HENNESSY ADVISORS INC
Form 10QSB
August 02, 2005

FORM 10-QSB

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF
THE SECURITIES AND EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2005

Commission File Number 000-49872

HENNESSY ADVISORS, INC.
(Exact name of registrant as specified in its charter)

California (State or other jurisdiction of incorporation or organization)	68-0176227 (I.R.S. Employer Identification No.)
750 Grant Avenue, Suite 100 Novato, California (Address of principal executive offices)	94945 (Zip Code)

(415) 899-1555
(Registrant's telephone number, including area code)

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

The number of shares outstanding of each of the issuer's classes of common equity as of June 30, 2005 was 2,459,213.

Transitional Small Business Disclosure Format: Yes _______ ; No X _______

HENNESSY ADVISORS, INC.
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Hennessy Advisors, Inc.
Balance Sheets

	June 30, 2005 (Unaudited)
Assets	
Current assets:	
Cash and cash equivalents	$ 5,705,788
Investments in marketable securities, at fair value	4,684
Investment fee income receivable	933,364
Prepaid expenses	81,706
Other current assets	23,677
Total current assets	6,749,219
Property and equipment, net of accumulated depreciation of $91,463 and $100,200	90,924
Management contracts, net of accumulated amortization of $628,627	14,142,520
Deferred income tax assets	126,900
Other assets	180,580
Total assets	$ 21,290,143
Liabilities and Stockholders' Equity	
Current liabilities:	
Accrued liabilities and accounts payable	$ 1,123,160
Income taxes payable	11,830
Current portion of long-term debt	1,128,721

Total current liabilities	2,263,711
Long-term debt	5,361,426
Deferred income tax liabilities	733,138
Total liabilities	8,358,275
Stockholders' equity:	
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: 2,459,213 shares issued and outstanding at June 30, 2005 and 2,452,713 at September 30, 2004	6,935,050
Additional paid-in capital	45,138
Retained earnings	5,951,680
Total stockholders' equity	12,931,868
Total liabilities and stockholders' equity	$ 21,290,143

See accompanying notes to condensed financial statements

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Hennessy Advisors, Inc.
Statements of Income
Three and Nine Months Ended June 30, 2005 and 2004
(Unaudited)

	Three Months		Nine Mont
	2005	2004	2005
Revenue			
Investment advisory fees	$ 2,482,829	$ 2,324,616	$ 7,379,279
Shareholder service fees	290,647	269,980	867,387
Other	32,609	7,139	71,357
Total revenue	2,806,085	2,601,735	8,318,023
Operating expenses			
Compensation and benefits	608,408	579,462	1,773,727
General and administrative	201,937	194,450	671,264
Mutual fund distribution	514,480	471,590	1,505,216
Amortization and depreciation	9,917	9,891	32,932
Total operating expenses	1,334,742	1,255,393	3,983,139
Operating income	1,471,343	1,346,342	4,334,884
Interest expense	98,779	77,982	283,018

Income before income tax expense	1,372,564	1,268,360	4,051,866	
Income tax expense	571,669	491,016	1,643,922	
Net income	$ 800,895	$ 777,344	$ 2,407,944	
Earnings per share:				
Basic	$ 0.33	$ 0.32	$ 0.98	
Diluted	$ 0.31	$ 0.31	$ 0.93	
Weighted average shares outstanding:				
Basic	2,458,100	2,443,260	2,455,119	
Diluted	2,596,361	2,517,993	2,592,422	

See accompanying notes to condensed financial statements

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Hennessy Advisors, Inc.
Statements of Changes in Stockholders' Equity
Nine Months Ended June 30, 2005
(Unaudited)

	Common Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Tot Stock Equ
Balances as of September 30, 2004	2,452,713	$ 6,881,205	$ 37,098	$ 3,789,411	$ 10,
Net income for the nine months ended June 30, 2005	-	-	-	2,407,944	2,
Dividends paid	-	-	-	(245,675)	(
Employee stock options exercised	6,500	53,845	-	-	
Tax benefit of employee stock sales	-	-	8,040	-	
Balances as of June 30, 2005	2,459,213	$ 6,935,050	$ 45,138	$ 5,951,680	$ 12,

