

HENNESSY ADVISORS INC
Form 10-K
December 06, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended September 30, 2007

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

For the Transition Period From _____ to _____

Commission File Number 000-49872

HENNESSY ADVISORS, INC.

(Exact name of registrant as specified in its charter)

California
(State or other jurisdiction of
incorporation or organization)

68-0176227
(IRS Employer
Identification No.)

7250 Redwood Blvd., Suite 200

Novato, California

94945

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(Address of principal executive office)

(Zip Code)

(415) 899-1555

(Issuer's telephone number)

Securities registered under Section 12(b) of the Exchange Act:

None.

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, no par value

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of Common Stock held by non-affiliates (as affiliates are defined in Rule 12b-2 of the Exchange Act) of the Registrant, based on the closing price of \$15.50 on March 31, 2007, was \$52,457,394.

APPLICABLE ONLY TO CORPORATE REGISTRANTS

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date:

As of November 9, 2007 there were 5,702,835 shares of Common Stock (no par value) issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the registrant's definitive proxy statement for its 2008 annual meeting of stockholders are incorporated by reference in Parts II and III.

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HENNESSY ADVISORS, INC.

FORM 10-K

For the Fiscal Year Ended September 30, 2007

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PART I

ITEM 1. DESCRIPTION OF BUSINESS
GENERAL

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 787% from \$194 million on September 30, 2001 to \$1.72 billion as of September 30, 2007.

Each of the Hennessy Funds pays 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. All six of our mutual funds also pay fees to us for shareholder services. Shareholder services consist 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 and shareholder services are based on a percentage of the average daily net asset values of our mutual funds.

Company History

We were founded in 1989 as a California corporation under the name Edward J. Hennessy Incorporated. We initially registered with the appropriate federal, state and self-regulatory organizations as a broker-dealer with a retail business. In addition, we were a member of the National Association of Securities Dealers, serving mainly individual investors, but we terminated this registration in July 2000 and are no longer engaged in the broker-dealer business. In 1990, we registered as an investment advisor. From 1990 to 1996, we provided management services to private clients and limited partnerships utilizing strategies similar to those we use in advising our mutual funds today. In 1996, we launched our first mutual fund, the Hennessy Balanced Fund. We initially managed the Hennessy Balanced Fund through The Hennessy Management Co., L.P., a California limited partnership for which we served as the general partner. As general partner, we performed all of the management functions on behalf of The Hennessy Management Co., L.P. for the Hennessy Balanced Fund.

In 1998, we launched our second mutual fund, the Hennessy Total Return Fund. We initially managed the Hennessy Total Return Fund through The Hennessy Management Co. 2, L.P., another California limited partnership for which we served as the general partner and as such, performed all of the management functions on behalf of The Hennessy Management Co. 2, L.P. for the Hennessy Total Return Fund.

In 2000, we began acquiring the rights to manage the assets of additional mutual funds by entering into agreements with the funds' investment advisors to acquire management contracts related to such funds. When we acquire the rights to manage the assets of a mutual fund, we generally either enter into a management agreement covering the mutual fund or reorganize the assets of the mutual fund into one of our existing mutual funds. An attractive acquisition target for us is a retail-oriented, no-load mutual fund with less than \$500 million in net assets.

In June 2000, we completed our first acquisition by entering into a management agreement covering the O'Shaughnessy Cornerstone Growth Fund and O'Shaughnessy Cornerstone Value Fund and changed the names of these funds to the Hennessy Cornerstone Growth Fund and the Hennessy Cornerstone Value Fund. In connection with this acquisition, we obtained an exclusive, perpetual license to use the names and investment strategies of the Cornerstone Growth Fund and Cornerstone Value Fund from Netfolio, Inc. These two mutual funds had approximately \$197 million in combined net assets at the time we began managing them.

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In May 2002, we completed our initial public offering, raising \$5.7 million in a non-underwritten offering at a split-adjusted price of \$2.97 and became a 1934 Act reporting company as a small-business issuer. At the time of our initial public offering, assets under management were approximately \$348 million. In connection with our initial public offering, the limited partners of The Hennessy Management Co., L.P. and The Hennessy Management Co. 2, L.P. agreed to merge their partnerships into our new public company, thereby allowing the consolidation of all our management activities directly into Hennessy Advisors, Inc.

