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HENNESSY ADVISORS INC  
Form 10QSB  
January 28, 2004

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 December 31, 2003

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 December 31, 2003 was 1,626,142.

Transitional Small Business Disclosure Format: Yes ; No X

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Item 1. Financial Statements

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Hennessy Advisors, Inc.  
Balance Sheets  
December 31, 2003 and September 30, 2003

	December 31 2003	Septemb 2003
Assets	----- (Unaudited)	-----
Cash and cash equivalents	\$ 3,149,539	\$ 2,800,000
Investments in marketable securities, at fair value	4,751	5,627
Investment fee income receivable	707,915	562,700
Management contracts acquired, net of accumulated amortization of \$628,627	5,677,588	5,630,000
Property and equipment, net of accumulated depreciation of \$79,340 and \$73,590	87,406	4,751
Deferred income tax assets	51,000	5,627
Other assets	180,785	4,751
	-----	-----
Total assets	\$ 9,858,984	\$ 9,140,000
	=====	=====
Liabilities and Stockholders' Equity		
Accrued liabilities and accounts payable	\$ 489,845	\$ 630,000

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Income taxes payable	299,738	
Note payable	527,912	52
Deferred income tax liability	180,364	15
	-----	-----
Total liabilities	\$ 1,497,859	\$ 1,31
	-----	-----
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: 1,626,142 shares issued and outstanding at December 31, 2003 and September 30, 2003	6,788,205	6,78
Additional paid-in capital	24,008	2
Retained earnings	1,548,912	1,02
	-----	-----
Total stockholders' equity	8,361,125	7,83
	-----	-----
Total liabilities & stockholders' equity	\$ 9,858,984	\$ 9,14
	=====	=====

See accompanying notes to condensed financial statements

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Hennessy Advisors, Inc.  
 Statements of Income  
 Three Months Ended December 31, 2003 and 2002  
 (Unaudited)

	2003
	----
Income	
Investment advisory fees	\$ 1,783,648
Shareholder service fees	222,179
Expert witness fees	-
Other	5,691
	-----
Total revenue	2,011,518
	-----
Expenses	
Compensation and benefits	474,560
General and administrative	227,819
Mutual fund distribution	442,066
Amortization and depreciation	5,750
	-----

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Total expenses	1,150,195
	-----
Income before income tax expense	861,323
	-----
Income tax expense	336,816
	-----
Net income	\$ 524,507
	=====
Basic earnings per share	\$ 0.32
	=====
.	
Diluted earnings per share	\$ 0.31
	=====

See accompanying notes to condensed financial statements

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Hennessy Advisors, Inc.  
 Statements of Changes in Stockholders' Equity  
 Three Months Ended December 31, 2003  
 (Unaudited)

	Common Shares -----	Common Stock -----	Additional Paid-in Capital -----
Balances as of September 30, 2003	1,626,142	\$ 6,788,205	\$ 24,008
Net income for the three months ended December 31, 2003	-	-	-
Balances as of December 31, 2003	1,626,142	\$ 6,788,205	\$ 24,008
	-----	-----	-----

See accompanying notes to condensed financial statements

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Hennessy Advisors, Inc.  
Statements of Cash Flows  
Three Months Ended December 31, 2003 and 2002  
(Unaudited)

Cash flows from operating activities:

Net income \$  
Adjustments to reconcile net income to net cash provided by  
operating activities:  
    Depreciation and amortization  
    Deferred income taxes  
    Unrealized gains on marketable securities  
  
    (Increase) decrease in operating assets:  
        Investment fee income receivable  
        Expert witness fees receivable  
        Other assets  
    Increase (decrease) in operating liabilities:  
        Accrued liabilities and accounts payable  
        Income taxes payable

Net cash provided by operating activities

Cash flows used in investing activities:

Purchases of property and equipment  
Purchases of investments  
Payments related to acquisition of management contracts

Net cash used in investing activities

Net increase in cash and cash equivalents

Cash and cash equivalents at the beginning of the period

Cash and cash equivalents at the end of the period \$

Supplemental disclosures of cash flow information:

Cash paid for:  
    Income taxes \$

See accompanying notes to condensed financial statements

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## Notes to Condensed Financial Statements

### 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 and results of operations for the periods represented. 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 months ended December 31, 2003, are not necessarily indicative of results which may be expected for the fiscal year ending September 30, 2004. For additional information, refer to the financial statements for the fiscal year ended September 30, 2003, which are included in the Company's annual report on Form 10-KSB, filed with the Securities and Exchange Commission on December 22, 2003.