See accompanying notes to condensed financial statements

Hennessy Advisors, Inc.
Statements of Cash Flows
Nine Months Ended June 30, 2005 and 2004
(Unaudited)

	2005
Cash flows from operating activities:	
Net income	$ 2,407,9
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	42
Deferred income taxes	280,93
Tax benefit from exercise of employee stock options	8,04
Unrealized gains on marketable securities	(5
(Increase) decrease in operating assets:	
Investment fee income receivable	(101,99
Prepaid expenses	(16,70
Other current assets	73
Other assets	(117,19
Increase (decrease) in operating liabilities:	
Accrued liabilities and accounts payable	(293,34
Income taxes payable	11,05
Net cash provided by operating activities	2,179,85
Cash flows provided by (used) in investing activities:	
Purchases of property and equipment	(26,60
Disposal of fully depreciated assets	32,51
Purchases of investments	(5
Payments related to acquisition of management contracts	
Net cash provided by (used) in investing activities	5,85
Cash flows provided by (used) in financing activities:	
Deferred offering costs	(9,87
Proceeds from long-term debt	
Principal payments on long-term debt	(846,54
Payment of loan acquisition costs	
Proceeds from exercise of employee stock options	53,84
Dividend payment	(245,67
Net cash provided by (used) in financing activities	(1,048,24
Net increase in cash and cash equivalents	1,137,46
Cash and cash equivalents at the beginning of the period	4,568,32
Cash and cash equivalents at the end of the period	$ 5,705,78

Supplemental disclosures of cash flow information:

Cash paid for:	
Income taxes	$ 1,277,93
Interest	$ 280,10
Non-cash investing and financing disclosures:	
Loan acquisition costs withheld from long-term debt proceeds	$

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, 2005, are not necessarily indicative of results which may be expected for the fiscal year ending September 30, 2005. For additional information, refer to the financial statements for the fiscal year ended September 30, 2004, which are included in the Company's annual report on Form 10-KSB, filed with the Securities and Exchange Commission on December 14, 2004.

The operating activities of the Company consist primarily of providing investment management services to six 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 Cornerstone Value Fund, Hennessy Balanced Fund, Hennessy Total Return Fund and Hennessy Focus 30 Fund.

(2) Management Contracts

As of June 30, 2005, Hennessy Advisors, Inc. had contractual management agreements with Hennessy Funds, Inc. for the Hennessy Balanced Fund and the Hennessy Total Return Fund and with Hennessy Mutual Funds, Inc. for the Hennessy Cornerstone Growth Fund, the Hennessy Cornerstone Value Fund and the Hennessy Focus 30 Fund.

The management agreements were renewed by the Board of Directors of Hennessy Funds, Inc. and Hennessy Mutual Funds, Inc., at their meeting on March 8, 2005 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. or Hennessy Mutual Funds, Inc. (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, fullfilment, clerical and bookkeeping services and maintaining books and records of the Funds. Hennessy Advisors, as deemed necessary or by contract, may be required to waive its management fee or subsidize other expenses for the Funds it manages. Hennessy Advisors has agreed to cap the expense ratio of the Hennessy Cornerstone Growth Fund, Hennessy Cornerstone Value Fund, Hennessy Total Return Fund and Hennessy Balanced Fund through June 2005 (these contractual expense caps were instituted under the terms of the proxy statement and prospectus dated December 8, 2003 for the reorganization of certain Lindner funds into certain Hennessy Funds)and to subsidize certain expenses. The expense ratios for each of

the funds are well below the contractual cap and subsidy is not currently required.

