b>	<b>519</b>	<b>8.8</b>
<b>Net income</b>	<b>\$ 950</b>	<b>16.2%</b>	<b>\$ 689</b>	<b>11.8%</b>

**Revenues:** Total revenue decreased 0.2% to \$5.9 million in the nine months ended June 30, 2011, due to decreased average assets under management. Investment advisory fees decreased 0.6% to \$5.2 million in the nine months ended June 30, 2011 and shareholder service fees increased 5.0% to \$0.6 million in the nine months ended June 30, 2011. The decrease in investment advisory fees is due to a decrease in the average daily net assets of our mutual funds. The increase in shareholder service fees is due to the implementation of a shareholder service fee on the original class shares of the Hennessy SPARX Japan Fund and the Hennessy SPARX Japan Smaller Companies Fund as of June 1, 2010.

Average daily net assets in our mutual funds for the nine months ended June 30, 2011 decreased by \$16.6 million, or 1.8%, to \$904.3 million from \$920.9 million in the prior comparable period. The decrease in average daily net assets is attributable to net outflows. The largest net outflows were from the Hennessy Cornerstone Growth Fund (\$50.2 million) and the Hennessy SPARX Japan Fund (\$36.6 million). The decrease is partly offset by market appreciation, particularly in the Hennessy Focus 30 Fund (\$56.3 million) and the Hennessy Cornerstone Growth Fund (\$55.8 million).

## **Table of Contents**

About 22.9% of the total average daily net assets (\$206.9 million) for the period are concentrated in the Hennessy Cornerstone Growth Fund. All of the largest funds generate revenue at a rate of 0.84% of daily average assets, except for the Hennessy Select Large Value Fund, which generates revenue at a rate of 0.95% of daily average assets. However, the Company pays a sub-advisor fee of 0.35% of daily average assets of the Hennessy Select Large Value Fund, which reduces the net income generated by the fund for the Company.

Total net assets in our mutual funds increased by \$70.0 million, or 8.6%, as of June 30, 2011, from \$812.6 million as of the end of the prior comparable period. The \$70.0 million increase in net mutual funds assets is attributable to market appreciation of \$217.2 million, partly offset by net outflows of \$147.2 million. Redemptions as a percentage of assets under management increased from an average of 2.6% per month to 3.2% per month during the same period due to increased net outflows.

The net outflows are due to investors remaining apprehensive of the equity markets. Despite investor fear, there has been market appreciation since the prior period, which has offset the net outflows.

The market appreciation was due, among other factors, to the following:

During the most recent economic downturn, many public companies reduced their expenses, such as their number of employees, creating leaner, more profitable companies. The increased corporate profits have created an upturn in the stock market.

Even though the markets remain volatile, some investors are gradually returning to the equity market.

The U.S. economy continues to show signs of strengthening, which has encouraged appreciation in the stock market. Redemptions from the funds were due, among other factors, to the following:

The economic environment is improving, but many investors are still drawing down liquid investments, such as investments in mutual funds, to pay for daily living expenses.

The equity markets are still quite volatile, and the fear created by that volatility continues to send many mutual fund investors from equity mutual funds to other types of investment products.

While all ten funds had positive performance for the calendar year-to-date ended June 30, 2011, only six out of the ten funds outperformed their relative benchmarks, and shareholders are performance sensitive. Current shareholders may feel uneasy and may be liquidating their equity investments while prospective investors are either investing their money in fixed income or other types of investment vehicles or remaining on the sidelines.

In the past, the Company has been obligated to waive fees to comply with contractual expense ratio limitations for all classes of shares, but now only has contractual expense ratio limitations for institutional class shares. The Company does not normally waive fees (other than for institutional class shares), nor does it anticipate waiving fees, on a voluntary basis. The Company waived fees of \$481 for the nine months ended

## Table of Contents

June 30, 2011, a decrease of \$95,000, or 99.5%, from the prior comparable period. The decrease is mainly due to the expiration of contractual waivers for the Hennessy Select Large Value Fund and the Hennessy Cornerstone Large Growth Fund (on March 31, 2010) and for the Hennessy Select SPARX Japan Fund and the Hennessy Select SPARX Japan Smaller Companies Fund (on February 28, 2010).