In September 2003, we acquired the management agreement for the SYM Select Growth Fund. In connection with that acquisition, we launched our fifth mutual fund, the Hennessy Focus 30 Fund, into which we reorganized the assets of the SYM Select Growth Fund. At the time of this acquisition, the SYM Fund had approximately \$35 million in net assets.

In March 2004, we acquired the management agreements for five funds managed by Lindner Asset Management, Inc., which we refer to as the Lindner Funds. In connection with this acquisition, the assets of the Lindner Funds were reorganized into four of our existing mutual funds. At the time of this acquisition, the Lindner Funds had approximately \$301 million in combined net assets.

In July 2005, we acquired the management agreement for The Henlopen Fund and changed the name to the Hennessy Cornerstone Growth Fund, Series II. At the time of this acquisition, The Henlopen Fund had approximately \$299 million in net assets.

BUSINESS OPERATIONS, PRODUCTS and STRATEGIES**Management Agreements and Fees**

We have entered into management agreements covering all of our mutual funds with the registered investment companies or trusts under which our mutual funds are organized. Our registered investment companies or trusts are currently Hennessy Funds, Inc., Hennessy Mutual Funds, Inc. and Hennessy Funds Trust. Our management agreement with Hennessy Funds, Inc. covers the Hennessy Total Return Fund and Hennessy Balanced Fund; with Hennessy Mutual Funds, Inc. covers the Hennessy Cornerstone Growth Fund, the Hennessy Cornerstone Value Fund and the Hennessy Focus 30 Fund; and with Hennessy Funds Trust covers the Hennessy Cornerstone Growth Fund, Series II. Under these agreements, we are responsible for overall investment and management services, subject to the oversight of the applicable board of directors or trustees and according to each mutual fund's particular fundamental investment objectives and policies. The boards of each of Hennessy Funds, Inc., Hennessy Mutual Funds, Inc. and Hennessy Funds Trust consist of four individuals, including our chairman of the board, president and chief executive officer, Neil J. Hennessy, and three independent directors or trustees. Under the Investment Company Act of 1940, a majority of the independent directors or trustees must approve the entry into and continuation of our management agreements. The independent directors also have sole responsibility for selecting and nominating other independent directors or trustees.

We also provide any ordinary clerical and bookkeeping services needed by our mutual funds that are not provided by the funds' custodian, administrator or transfer agent. We fulfill requests for information about our mutual funds or pay the fulfillment expenses that our mutual funds would otherwise incur.

In exchange for all of these services, we receive a management fee from each of our mutual funds, which is based on the amount of each fund's average daily net assets. The annual management fees payable to us by our mutual funds are as follows:

Fund	Management Fee (as a percentage of fund assets)
Hennessy Cornerstone Growth Fund	0.74
Hennessy Cornerstone Growth Fund, Series II	0.74
Hennessy Focus 30 Fund	0.74
Hennessy Cornerstone Value Fund	0.74
Hennessy Total Return Fund	0.60
Hennessy Balanced Fund	0.60

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In the past, we have had contractual obligations for the partial waiver or limiting of our management fees for our funds, but such obligations are now expired. We may still choose to voluntarily waive part of our management fees in order to maintain competitive expense ratios for the funds.

Our management agreements must be renewed annually by a majority of the directors and trustees of the investment companies, and the majority must include a majority of all disinterested directors or trustees. Two other circumstances might lead to termination of the management agreements: the assignment of a management agreement to another advisor automatically terminates the agreement (assignment includes indirect assignment, which is the transfer of our common stock in sufficient quantities deemed to constitute a controlling block), and the termination of the agreement, via written notice, by our firm or by one of the funds' investment companies which causes termination after 60 days of the notice. The current management agreements were renewed by the Board of Directors of the Hennessy Funds, Inc. and Hennessy Mutual Funds, Inc. and by the trustees of the Hennessy Funds Trust on March 6, 2007 for a period of one year.