(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 requires fifty-nine (59) monthly payments in the amount of $94,060 plus interest at the bank's prime rate, which may change from time to time (6.25% at June 30, 2005), and is secured by the Company's assets. The final installment of the then outstanding principal and interest is due March 10, 2009. In connection with securing the financing, Hennessy Advisors, Inc. incurred loan costs in the amount of $61,052. These costs are included in other assets and are being amortized on a straight-line basis over 60 months.

On July 1, 2005, we completed the previously announced acquisition of mutual fund assets related to the management contract for The Henlopen Fund. We paid $6.7 million, which equaled 2.25% of the $299 million in assets under management at the close of business on June 30, 2005. The transaction was financed by U.S. Bank National Association and terms of the loan are included in Exhibit 10.1.

(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 and the Hennessy Cornerstone Value Fund. The annual advisory fee for the Hennessy Focus 30 Fund is 1.0%. 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 and Hennessy Cornerstone Value Fund, are charged at an annual rate of 0.1% of average daily net assets.

Effective July 1, 2005, concurrent with our acquisition of The Henlopen Fund, advisor fees for the Focus 30 Fund will be reduced to an annual rate of 0.74% and shareholder service fees will be charged at an annual rate of 0.1%.

(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.

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 rates for three and nine months ended June 30, 2005, were 41.6% and 40.6% respectively, and differ from the federal statutory rate of 34% primarily due to the effects of state income taxes.

(6) Reclassification of Prior Period's Statements

Certain items previously reported have been reclassified to conform with the current period's presentation.

(7) 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 27, 2005, our Board of Directors declared a three-for-two stock split which was implemented on March 8, 2005 for shareholders of record as of February 15, 2005. The following table presents the pre-split and post-split computations of weighted average shares outstanding and earnings per share calculations:

	Three Months Ended June 30,	
	2005	2004
		(Amounts in
Net earnings:	$ 800,895	$ 777,344
Pre-Split Basis		
Basic earnings per share:	$ 0.49	$ 0.48

Weighted average shares outstanding for basic earnings per share calculation	1,638,733	1,628,840
Diluted earnings per share:	$ 0.46	$ 0.46
Weighted average shares outstanding for diluted earnings per share calculation	1,730,907	1,678,662
Adjusted for the effect of three-for-two stock split and as reported herein, June 30, 2005		
Basic earnings per share:	$ 0.33	$ 0.32
Weighted average shares outstanding for basic earnings per share calculation	2,458,100	2,443,260
Diluted earnings per share:	$ 0.31	$ 0.31
Weighted average shares outstanding for diluted earnings per share calculation	2,596,361	2,517,993

8) 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.

As the exercise price 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 3,500 options granted during the three months ended June 30, 2005, and 3,000 options were granted during the quarter ended June 30, 2004. During the nine months ended June 30, 2005, 119,000 options were granted and 21,750 options were granted during the nine months ended June 30, 2004. The following tables illustrate the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation", as amended, to options granted under the stock option plan. Because the estimated value is determined as of the date of grant, the actual value ultimately realized by the employee may be significantly different.

As required under FASB Statement No. 123 and FASB Statement No. 148, "Accounting for Stock-based Compensation - Transition and Disclosure", the proforma effects of stock-based compensation on net income and earnings per common share have been estimated at the date of grant using the Black-Scholes option pricing model.

The value of options granted during the three months ended June 30, 2005, was determined at the date of grant by using an options pricing model with an assumed risk-free interest rate of 4.24%, an expected life of 5 years, 0.41% dividends and a volatility factor of 24.09%:

	Net Income	Bas EP
For the three months ended June 30, 2005		
Net income	$ 800,895	$
Fair value of stock options - net of tax	14,553	
Proforma net income	$ 786,342	$

The value of options granted during the three months ended June 30, 2004, was determined at the date of grant by using an options pricing model with an assumed risk-free interest rate of 2.84%, an expected life of 5 years, zero dividends and a volatility factor of 36.50%:

	Net Income	Bas EP
For the three months ended June 30, 2004		

Net income	$ 777,344	$
Fair value of stock options - net of tax	10,992	
Proforma net income	$ 766,352	$