Although the Company may earn incentive income on the Micro Cap Fund, the Company did not earn incentive income for the nine months ended June 30, 2011 and 2010.

Operating Expenses: Total operating expenses decreased 9.6% to \$4.2 million in the nine months ended June 30, 2011, from \$4.6 million in the prior comparable period. The decrease is due to decreased expenses in all categories. As a percentage of total revenue, total operating expenses decreased by 7.5% to 71.4% in the nine months ended June 30, 2011, as compared to 78.9% in the prior comparable period.

Compensation and Benefits: Compensation and benefits decreased 17.0% to \$1.7 million in the nine months ended June 30, 2011, from \$2.1 million in the prior comparable period. The decrease resulted primarily from the elimination of a position in January, 2010, a retirement in June, 2010 and the consolidation of a position in January, 2011. As a percentage of total revenue, compensation and benefits decreased by 6.0% to 29.6% for the nine months ended June 30, 2011, compared to 35.6% in the prior comparable period.

General and Administrative Expenses: General and administrative expense decreased 1.8% to \$1.39 million in the nine months ended June 30, 2011, from \$1.41 million in the prior comparable period, primarily due to decreased office rent expense due to a renegotiation of the Novato office lease in April, 2010. As a percentage of total revenue, general and administrative expense decreased by 0.4% to 23.7% in the nine months ended June 30, 2011, from 24.1% in the prior comparable period.

Mutual Fund Distribution Expenses: Distribution expense decreased 1.6% to \$0.49 million in the nine months ended June 30, 2011, from \$0.51 million in the prior comparable period. As a percentage of total revenue, distribution expense decreased by 0.1% to 8.5% for the nine months ended June 30, 2011, compared to 8.6% in the prior comparable period.

The mutual fund distribution expense consists of fees paid for our mutual funds to be offered on various financial platforms. The platforms allow consumers to purchase shares from numerous mutual fund companies through a single location, which provides those customers with a single statement of investments and a single source for mutual fund information and customer service. When our funds are purchased through one of these platforms, such as Charles Schwab, Fidelity, TD Ameritrade or Morgan Stanley Smith Barney, the platform typically charges us an asset based fee which is recorded in mutual fund distribution expense in our statement of operations. The fees increase or decrease in line with the value of the funds held on the platforms, which can be affected by inflows, outflows and market impact.

The decreased costs in the current period are due to a decrease in the value of average assets held through mutual fund platforms such as Charles Schwab, Fidelity and TD Ameritrade. For the nine months ended June 30, 2011, the value of the mutual funds held on Charles Schwab (the platform to which we pay over half of our total mutual fund distribution fees) decreased by more than 12% from the prior comparable period.

**Table of Contents**

The incremental assets purchased through the mutual fund platforms are not as profitable as those purchased in direct shareholder accounts due to the participation fees paid on assets held in the various mutual fund platforms. All of our funds are impacted by activity on the financial platforms as they are all available on several platforms.

**Sub-advisor Fee Expense:** Sub-advisor fee expense decreased 7.9% to \$0.49 million in the nine months ended June 30, 2011, from \$0.53 million in the prior comparable period. The decrease is a result of a decrease in sub-advised assets in the current period, mainly due to net outflows. As a percentage of total revenue, sub-advisor fee expense decreased by 0.7% to 8.3% for the nine months ended June 30, 2011, compared to 9.0% in the prior comparable period.

**Amortization and Depreciation Expense:** Amortization and depreciation expense decreased 16.1% to \$0.08 million in the nine months ended June 30, 2011, from \$0.09 million in the prior comparable period. As a percentage of total revenue, Amortization and depreciation expense decreased by 0.3% to 1.3% for the nine months ended June 30, 2011, compared to 1.6% in the prior comparable period.

**Interest Expense:** Interest expense increased by 81.5% from the prior comparable period due to an amendment to the loan providing an additional \$2.0 million on September 27, 2010. Monthly principal payments of \$0.05 million began in November, 2010. As a percentage of total revenue, interest expense increased by 0.4% to 0.9% for the nine months ended June 30, 2011, compared to 0.5% in the prior comparable period.