Shareholder Services

In addition to our management agreements, we also have shareholder servicing agreements covering the Hennessy Cornerstone Growth Fund, Hennessy Cornerstone Growth Fund, Series II, Hennessy Focus 30 Fund, Hennessy Cornerstone Value Fund, Hennessy Total Return Fund and Hennessy Balanced Fund. We have provided shareholder services under a shareholder servicing agreement to the Hennessy Cornerstone Growth Fund and Hennessy Cornerstone Value Fund since October 2003, to the Hennessy Focus 30 Fund since June 30, 2005, to the Hennessy Cornerstone Growth Fund, Series II since July 1, 2005, and to the Hennessy Total Return Fund and Hennessy Balanced Fund since July 1, 2007. Under these agreements, we provide administrative support services to these funds, including, among other things, the following:

maintaining an 800 number that current fund shareholders may call to ask questions about the funds or their accounts with the funds;

assisting shareholders in processing exchange and redemption requests;

assisting shareholders in changing dividend options, account designations and addresses;

responding generally to shareholder questions; and

providing other similar services that the funds may request.

In exchange for these services, we receive an annual shareholder servicing fee from each of the above-named funds of 0.10% of the funds' average daily net assets.

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12b-1 Plan

The Hennessy Total Return Fund and Hennessy Balanced Fund have each adopted a 12b-1 plan. Under Rule 12b-1 of the Investment Company Act of 1940, mutual funds can adopt a plan that allows them to make payments to third parties in connection with the distribution of their fund shares. Such distribution activities might include: advertising; compensation paid to financial institutions, broker-dealers, and others for sales and marketing; shareholder accounting services; the printing and mailing of prospectuses to other than existing shareholders; and the printing and mailing of sales literature. Mutual funds can also employ a distributor to distribute and market mutual fund shares. 12b-1 fees can be used to pay the distributor for expenses incurred for telephone costs, overhead costs, costs of employees who engage in or support the distribution of the fund shares, the printing of prospectuses and other reports for other than existing shareholders, advertising and the preparation and distribution of sales literature. The 12b-1 plan adopted by the Hennessy Total Return Fund and the Hennessy Balanced Fund authorizes each fund to make payments at an annual rate not to exceed 0.25% of each Fund's average daily net assets. At its meeting on June 5, 2007, the Board of Directors approved a 0.10% reduction of the 12b-1 fee accrual. Effective July 1, 2007, the Total Return and Balanced Funds Plan will accrue 12b-1 fees at a rate of 0.15% of the average net assets of each fund for the activities described above. The SEC has considered changes to Rule 12b-1 of the Investment Company Act of 1940 and although no specific proposals are currently pending, changes to Rule 12b-1 could restrict our current practices.

Custodial and Brokerage Arrangements

All shareholder funds are held by third party custodians. Independent brokerage firms execute all trades for our funds, at our direction.

Currently, we participate in two soft dollar arrangements. This means that we receive research reports and real-time electronic research to assist us in trading and managing our mutual funds. Under these soft dollar arrangements, we pay brokerage commissions for securities trades on behalf of a mutual fund that may be higher than the commissions that we would pay through a different brokerage firm, but in exchange we receive research or other services that benefit our mutual funds. Last year the SEC provided new guidance regarding soft dollars. Our soft dollar arrangements comply with the new guidance. This new guidance had no material effect on our business.

License Agreement

Our ability to use the names and formulaic investment strategies of the funds now known as the Hennessy Cornerstone Growth Fund and Hennessy Cornerstone Value Fund are governed by the terms and conditions of a license agreement, dated as of April 10, 2000, with Netfolio, Inc. Under the license agreement, Netfolio, Inc. granted us a perpetual, paid-up, royalty-free, exclusive license to use certain marks, such as Strategy Indexing, Cornerstone Growth and Cornerstone Value, as well as the formula investment strategies used by the Hennessy Cornerstone Growth Fund and Hennessy Cornerstone Value Fund. All of our advertising, marketing, promotional and other materials incorporating or referring to the marks are subject to the prior written approval of Netfolio, Inc., except that we do not need Netfolio Inc.'s prior written approval to use the marks in a manner that is not substantially unchanged from any prior use by Netfolio, Inc. in its own business or from any prior use by us previously approved by Netfolio, Inc. We can assign the license to another person or entity if the assignee agrees in writing to be bound by the terms of the license agreement. There are no ongoing licensing fees associated with this license agreement and Netfolio, Inc. does not have any contractual rights to terminate the license agreement.

Business Strategy

From 1996, when we started our first mutual fund, until September 30, 2007, we have grown our assets under management to \$1.72 billion. We intend to continue increasing our profitability and assets under management by implementing the following key strategies:

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-Utilizing our branding and marketing campaign for growth.