The value of options granted during the nine months ended June 30, 2005, was determined at the date of grant by using an options pricing model with an assumed risk-free interest rate of 3.44%, an expected life of 5 years, 0.96% dividends and a volatility factor of 24.09%:

	Net Income	Bas EP
For the nine months ended June 30, 2005		
Net income	$ 2,407,944	$
Fair value of stock options - net of tax	508,368	
Proforma net income	$ 1,899,576	$

The value of options granted during the nine months ended June 30, 2004, was determined at the date of grant by using an options pricing model with an assumed risk-free interest rate of 2.84%, an expected life of 5 years, zero dividends and a volatility factor of 36.50%:

	Net Income	Bas EP
For the nine months ended June 30, 2004		
Net income	$ 1,977,623	$
Fair value of stock options - net of tax	23,817	
Proforma net income	$ 1,953,806	$

The Company will continue to account for its stock option plan under the intrinsic value recognition and measurement principles of APB Opinion No. 25 and related interpretations through fiscal year end, September 30, 2005.

9) New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB)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". The are two possible methods of reporting share-based payment expenses: the "Modified Prospective" method and the "Modified Retrospective" method. We are currently evaluating the provisions of each method and have not determined the potential impact that adoption of FASB Statement No. 123R will have on our financial condition and results of operations. The effective date for implementation by small business issuers is the first interim or annual reporting period that begins after December 15, 2005.

On March 29,2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107, which contains the Staff's views and guidance regarding valuation of share-based payment arrangements by public companies, and appropriate disclosures in Management's Discussion and Analysis reporting subsequent to adoption of FASB Statement No. 123R.

In accordance with the provisions of FASB Statement No. 123R, and Staff Accounting Bulletin No. 107, we will begin reporting compensation expense for all stock option grants in our first quarterly report for fiscal year 2006 (quarter ending December 31, 2005). We will use the Black-Scholes option pricing model to determine share-based compensation expense at the date of grant at fair value.

During the first fiscal year that stock options were granted (year ended September 30, 2002) and through the nine months ended June 30, 2005, we have not recorded any compensation expense for stock option grants, as allowed by the intrinsic value recognition and measurement principles of APB Opinion No. 25. Proforma effects on net income and earnings per common share have been estimated and reported using the Black-Scholes option pricing model, as displayed in note #8 above.

(10) Subsequent Events

On July 1, 2005, we completed the previously announced acquisition of mutual fund assets related to the management contract for The Henlopen Fund. We paid $6.7 million, which equaled 2.25% of the $299 million in assets under management at the close of business on June 30, 2005. The transaction was financed by U.S. Bank National Association, and terms of the loan are included in Exhibit 10.1. Following completion of the acquisition, we changed the name of The Henlopen Fund to the Hennessy Cornerstone Growth Fund, Series II (symbol HENLX), and began to implement our investment strategy for Series II.

On July 26, 2005, we filed a Form S-1 Registration Statement with the Securities and Exchange Commission (File No. 333-126896), for a public offering of common stock (symbol HNNA). We also intend to apply to have our stock listed on the NASDAQ National stock exchange.

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Item 2. Management's Discussion and Analysis

Overview

We are a publicly traded investment management firm. Our principal business activity is managing, servicing and marketing our six open-end mutual funds. All of our mutual funds are no-load, meaning investors do not pay any upfront or deferred sales charges. We use quantitative stock selection strategies to manage each of the Hennessy Funds. The net assets of the mutual funds we manage have increased by 856% from $194 million on September 30, 2001 to $1.67 billion as of July 1, 2005, including approximately $299 million in net assets added on July 1, 2005 in connection with the acquisition of the

management agreement for The Henlopen Fund, which we renamed the Hennessy Cornerstone Growth Fund, Series II. During this same period, the total number of shareholders in our mutual funds has increased by 845% from 10,629 shareholders on September 30, 2001 to 100,398 shareholders on July 1, 2005.