**Other Income:** Other income decreased by 120% from an expense of \$0.005 million in the prior comparable. As a percentage of total revenue, other income remained the same at 0% for the nine months ended June 30, 2011 as compared to the prior comparable period.

**Income Taxes:** The provision for income taxes increased 30.1% to \$0.7 million in the nine months ended June 30, 2011, from \$0.5 million in the prior comparable period. The change is due to increased income before tax in the current period.

**Net Income:** Net income increased by 37.9% to a net income of \$1.0 million in the nine months ended June 30, 2011, from \$0.7 million in the prior comparable period, as a result of the factors discussed above.

## **Table of Contents**

### Recent Accounting Pronouncements

In June, 2009, the FASB issued Accounting Standards Update No. 2009-17, Consolidation of Variable Interest Entities (ASC 810-10). The update requires ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity. It also eliminates the quantitative approach previously required for determining the primary beneficiary of a variable interest entity. The update is effective for annual and interim reporting periods in fiscal years beginning after December 15, 2009 (the Company's fiscal year 2011). The adoption of this update has had no effect on our financial statements or results of operations.

In January, 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-06, Improving Disclosure about Fair Value Measurements (ASC 820-10). This ASU will add new requirements for disclosures into and out of Levels 1 and 2 fair value measurements and information on purchases, sales, issuances and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. It also clarifies existing fair value disclosures about the level of disaggregation, inputs and valuation techniques. The guidance in the ASU is effective for annual and interim reporting periods in fiscal years beginning after December 15, 2010 (the Company's fiscal year 2012). We do not anticipate that the adoption of the new guidance will have any effect on our financial statements or results of operations.

### Critical Accounting Policies

Accounting policies, methods, and estimates are an integral part of the financial statements prepared by management and are based upon management's current judgments. Those judgments are normally based on knowledge and experience with regard to past and current events and assumptions about future events. Certain accounting policies, methods, and estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgment.

Our operating revenues consist of contractual management and shareholder service fees. We earn our management fees through portfolio management of our mutual funds and private pooled equity fund, and we earn our shareholder service fees by assisting customers in purchases, sales, distribution and customer service. The revenues are earned and calculated daily by our fund accountant. In accordance with the FASB guidance on revenue recognition, the fees are recognized monthly by the Company. Our contractual agreements provide persuasive evidence that an arrangement exists with fixed and determinable fees, and the services are rendered daily. The collectability is probable as the fees are received from our fund accountant in the month subsequent to the month in which the services are provided.

The management agreements acquired by the Company are considered intangible assets with an indefinite life. In June 2001, the Financial Accounting Standards Board issued the FASB guidance Intangibles - Goodwill and Other. It states that goodwill and intangible assets with indefinite useful lives are not amortized, but are tested at least annually for impairment. We fully implemented the provisions of the FASB guidance 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.



## **Table of Contents**

In conducting the impairment analysis, the future revenues are calculated as a percent of assets under management based on our existing management agreements with the Hennessy Funds. The future expenses are based on projections of our current expenses, adjusted for changes in the assets under management. For example, variable expenses such as platform fees and sub-advisor fees grow in direct proportion with our assets under management. Other semi-variable expenses, such as office rent and professional services, grow at a rate slower than the growth in assets under management. Specifically, the projected revenues and expenses are based on assumptions about the growth of our assets under management. Since our management contracts have an indefinite life, the projections of revenues and expenses in theory are calculated into perpetuity. The actual values, however, were calculated over the future 15 years, and the value developed for the periods beyond the 15 year forecast is reflected in the terminal value calculation. Ultimately, growth rates of equities over the long-term were used in estimating future rates, primarily based on the consistent tendency of returns to center about the 11% range, as evidenced by S&P 500 returns since inception. In addition, studies have concluded that in general, flows into various mutual fund groups are highly correlated with market performance, which suggests the Hennessy Funds will average reasonable inflows over the future 15 years in response to market appreciation.