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

### Management Contracts

Hennessy Advisors, Inc. has management agreements with Hennessy Funds, Inc. for the Hennessy Balanced Fund and 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 5, 2003 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, fulfillment, clerical and bookkeeping services and maintaining books and records of the Funds.

Hennessy Advisors, as deemed necessary and without contractual obligation, may voluntarily waive its management fee or subsidize other Fund expenses.

### Investment Fee Income

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Advisory and Shareholder Service fees, which comprise investment fee income, 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 rate for the Hennessy Focus 30 Fund is 1.0%. The annual rate for the Hennessy Balanced Fund and Hennessy Total Return Fund is 0.60%.

Effective October 1, 2002, the Board of Directors of Hennessy Mutual Funds, Inc. authorized an additional monthly fee for shareholder support services provided to the Hennessy Cornerstone Growth and Hennessy Cornerstone Value Fund, at an annual rate of 0.1% of average daily net assets.

### Expert Witness Fees

The Company receives fees for services provided by the Company's president and staff in mediating, reviewing, and consulting on various cases within the securities industry. Such fees are recognized when earned.

### 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 rate of 39.1% for the three months ended December 31, 2003, differs from the federal statutory rate of 34% primarily due to the effects of state income taxes.

### 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.

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The weighted average common shares outstanding used in the calculation of basic earnings per share, and the weighted average common shares outstanding, adjusted for common stock equivalents, used in the computation of diluted earnings per share, were as follows for the three months ended December 31, 2003 and 2002:

	Three Months Ended December 31, 2003 and 2002	
	2003	2002
Weighted Average common stock outstanding	1,626,142	1,626,142
Common stock equivalents		
- stock options	46,675	5,502
	1,672,817	1,631,644

### Stock-Based Compensation

In December, 2002, FASB issued FASB Statement No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" which amended FASB Statement No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, FASB Statement No. 148 amends the disclosure requirements of FASB Statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. Effective for interim periods beginning after December 15, 2002, FASB Statement No. 148 requires disclosure of pro-forma results on a quarterly basis as if the Company had applied the fair value recognition provisions of FASB Statement No. 123. The Company continues to account for its stock option plan under the intrinsic value recognition and measurement principles of APB Opinion No. 25 and related interpretations.

During the three month period ended December 31, 2003, there were 12,500 options granted. No compensation cost has been recognized for these grants. No options were granted during the three month period ended December 31, 2002. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, 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. The value of options granted during the three months ended December 31, 2003, 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 0.0001%:



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	Net Income	Basic EPS
For the three months ended December 31, 2003		
Net income	\$ 524,507	\$ 0.32
Fair value of stock options - net of tax	12,825	0.01
Proforma net income	\$ 511,682	\$ 0.31

### Item 2. Management's Discussion and Analysis

#### Overview and General Industry Conditions

Our primary sources of revenue are investment fees derived from managing our five mutual funds. Advisory services include investment research, supervision of investments, conducting clients' 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. Shareholder services primarily include providing a call center to respond to shareholder inquiries, including specific mutual fund account information.

Investment advisory fees and shareholder service fees are charged as a specified percentage of the average daily net value of the assets under management. Hennessy's total assets under management were \$1.046 billion as of December 31, 2003, of which \$1.013 billion were mutual fund assets. Approximately 99% of Hennessy's total revenues were attributable to the five Hennessy mutual funds for the three months ended December 31, 2003.

Neil J. Hennessy, our Chief Executive Officer, President and Chairman of the Board served as expert witness and mediator in securities cases in the past. Mr. Hennessy has limited his mediation activities to devote more time to managing the investment advisory business of Hennessy Advisors, Inc., resulting in significant reduction of revenue from these activities compared to prior periods.

The principal asset on our balance sheet represents the capitalized acquisition costs of the investment advisory agreements with all five mutual funds. As of December 31, 2003, the management contracts acquired asset had a net balance of \$5,677,588.