Neil J. Hennessy has served as chairman of the board, president and chief executive officer of Hennessy since 1989 and as director, president and portfolio manager of our mutual funds since 1996.

Each of the Hennessy Funds pay fees to us for our management services. Management services include investment research, supervision of investments, conducting investment programs, including evaluation, sale and reinvestment of assets, the placement of orders for purchase and sale of securities, solicitation of brokers to execute transactions and the preparation and distribution of reports and statistical information. Some of our mutual funds also pay fees to us for shareholder servicing. Shareholder servicing consists primarily of providing a call center to respond to shareholder inquiries, including inquiries regarding specific mutual fund account and investment information. The fees that we receive for management services and shareholder servicing are based on a percentage of the average daily net asset value of 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, our completed acquisitions of management agreements, market conditions and the success of our marketing efforts. Total assets under management were $1.67 billion as of July 1, 2005.

The assets we manage have grown rapidly as a result of acquisitions of management agreements, fund inflows and market appreciation. The following tables illustrate the growth in assets under management since June 30, 2003 through June 30, 2005:

Assets Under Management
At Each Quarter End, June 30,2004 through Jun

	6/30/2004	9/30/2004	12/30/2004	3/31/20
Beginning assets under management................	$ 1,314,064	$ 1,284,720	$ 1,222,073	$ 1,376,
Acquisition flows..........	-	-	-	
Organic inflows............	48,096	33,306	64,390	107,
Redemptions................	(94,936)	(65,253)	(91,804)	(108,
Market appreciation (depreciation)............	17,496	(30,700)	181,644	(27,
Ending assets under management................	$ 1,284,720	$ 1,222,073	$ 1,376,303	$ 1,347,

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(1) Does not include $299 million in assets under management added

in connection with the acquisition of The Henlopen Fund (now known as the Hennessy Cornerstone Growth Fund, Series II), which was completed on July 1, 2005.

Assets Under Management
At Each Quarter End, June 30,2003 through Jun

	6/30/2003	9/30/2003	12/30/2003	3/31/20
Beginning assets under management................	$ 497,962	$ 663,243	$ 835,139	$ 1,012,
Acquisition flows..........	-	34,928	-	301,
Organic inflows............	110,767	79,619	117,651	116,
Redemptions................	(35,147)	(29,155)	(40,318)	(100,
Market appreciation (depreciation)............	89,661	86,504	100,431	(15,
Ending assets under management................	$ 663,243	$ 835,139	$ 1,012,903	$ 1,314,

Historically, we have received operating revenues from providing Mr. Hennessy's services as an expert witness and mediator in securities cases. Also, until June 2005, we provided management services to high net worth investors. However, our business strategy has evolved and we no longer generate any operating revenues from these services.

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A significant portion of our expenses, including employee compensation, are fixed and have historically demonstrated minimal variation. To implement our business strategy, we intend to expand and upgrade our facilities and anticipate increasing our staffing. As a result, we expect our fixed expenses to increase.

Due to the increases in fixed expenses and dilution of the shareholder base expected in connection with our proposed public offering, our earnings per share may decrease in the short-term.

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, 2005, this asset had a net balance of $14,142,520.

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. As of June 30, 2005, this liability, including the current portion of long-term debt, had a balance of $6.4 million. On July 1, 2005, we incurred an additional $6.7 million of long-term debt to finance our acquisition of the management agreement for The Henlopen Fund (now known as the Hennessy Cornerstone Growth Fund, Series II). We intend to repay in full this bank debt out of the net proceeds of our proposed public offering.