We engaged an independent valuation firm and measured the fair value of the management contracts by incorporating our estimates and assumptions into a projection of future revenues, based in part upon estimates of assets under management growth and client attrition, and expenses. Based on the analysis, we concluded that projected revenues exceed projected expenses by an amount that is greater than the current carrying value of the management contracts. We therefore concluded that the management contract assets are not impaired as of September 30, 2010. We continually evaluate whether events or circumstances have occurred that indicate the management contracts may be impaired. If future valuations in the marketplace decline, the valuation of management agreements acquired may become impaired and net earnings would be negatively impacted by the resulting impairment adjustment. As of June 30, 2011, no events or circumstances occurred that indicated potential impairment of the management contracts.

The costs related to the Company's acquisition of management contracts are capitalized as incurred. The costs are defined as an intangible asset per FASB standard Intangibles Goodwill and Other. The acquisition costs include legal fees, fees for soliciting shareholder approval and a percent of asset costs to acquire the management contracts. The amounts are included in the management contract asset totaling \$22.3 million as of June 30, 2011.

### 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, 2011 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.

**Table of Contents**

Total assets under management as of June 30, 2011 were \$882.6 million, which was an increase of \$70.0 million, or 8.6%, from September 30, 2010. The primary source of our revenue, liquidity and cash flow are our fees, which are based on and generated by our average assets under management. Property and equipment and management agreements acquired totaled \$22.4 million as of June 30, 2011. We also invested \$0.5 million in the Micro Cap Fund on October 30, 2007. We intend to keep this investment, decreasing our short-term liquidity. Our remaining assets are very liquid, consisting primarily of cash and receivables derived from mutual fund asset management activities. As of June 30, 2011, we had cash and cash equivalents of \$8.2 million.

The following table summarizes key financial data relating to our liquidity and use of cash for the nine months ended June 30, 2011 and 2010:

	<b>For the Nine Months Ended June 30, (unaudited, in thousands)</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash flow data:</b>		
Operating cash flows	\$ 1,384	\$ 1,449
Investing cash flows	(42)	(108)
Financing cash flows	(1,218)	(1,141)
<b>Net increase in cash and cash equivalents</b>	<b>\$ 124</b>	<b>\$ 200</b>

The decrease in cash provided by operating activities is due to a \$0.46 million federal tax refund in the prior period due to the net operating loss in fiscal year 2009.

The increase in cash used for financing activities is due to more dividends paid to shareholders in the current period.

**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. 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. On September 27, 2010, we amended the loan to borrow an additional \$2.0 million, which bears interest at U.S. Bank National Association's prime rate, as set by U.S. Bank National Association from time to time, less one percent (2.25% as of December 17, 2008) and is secured by the Company's assets. The loan was amended to require 60 monthly payments in the amount of \$52,083 plus interest, with the final installment of the then outstanding principal and interest due on September 30, 2015. The loan agreement includes certain reporting requirements and loan covenants requiring the maintenance of certain financial ratios. We are in compliance with our loan covenants as of June 30, 2011. As of June 30, 2011, we have \$2.7 million currently outstanding under our bank loan.

**Table of Contents**

Item 4. Controls and Procedures

An evaluation was performed by management of the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended, as of June 30, 2011. Based on that evaluation, management, including the Company's principal executive and principal financial officers, concluded that the Company's disclosure controls and procedures are effective.

There has been no change in the internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934 that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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
- 101\* Financial statements from the Quarterly Report on Form 10-Q of Hennessy Advisors, Inc. for the quarter ended June 30, 2011, filed on August 4, 2011, formatted in XBRL: (i) the Condensed Statements; (ii) the Condensed Balance Sheets; (iii) the Condensed Statement of Cash Flows; and (iv) the Notes to Unaudited Condensed Financial Statements tagged as blocks of text.

\* In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

**Table of Contents**

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:

HENNESSY ADVISORS, INC.

Date: August 4, 2011

By: /s/ Teresa M. Nilsen  
Teresa M. Nilsen, Executive Vice President,

Chief Financial Officer

and Secretary

EXHIBIT INDEX

- 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
- 101\* Financial statements from the Quarterly Report on Form 10-Q of Hennessy Advisors, Inc. for the quarter ended June 30, 2011, filed on August 4, 2011, formatted in XBRL: (i) the Condensed Statements; (ii) the Condensed Balance Sheets; (iii) the Condensed Statement of Cash Flows; and (iv) the Notes to Unaudited Condensed Financial Statements tagged as blocks of text.

\* In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.