We believe that we can attract investors to our mutual funds by effectively marketing our unique quantitative investment style. We believe that our investment philosophy appeals to investors who want to understand exactly how their investments are managed and who favor statistical analysis and empirical evidence as the basis for investment decisions. We will continue our efforts to make Hennessy a name readily recognizable by investors through frequent print media, radio and television appearances. We use our media appearances to convey to investors that we manage our funds with the discipline and consistency of an index fund by never straying from our strategies. We believe that a straightforward, quantitative approach is easily understood by investors and makes them more likely to recommend us to others by word of mouth. As our brand recognition broadens, we believe that our investment philosophy will generate organic growth through new investments in our mutual funds.

-Expanding our distribution network to additional mutual fund supermarkets.

One of the ways that investors can buy shares of our mutual funds is through mutual fund supermarkets, principally Schwab, Fidelity, TD Ameritrade and Pershing. Mutual fund supermarkets can offer funds of many different investment companies to investors, often without a transaction fee or sales charge to the investor. Instead of charging a fee to investors, mutual fund supermarkets are reimbursed for their services by the applicable fund or that fund's investment advisor. This ability to purchase various mutual funds at no cost in a single location is very attractive to investors. Mutual fund supermarkets have been a significant source of our asset growth. Of the \$1.72 billion of assets under management in our mutual funds as of September 30, 2007, approximately 66% of those assets came from mutual fund supermarkets. We see continued opportunities to form new relationships with mutual fund supermarkets, thereby enhancing the accessibility of our no-load mutual funds to investors.

-Increasing our current base of investment professionals who utilize no-load mutual funds for their clients.

Investment professionals generally have a wide variety of investment products that they can recommend to their clients. A recommendation by an investment professional to a client to buy one of our mutual funds can be very influential to that client. Thus, we believe that expanding our current base of investment professionals who utilize no-load funds for their clients will help us increase the amount of assets that we manage, which will in turn increase our revenues.

-Securing participation in the platforms of national full-service firms that permit their investment professionals to utilize no-load funds for their clients.

We will strive to continue developing relationships with national full-service firms that permit their investment professionals to offer no-load funds to their clients as a way to increase the amount of assets that we manage, which will in turn increase our revenues.

-Pursuing selective acquisitions.

We selectively consider strategic acquisitions of management agreements of additional mutual funds. Through our acquisition strategy, we have added over \$832 million of net assets to our family of mutual funds over a period of approximately five years. We believe there are a number of attractive acquisition opportunities from smaller mutual fund managers who are reaching retirement age or whose investment strategy does not lend itself to the economies of scale inherent in our strictly quantitative approach. We have been able to offer lower overall expense ratios to the shareholders of acquired funds as well as improved performance.

-Deliver strong, high quality financial results.

We seek to manage our investment management business to the highest regulatory, ethical and business standards while strenuously controlling costs and creating high margins for the Hennessy shareholders. Because we apply quantitative investment strategies, we have been able to rapidly increase assets under management, through both acquisitions and organic growth, while maintaining a small staff.

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Marketing

We generate all of our operating revenues by providing management and shareholder services to the mutual funds. The revenues that we receive from the mutual funds are based on the amount of average daily net assets in the funds and thus, we can increase our revenues by growing the amount of net assets in the funds. One of the best ways we can grow the assets of the mutual funds is by delivering strong investment performance, which we believe should:

result in an increase in the value of existing assets in the funds;

encourage more investors to buy shares of our mutual funds and decrease the number of investors who redeem their shares and leave our mutual funds; and

motivate current investors to invest additional money in our mutual funds.

We have developed an aggressive public relations outreach program to target audiences we would otherwise be unable to address. Our public relations outreach program has resulted in Hennessy Funds being mentioned in national print and broadcast media an average of once every three to four days in such vehicles as CNBC, Fox News, The Wall Street Journal, The New York Times, Smart Money, Barron's, and Investors Business Daily, to name a few.

We also send quarterly information mailings, fund performance updates, news articles pertaining to the funds and commentaries from our portfolio manager, Neil J. Hennessy, to clients and prospective clients, and we exhibit at select investment advisor trade shows throughout the year.