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, 2005 and 2004:

	Three Months Ended June 30,		
	2005		2004
	Amounts	Percent of Total Revenue	Amounts
Revenue:			
Investment advisory fees	$ 2,482,829	88.5%	$ 2,324,616
Shareholder service fees	290,647	10.4	269,980
Other	32,609	1.1	7,139
Total revenue	2,806,085	100.0	2,601,735
Operating expenses:			
Compensation and benefits	608,408	21.7	579,462
General and administrative	201,937	7.2	194,450
Mutual fund distribution	514,480	18.3	471,590
Amortization and depreciation	9,917	0.4	9,891
Total operating expenses	1,334,742	47.6	1,255,393
Operating income	1,471,343	52.4	1,346,342
Interest expense	98,779	3.5	77,982
Income before income tax expense	1,372,564	48.9	1,268,360
Income tax expense	571,669	20.4	491,016
Net income	$ 800,895	28.5%	$ 777,344

Revenues: Total revenue increased by $204,350, or 7.9%, in the three months ended June 30, 2005, from $2,601,735 in the prior comparable period, primarily due to fees earned from increased assets under management. Investment management fees increased by $158,213, or 6.8%, in the three months ended June 30, 2005, from $2,324,616 in the prior comparable period, and shareholder

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service fees increased by $20,667, or 7.7%, in the three months ended June 30, 2005, from $269,980 in the prior comparable period. These increases resulted from increases in the average daily net assets of our mutual funds, which can differ considerably from net assets of our mutual funds at the end of an accounting period. Net assets in our mutual funds increased by $88.4 million, or 6.9%, as of June 30, 2005, from $1.285 billion as of the end of the prior

comparable period. This increase in the net assets of our mutual funds resulted from cash inflows of $277.5 million, redemptions of $353.1 million and market appreciation of $164.0 million. In comparison, from June 30, 2003 to June 30, 2004, cash inflows of our mutual funds were $697.8 million, which included $336.1 million of cash inflows from acquisitions, redemptions were $264.8 million and market appreciation was $188.5 million. Although the amount of redemptions increased by $23.0 million for the one year period ending June 30, 2005 as compared to the one year period ending June 30, 2004, redemptions as a percentage of assets under management increased only marginally from an average of 2.1% per month to 2.3% per month during the same period.

Operating Expenses: Total operating expenses increased by $79,349, or 6.3%, in the three months ended June 30, 2005, from $1,255,393 in the prior comparable period. The increase resulted from higher compensation expense, increases in several components of general and administrative expense and mutual fund distribution costs. As a percentage of total revenue, total operating expenses decreased by 0.7% to 47.6% in the three months ended June 30, 2005, as compared to 48.3% in the prior comparable period.

Employee Compensation and Benefits: Compensation and benefits increased by $28,946, or 5.0%, in the three months ended June 30, 2005, from $579,462 in the prior comparable period. The increase resulted from the addition of a chief compliance officer, the addition of a portfolio management specialist and salary increases for officers and staff. As a percentage of total revenue, compensation and benefits decreased by 0.6% to 21.7% for the three months ended June 30, 2005, compared to 22.3% in the prior comparable period.

General and Administrative Expenses: General and administrative expense increased by $7,487, or 3.9%, in the three months ended June 30, 2005, from $194,450 in the prior comparable period, primarily due to increases in professional fees, board of directors fees and expenses and business insurance. Partially offsetting these increases were reductions in marketing and promotion expenses. As a percentage of total revenue, general and administrative expense decreased by 0.3% to 7.2% in the three months ended June 30, 2005, from 7.5% in the prior comparable period.

Mutual Fund Distribution Expenses: Distribution expenses increased by $42,890, or 9.1%, in the three months ended June 30, 2005, from $471,590 in the prior comparable period. As a percentage of total revenue, distribution expenses increased by 0.2% to 18.3% for the three months ended June 30, 2005, compared to 18.1% in the prior comparable period. This slight increase is due to increased assets through mutual fund supermarkets such as Charles Schwab, Fidelity and TD Waterhouse.

Amortization and Depreciation Expense: Amortization and depreciation expense remained essentially unchanged in the three months ended June 30, 2005, from the prior comparable period.

Interest Expense: We incurred interest expense of $98,779 during the three months ended June 30, 2005 as a result of the $7.9 million loan that we entered into with U.S. Bank National Association to acquire the management agreements for the Lindner Funds. Interest increased $20,797 from the prior comparable period due to increases in interest rates. Interest accrues at the prime rate in effect from time to time, which was 6.25% on June 30, 2005 and 4.0% on June 30, 2004.