#### Results of Operations

The following table reflects items in the statements of income as dollar amounts and as percentages of total revenue for the three months ended December 31, 2003 and 2002:

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	Three Months Ended December 31, 2003 and 2002		
	2003		2002
	Amounts	Percent of Total Revenue	Amounts
<b>Revenue:</b>			
Investment advisory fees	1,783,648	88.7%	\$ 831,338
Shareholder service fees	222,179	11.0	108,752
Expert witness fees	-	-	7,150
Other	5,691	0.3	7,915
<b>Total revenue</b>	<b>2,011,518</b>	<b>100.0</b>	<b>955,155</b>
<b>Operating Expenses:</b>			
Compensation and benefits	474,560	23.6	293,350
General and administrative	227,819	11.3	173,598
Mutual fund distribution	442,066	22.0	144,114
Amortization and depreciation	5,750	0.3	5,270
<b>Total operating expenses</b>	<b>1,150,195</b>	<b>57.2</b>	<b>616,332</b>
Income before income tax expense	861,323	42.8	338,823
Income tax expense	336,816	16.7	108,858
<b>Net income</b>	<b>\$ 524,507</b>	<b>26.1%</b>	<b>\$ 229,965</b>

Three Months Ended December 31, 2003 Compared to the Three Months Ended December 31, 2002:

Total revenue increased \$1,056,363 (+110.6%) in the three months ended December 31, 2003, from \$955,155 in the same period of 2002, primarily due to fees earned from increased mutual fund assets under management, resulting from increased net cash inflows and higher market valuations. In total, mutual fund assets increased \$519.2 million to \$1.013 billion as of December 31, 2003, compared to \$493.7 million as of December 31, 2002 (+105.2%). Net cash inflows accounted for \$212.1 million (40.9%) of increased assets while market valuations contributed the remaining \$307.1 million (59.1%). Investment advisory fees increased \$952,310 (+114.6%) in the three months ended December 31, 2003, while shareholder service fees increased \$113,427 (+104.3%).

There were no expert witness fees earned in the three months ended December 31, 2003, a decrease of \$7,150 from the three months ended December 31, 2002. Mr. Hennessy is working in a limited capacity as a securities litigation mediator, devoting the majority of his time to managing Hennessy Advisors, Inc.

Total operating expenses increased \$533,863 (+86.6%) in the three months ended December 31, 2003, from \$616,332 in the same period of 2002. 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 to 57.2% in the three months ended December 31, 2003, compared to 64.5% in the prior comparable period.

Compensation and benefits increased \$181,210 (+61.8%) in the three months ended December 31, 2003, from \$293,350 in the prior comparable period. The increase resulted from the addition of one employee and implementation of salary increases and performance incentives for officers and staff. As a percentage of total revenue, compensation and benefits decreased to 23.6% for the three months ended December 31, 2003, compared to 30.7% in the prior comparable period.

General and administrative expense increased \$54,221 (+31.2%), in the three months ended December 31, 2003, from \$173,598 in the three months ended December 31, 2002, due to increases in advertising and business promotion, marketing programs, investor communication services, printing and travel expenses. As a percentage of total revenue, general and administrative expense decreased to 11.3% in the three months ended December 31, 2003, from 18.2% in the prior comparable period.

Mutual fund distribution expenses increased \$297,952 (+206.7%) in the three months ended December 31, 2003, from \$144,114 in the three months ended December 31, 2002. As a percentage of total revenue, distribution expenses increased to 22.0% for the three months ended December 31, 2003, compared to 15.1% in the prior comparable period. The value of mutual fund assets to which distribution expenses relate increased 105.2% from December 31, 2002 to December 31, 2003. Additionally, fees charged by Charles Schwab, Inc. increased to 40 basis points in the 3 months ended December 31, 2003 compared to 35 basis points in the prior comparable period. These expenses represent "no transaction fee" (NTF) programs through which Hennessy mutual fund shares are distributed. These expenses increase as assets under management grow through use of "NTF" programs, and expansion of these programs has been and continues to be an integral part of management's business growth strategy.

Amortization and depreciation expense increased a modest \$480 in the three months ended December 31, 2003, from \$5,270 for the three months ended December 31, 2002, resulting from limited purchases of furniture and equipment.