Acquisition Strategy and Market Opportunity

We believe that we are well positioned to experience organic growth, and possibly growth by acquisition, in the future. Our scalable business model allows us to increase our profit margins as assets under management grow, since we do not need to add personnel proportional to the increase in assets under management.

Together with organic growth, our growth strategy revolves around the acquisition of management agreements. An attractive acquisition target for us is a retail-oriented, no-load mutual fund with less than \$500 million in assets. We believe the regulatory burden imposed upon the mutual fund industry has compressed the margins of smaller mutual fund managers, making those managers more receptive to an acquisition. We believe that we are well positioned to benefit from these attractive acquisition trends and from the increasing supply of potential targets.

Investment Strategy

We manage each of the Hennessy Funds using a quantitative stock selection strategy that we have evaluated and tested over historical periods for hypothetical performance results. We manage our funds according to strict, formulaic investment strategies and do not try to outsmart or time the market. We purchase a portfolio of securities for each of our mutual funds, as dictated by the funds' strategies, and only adjust or rebalance those portfolios approximately once a year. A brief description of each of our mutual funds follows:

-Hennessy Cornerstone Growth Fund (HFCGX). The Hennessy Cornerstone Growth Fund seeks long-term growth of capital by investing primarily in small-cap, growth-oriented companies. This fund screens a universe of stocks with a market capitalization of more than \$175 million, a price-to-sales ratio of less than 1.5, higher annual earnings than in the previous year and positive relative strength over the prior three- and six-month periods. From that list, the fund invests in the 50 stocks with the best relative strength over the past year.

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-Hennessy Cornerstone Growth Fund, Series II (formerly known as The Henlopen Fund) (HENLX). The Hennessy Cornerstone Growth Fund, Series II seeks long-term capital appreciation. This fund utilizes the same investment strategy as the Hennessy Cornerstone Growth Fund but selects its portfolio at a different time of the year, thus creating a substantially different portfolio of stocks.

-Hennessy Focus 30 Fund (HFTFX). The Hennessy Focus 30 Fund seeks long-term growth of capital by investing in mid-cap, growth-oriented companies. This fund's strategy is similar to the Cornerstone Growth strategy, but it focuses on domestic, mid-cap companies. This fund screens a universe of U.S. stocks with a market capitalization of between \$1 to \$10 billion, excluding American Depository Receipts and stocks with a share price of less than \$5, to find companies with a price-to-sales ratio of less than 1.5, higher annual earnings than in the previous year and positive stock price appreciation over a three- and six-month period. From that list, the fund invests in the 30 stocks with the best relative strength over the past year.

-Hennessy Cornerstone Value Fund (HFCVX). The Hennessy Cornerstone Value Fund seeks total return, consisting of capital appreciation and current income, by investing in dividend-paying, large-cap companies. This fund screens a universe of stocks to find companies with above average market capitalization, shares outstanding, cash flow and 12-month sales that are at least 50% higher than average. From that list, the fund invests in the 50 stocks with the highest dividend yield, which is calculated as the annual dividends paid by a company divided by the per share price of its stock.

-Hennessy Total Return Fund (HDOGX). The Hennessy Total Return Fund seeks total return, consisting of capital appreciation and current income, and seeks to exceed, in the long run, the returns of the Dow Jones Industrial Average but with lower associated risk. Through the defined strategy of the fund, approximately 75% of its return is based on the 10 highest dividend yielding common stocks of the Dow Jones Industrial Average and the remaining 25% of its return is based on U.S. Treasury securities with a maturity of less than one year. The 10 highest dividend yielding stocks in the Dow Jones Industrial Average are commonly referred to as the "Dogs of the Dow" stocks.

-Hennessy Balanced Fund (HBF BX). The Hennessy Balanced Fund seeks a combination of capital appreciation and current income by investing approximately fifty percent in the Dogs of the Dow stocks and approximately fifty percent in U.S. Treasury securities with a maturity of less than one year.