Income Taxes: The provision for income taxes increased by $80,653, or 16.4%, in the three months ended June 30, 2005, from $491,016 in the prior

comparable period.

Net Income: Net income increased by $23,551, or 3.0%, in the three months ended June 30, 2005, compared to $777,344 in the prior comparable period, as a result of the factors discussed above.

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, 2005 and 2004:

	Nine Months Ended June 30,		
	2005		2004
	Amounts	Percent of Total Revenue	Amounts
Revenue:			
Investment advisory fees	$ 7,379,279	88.7%	$ 6,234,999
Shareholder service fees	867,387	10.4	749,888
Other	71,357	0.9	19,099
Total revenue	8,318,023	100.0	7,003,986
Operating expenses:			
Compensation and benefits	1,773,727	21.3	1,604,259
General and administrative	671,264	8.1	645,645
Mutual fund distribution	1,505,216	18.1	1,395,232
Amortization and depreciation	32,932	0.4	22,905
Total operating expenses	3,983,139	47.9	3,668,041
Operating income	4,334,884	52.1	3,335,945
Interest expense	283,018	3.4	92,353
Income before income tax expense	4,051,866	48.7	3,243,592
Income tax expense	1,643,922	19.8	1,265,969
Net income	$ 2,407,944	28.9%	$ 1,977,623

Revenues: Total revenue increased by $1,314,037, or 18.8%, in the nine months ended June 30, 2005, from $7,003,986 in the prior comparable period, primarily due to fees earned from increased assets under management. Investment management fees increased by $1,144,280, or 18.4%, in the nine months ended June 30, 2005, from $6,234,999 in the prior comparable period, and shareholder service fees increased by $117,499, or 15.7%, in the nine months ended June 30, 2005, from $749,888 in the prior comparable period. These increases resulted from increases in the average daily net assets of our mutual funds, which can differ considerably from net assets of our mutual funds at the end of an accounting period. Net assets in our mutual funds increased by $88.4 million, or 6.9%, as of June 30, 2005, from $1.285 billion as of the end of the prior

comparable period. This increase in the net assets of our mutual funds resulted from cash inflows of $277.5 million, redemptions of $353.1 million and market appreciation of $164.0 million. In comparison, from June 30, 2003 to June 30, 2004, cash inflows of our mutual funds were $697.8 million, which included $336.1 million of cash inflows from acquisitions, redemptions were $264.8

million and market appreciation was $188.5 million. Although the amount of redemptions increased by $23.0 million for the one year period ending June 30, 2005 as compared to the one year period ending June 30, 2004, redemptions as a percentage of assets under management increased only marginally from an average of 2.1% per month to 2.3% per month during the same period.

Operating Expenses: Total operating expenses increased by $315,098, or 8.6%, in the nine months ended June 30, 2005, from $3,668,041 in the prior comparable period. The increase resulted from higher compensation expense, increases in several components of general and administrative expense and mutual fund distribution costs. As a percentage of total revenue, total operating expenses decreased by 4.5% to 47.9% in the nine months ended June 30, 2005, as compared to 52.4% in the prior comparable period.

Employee Compensation and Benefits: Compensation and benefits increased by $169,468, or 10.6%, in the nine months ended June 30, 2005, from $1,604,259 in the prior comparable period. The increase primarily resulted from the addition of a chief compliance officer, the addition of a portfolio management specialist, salary increases for officers and staff and increased medical insurance premiums. As a percentage of total revenue, compensation and benefits decreased by 1.7% to 21.3% for the nine months ended June 30, 2005, compared to 23.0% in the prior comparable period.