For the three months ended December 31, 2003, the provision for income taxes increased \$227,958, resulting from an increase in pre-tax income of \$522,500.

Net income increased \$294,542 to \$524,507 in the three months ended December 31, 2003, compared to \$229,965 in the prior comparable period, as a result of the factors discussed above.

#### Liquidity and Capital Resources

As of December 31, 2003, Hennessy Advisors, Inc. had cash and cash equivalents of \$3,149,539.

With the exception of property and equipment and management contracts acquired, which amount to a combined \$5,764,994 as of December 31, 2003, the remaining assets of \$4,093,990 are very liquid, consisting primarily of cash and receivables derived from mutual fund asset management activities. Total

assets as of December 31, 2003 were \$9,858,984, compared to \$9,148,863 at September 30, 2003, an increase of 7.8%.

Capital requirements for Hennessy Advisors, Inc. are continually reviewed to ensure that sufficient funding is available to support business growth strategies. The management of Hennessy Advisors, Inc. anticipates that cash and other liquid assets on hand as of December 31, 2003, will be sufficient to 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 and/or equity markets. There can be no assurance that Hennessy Advisors, Inc. will be able to borrow funds or raise additional equity.

In September, 2003, Hennessy Advisors, Inc., acquired the investment advisory agreement for the SYM Select Growth Fund (SYM), which was a Mid-cap growth fund with \$34.7 million in assets under management. On September 18, 2003, the acquisition transaction was completed and assets of the SYM Select Growth Fund were merged into the Hennessy Focus 30 Fund. The acquisition was funded through cash from Hennessy Advisors, Inc. in the amount of \$629,413 and an interest free note from SYM Financial Corporation, in the amount of \$527,912. The note is due and payable on September 18, 2004.

On October 14, 2003, Hennessy Advisors, Inc. signed a definitive agreement to acquire the investment advisory contract for a majority of the mutual fund assets managed by Lindner Asset Management, Inc. ("Lindner"), based in Deerfield, Illinois. Under terms of the agreement, Hennessy Advisors, Inc. would acquire the investment advisory contract for five of Lindner's mutual funds with assets of approximately \$300 million, at a purchase price equal to 2.625% of those assets. The estimated \$8 million transaction is expected to be funded through a credit facility of up to \$10 million offered by US Bank, St. Louis, Missouri. Pending approval of Lindner shareholders, the acquisition is expected to close in February, 2004.

#### 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, for example:

- o Continuing volatility in the equity markets have caused the levels of our assets under management to fluctuate significantly.
- o Weak market conditions or loss of investor confidence in the mutual fund industry may lower our assets under management and reduce our revenues and income.
- o We face strong competition from numerous and sometimes larger companies.

- o Changes in the distribution channels on which we depend could reduce our revenues or hinder our growth.
- o For the next several years, insurance costs are likely to increase materially and we may not be able to obtain the same types or amounts of coverage.
- o For the next several years, professional service fees are likely to increase due to increased securities industry legislation.
- o Business growth through asset acquisitions may not proceed as planned and result in significant expenses adversely affecting earnings.
- o International conflicts and the ongoing threat of terrorism may adversely affect 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 22, 2003.

### 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 AND SIGNATURES

There were no reportable events for items 1 through 5 during the three months ended December 31, 2003.

### Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibits

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Exhibit 31.1 Rule 13a - 14a Certification of the Chief Executive Officer

Exhibit 31.2 Rule 13a - 14a Certification of the Chief Financial Officer

Exhibit 32.1 Written Statement of the Chief Executive Officer, Pursuant to 18 U.S.C. ss. 1350

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

(b) Reports on Form 8-K

Hennessy Advisors, Inc. furnished Forms 8-K during the quarter ended December 31, 2003, as follows:

- Form 8-K, furnished October 14, 2003, Lindner Funds acquisition.
- Form 8-K, furnished December 3, 2003, Mutual Fund assets surpass \$1.0 billion.
- Form 8-K, furnished December 22, 2003, Earnings Release for fiscal year ended September 30, 2003.

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Signatures

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

HENNESSY ADVISORS, INC.

Date: January 28, 2004

By: /s/ Teresa M. Nilsen

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

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EXHIBIT INDEX

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Exhibit 31.1 Rule 13a - 14a Certification of the Chief Executive Officer

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