Historical Fund Investment Performance

The following table presents the average annualized returns for each of our mutual funds and the relevant benchmark indices for the one-year, three-year, five-year, ten-year and since inception periods ended September 30, 2007. Although we did not begin managing the Hennessy Cornerstone Growth Fund and Hennessy Cornerstone Value Fund until June 2000, we have included historical performance information for these funds from their inception date of November 1, 1996 because the previous investment manager to these funds managed the funds using the same strategies that we still use today. Returns are presented net of all expenses borne by mutual fund shareholders, but are not net of fees waived or expenses borne by us. The past investment performance of our mutual funds is no guarantee of future performance and all of these mutual funds have experienced negative performance over various time periods in the past and may do so again in the future:

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	1 Year	3 Years	5 Years	10 Years	Since Inception (11/01/96)
Hennessy Cornerstone Growth Fund					
Average Annual Total Return	14.65%	14.72%	17.10%	11.67%	15.04%
S&P 500 (1)(2)	16.44%	13.14%	15.45%	6.57%	9.10%
Russell 2000 Index (2)(3)	12.34%	13.36%	18.75%	7.22%	9.61%
	1 Year	3 Years	5 Years	10 Years	Since Inception (7/01/05)
Hennessy Cornerstone Growth Fund, Series II					
Average Annual Total Return	7.48%	N/A	N/A	N/A	5.79%
S&P 500 (1)(2)	16.44%	N/A	N/A	N/A	13.63%
Russell 2000 Index (2)(3)	12.34%	N/A	N/A	N/A	11.83%
	1 Year	3 Years	5 Years	10 Years	Since Inception (09/17/03)
Hennessy Focus 30 Fund					
Average Annual Total Return	18.18%	23.36%	N/A	N/A	19.32%
S&P 500 (1)(2)	16.44%	13.14%	N/A	N/A	12.38%
S&P Mid-cap Index (2)(6)	18.76%	15.63%	N/A	N/A	15.15%
	1 Year	3 Years	5 Years	10 Years	Since Inception (11/01/96)
Hennessy Cornerstone Value Fund					
Average Annual Total Return	13.85%	12.60%	15.44%	7.69%	8.43%
S&P 500 (1)(2)	16.44%	13.14%	15.45%	6.57%	9.10%
Russell 1000 Index (2)(4)	16.90%	13.77%	15.98%	6.86%	9.34%
	1 Year	3 Years	5 Years	10 Years	Since Inception (07/29/98)
Hennessy Total Return Fund					
Average Annual Total Return	12.24%	11.86%	13.16%	N/A	5.50%
S&P 500 (1)(2)	16.44%	13.14%	15.45%	N/A	5.05%
Dow Jones Industrial Average (2)(5)	21.69%	13.87%	15.44%	N/A	7.08%
	1 Year	3 Years	5 Years	10 Years	Since Inception (03/08/96)
Hennessy Balanced Fund					
Average Annual Total Return	9.71%	7.72%	7.87%	4.10%	5.50%
S&P 500 (1)(2)	16.44%	13.14%	15.45%	6.57%	9.70%
Dow Jones Industrial Average (2)(5)	21.69%	13.87%	15.44%	7.86%	10.55%

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- (1) The S&P 500 is the Standard & Poor's Composite Index of 500 stocks, a widely recognized index of common stocks.
 - (2) Reflects no deduction for fees or expenses.
 - (3) The Russell 2000 Index is a recognized small-cap index of the 2,000 smallest stocks of the Russell 3000 Index, which is comprised of the 3,000 largest U.S. stocks as determined by total market capitalization.
 - (4) The Russell 1000 Index is comprised of large-cap U.S. stocks and is commonly used as a benchmark for U.S. large-cap funds.
 - (5) The Dow Jones Industrial Average is an index of common stocks comprised of major industrial companies and assumes reinvestment of dividends.
 - (6) The S&P Mid-cap Index is a widely recognized index of common stocks.
- Development of New Investment Strategies

We begin developing new investment strategies by identifying client needs and reviewing asset allocation tables to determine where we can augment our family of mutual funds. Once we identify an attractive market segment, we develop a new investment strategy by screening the appropriate universe of stocks with a set of parameters that we believe identify stocks that will produce higher long-term returns with lower associated risk than their relative indices. We introduce new investment strategies into the marketplace by opening and directly marketing a new mutual fund, by acquiring the management agreement for an existing mutual fund and implementing our new strategy or potentially by changing the investment strategy of one of our existing funds.

The creation of a new Large Cap Growth Fund and a new non-registered private pooled investment fund were approved by the Board of Directors in May, 2007, as noted in our Form 8-K filed May 3, 2007. As of September 30, 2007, neither fund had begun operations.