General and Administrative Expenses: General and administrative expense increased by $25,619, or 4.0%, in the nine months ended June 30, 2005, from $645,645 in the prior comparable period, primarily due to increases in board of directors fees and expenses, professional fees, business insurance, and computer support services. Partially offsetting these increases were reductions in marketing and promotion expenses. As a percentage of total revenue, general and administrative expense decreased by 1.1% to 8.1% in the nine months ended June 30, 2005, from 9.2% in the prior comparable period.

Mutual Fund Distribution Expenses: Distribution expenses increased by $109,984, or 7.9%, in the nine months ended June 30, 2005, from $1,395,232 in the prior comparable period. As a percentage of total revenue, distribution expenses decreased by 1.8% to 18.1% for the nine months ended June 30, 2005, compared to 19.9% in the prior comparable period. The proportion of assets held through mutual fund supermarkets declined in relation to assets held at other financial institutions primarily as a result of the acquisition of the management agreements for the Lindner Funds in March 2004. Because most of the net assets of the Lindner Funds were not held through mutual fund supermarkets and we do not pay distribution expenses on assets that are not held through mutual fund supermarkets, our distribution expense as a percentage of total revenues declined following our acquisition of the management agreements for the Lindner Funds.

Amortization and Depreciation Expense: Amortization and depreciation expense increased $10,027 in the nine months ended June 30, 2005, from $22,905 in the prior comparable period resulting from loan amortization costs and purchases of furniture and equipment.

Interest Expense: We incurred interest expense of $283,018 during the nine months ended June 30, 2005 as a result of the $7.9 million loan that we

entered into with U.S. Bank National Association to acquire the management agreements for the Lindner Funds. Interest increased $190,665 from the prior comparable period due to increases in interest rates. Interest accrues at the prime rate in effect from time to time, which was 6.25% on June 30, 2005 and 4.0% on June 30, 2004.

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Income Taxes: The provision for income taxes increased by $377,953, or 29.9%, in the nine months ended June 30, 2005, from $1,265,969 in the prior comparable period.

Net Income: Net income increased by $430,321, or 21.8%, in the nine months ended June 30, 2005, compared to $1,977,623 in the prior comparable period, as a result of the factors discussed above.

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, 2005 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 as of June 30, 2005 were $21,290,143, which was an increase of $1,376,264, or 6.9%, from September 30, 2004. Property and equipment and management agreements acquired totaled $14,233,444 as of June 30, 2005. Our remaining assets are very liquid, consisting primarily of cash and receivables derived from mutual fund asset management activities. As of June 30, 2005, we had cash and cash equivalents of $5,705,788.

Dividend Payments: On March 8, 2005, we paid a cash dividend of $0.10 per common share. The total payment from cash on hand was $245,675. Upon the successful completion of our proposed public offering announced July 26, 2005, we intend to begin paying dividends on a quarterly basis.

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 $13.1 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 (6.25% as of July 1, 2005). 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. We intend to retire this loan in full with a portion of the proceeds of our proposed public offering.

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, including, among other things, revenues we expect to receive from our new management agreement covering Hennessy Cornerstone Growth Fund, Series II;
- our ability to maintain and grow our distribution channels on which we depend;
- our estimates regarding anticipated revenues and operating expenses;
- the costs we may incur in complying with increased securities industry regulation;
- our ability to retain the mutual fund assets we currently manage; and
- the effect international conflicts and the ongoing threat of terrorism may have on the general economy, financial and capital markets and our business.

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. Risk factors are described in more detail in the "Risk Factors" section of the Company's Annual Report, filed on Form 10-KSB with the U.S. Securities and Exchange Commission on December 14, 2004.

Item 3. 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

10.1* Amended and Restated Loan Agreement, dated July 1, 2005, between Hennessy Advisors, Inc. and U.S. Bank National Association

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. ss. 1350

32.2 Written Statement of the Chief Financial Officer, Pursuant to 18 U.S.C. ss. 1350

* Incorporated by reference from the Company's Form S-1 Registration Statement (SEC File No. 333-126896).

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 2, 2005

By: /s/ Teresa M. Nilsen

Teresa M. Nilsen, Executive Vice President, Chief Financial Officer and Secretary

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