Competition

We face substantial competition in the investment management industry. The investment management industry is characterized by a relatively low cost of entry and by the formation of new investment management entities that may compete directly with us. We compete directly with a large number of global and U.S. investment advisors, commercial banks, brokerage firms, broker-dealers, insurance companies and other financial institutions. These institutions range from small boutique firms to large financial service complexes. We compete on a wide variety of factors, including:

investment performance of our mutual funds;

expense ratio of our mutual funds;

product offerings;

quality of service;

brand recognition; and

business reputation.

We are considered a small investment management firm. Many competing firms are part of larger financial services companies and have greater marketing, financial, technical, research and other capabilities. Most larger firms offer a broader range of financial services than we do and compete with us for retail and institutional clients. Nonetheless, we have learned to compete successfully with these firms by creating unique investment strategies and by branding our investment style through public relations and outstanding customer service.

Our mutual funds also face competition, primarily from nationally and regionally distributed funds that offer equivalent financial products with returns equal to or greater than those we offer. The competition for new investors is intense, but we feel that by increasing our mutual funds distribution channels and continuing to brand our investment style, we can capture portions of the available investment business.

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Regulation

Virtually all aspects of our business are subject to federal and state laws and regulations. These laws and regulations are primarily intended to protect shareholders of registered investment companies and clients of registered investment advisors. We believe that we are in compliance in all material respects with all laws and regulations.

We are registered as an investment advisor with the Securities and Exchange Commission (SEC). As a registered investment advisor, we must comply with the requirements of the Investment Advisors Act of 1940 and related SEC regulations. Such requirements relate to, among other things, fiduciary duties to clients, engaging in transactions with clients, maintaining an effective compliance program, solicitation arrangements, conflicts of interest, advertising, limitations on agency cross and principal transactions between an advisor and advisory clients, recordkeeping and reporting requirements, disclosure requirements and general anti-fraud provisions. Our mutual funds are registered with the SEC under the Investment Company Act of 1940. The Investment Company Act of 1940 imposes additional obligations on both the funds and the advisor, including detailed operational requirements. The SEC is authorized to institute proceedings and impose sanctions for violations of the Investment Advisors Act and Investment Company Act, ranging from fines and censures to termination of an investment advisor's registration. Our failure to comply with the SEC requirements could have a material adverse effect on us. We believe we are in compliance with SEC requirements.

In response to the 2001 to 2004 scandals in the financial services industry regarding late trading, market timing and the selective disclosure of portfolio information, the U.S. Congress and the various regulatory agencies that supervise our operations have adopted various legislative and regulatory proposals. The SEC, other regulators and Congress continue to investigate certain practices in our industry. In addition, we are subject to periodic examination by the SEC under SEC rules and regulations. The most recent SEC examination occurred in August, 2007 for the period of January 1, 2005 to June 30, 2007. The findings of the examination were minor in nature and did not have any effect on our financial statements.

At the end of 2003, the SEC adopted rules requiring investment advisors and investment companies to adopt written compliance programs designed to prevent violations of the federal securities laws. These compliance programs must be reviewed annually for adequacy and effectiveness. Investment advisors and investment companies must also designate a chief compliance officer to implement the compliance policies and procedures and to report directly to the fund's board of directors or trustees.

Over the past several years, Congress has occasionally advanced the ideas of eliminating asset-based distribution fees or Rule 12b-1 fees for open-end funds. The changes could prohibit revenue sharing, which allows a mutual fund company to pay for shelf space at brokerage firms or other intermediaries selling mutual shares. Although such reforms have been advanced, they have not been adopted. Should adoption occur, it may become more expensive for us to distribute and manage our mutual funds.

Because many regulations are subject to varying interpretations, our firm's compliance with these regulations subjects it to a number of risks. Regulators make periodic examinations and review annual, monthly and other reports on our operations, track record and financial condition. In the event that we violate or fail to comply with an applicable law or regulation, governmental regulators may institute administrative or judicial proceedings against us that could result in censures, fines, compensation orders, civil penalties, criminal penalties, the issuance of cease-and-desist orders, the deregistration or suspension of our firm, the suspension or disqualification of our officers or employees and other adverse consequences. We have not experienced any such penalties to date. Such violations or non-compliance could also subject us and/or our employees to civil actions by private persons.

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EMPLOYEES

As of September 30, 2007, Hennessy Advisors, Inc. employed twelve full-time employees and one part-time employee.

Neil J. Hennessy is the Chairman of the Board, President, Chief Executive Officer and Portfolio Manager. Teresa M. Nilsen is an Executive Vice President, Chief Financial Officer, Secretary and a Director. Daniel B. Steadman is an Executive Vice President in charge of expansion and a Director. Frank Ingarra is responsible for stock trading and is the Assistant Portfolio Manager of our mutual funds. Other employees include Tania Kelley, Marketing Director; Harry Thomas, Chief Compliance Officer; Brian Peery, Wholesaler/Salesman; Dominic Chu, Portfolio Specialist; Kathryn Walwyn, Controller; Ana Miner, Operations Specialist; Joseph Fahy, Internal Salesman; Michelle Hennessy, Receptionist and Marketing Associate; and, Lauren Puliafico, Receptionist.

ITEM 1A. RISK FACTORS

Risks relating to our business

-Our revenues will decline if the value of the securities held by the mutual funds we manage declines.

We derive all of our operating revenues from management and shareholder servicing fees paid to us by the mutual funds we manage. These fees are calculated as a percentage of the average daily net assets of our mutual funds and vary from fund to fund. The securities markets are inherently volatile and may be affected by factors beyond our control, including global economic conditions, interest rate fluctuations, inflation rate increases and other factors that are difficult to predict. Volatility in the securities markets, and the equity markets in particular, could reduce the net assets of our mutual funds and consequently reduce our revenues. In addition to declines in the equity markets, failure of these markets to sustain prior levels of growth or continued short-term volatility in these markets could result in investors withdrawing their investments from our mutual funds or decreasing their rate of investment, either of which would likely adversely affect our revenues. This risk is further discussed and quantified in Item 7A in this Annual Report to form 10-K.

-Investors in our mutual funds can redeem their investments in our funds at any time and for any reason, including poor investment performance, which would adversely affect our revenues.

Fund investors may redeem their investments in any of our mutual funds at any time and for any reason without prior notice. Investors may also reduce the total amount of assets that they have invested with us for a number of reasons, including our investment performance, changes in prevailing interest rates and financial market performance. Success in the investment management and mutual fund business is dependent on investment performance, as well as distribution and client servicing. If our mutual funds perform poorly compared to the mutual funds of other investment management firms, we may experience a decrease in purchases of shares of our mutual funds and an increase in redemptions of shares of our mutual funds. A decrease in the net assets of our mutual funds would adversely affect our revenues.

-Adverse opinions of our mutual funds by third party rating agencies or industry analysts could decrease new investments in or accelerate redemptions from our mutual funds, which would adversely affect our revenues.

Many investors rely heavily on the opinions of third party rating agencies and industry analysts when making decisions to purchase or redeem shares of mutual funds. Adverse opinions regarding our mutual funds could erode investor confidence, potentially leading to a decrease in new investments and an increase in redemptions, thereby reducing the net assets of our mutual funds. A decrease in the net assets of our mutual funds would adversely affect our revenues.

-Investor behavior is influenced by short-term investment performance of mutual funds. Poor short-term performance of our mutual funds could cause a decrease in new investments in or accelerate redemptions from our mutual funds, which would adversely affect our revenues.

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Investor behavior may be based on many factors, including short-term investment performance. Poor short-term performance of our mutual funds, irrespective of longer-term success, could potentially lead to a decrease in new investments and an increase in redemptions, thereby reducing the net assets of our mutual funds. A decrease in the net assets of our mutual funds would adversely affect our revenues.

-We utilize quantitative investment strategies that require us to invest in specific portfolios of securities and hold these positions for approximately one year. Entering into, maintaining or liquidating one or more of these positions in accordance with our investment strategies could have a material adverse effect on the performance of our mutual funds.

We adhere to the investment strategies for each of our mutual funds during the annual rebalancing period and throughout the course of the year. Adhering to our investment strategies during the annual rebalancing of our mutual funds may result in the elimination of better performing assets from our funds' portfolios and an increase in investments with relatively lower total return. Additionally, we will maintain a position in a relatively poorly performing security throughout the course of the portfolio holding period. Either of these actions could result in relatively lower performance of our mutual funds and adversely affect the net assets of our mutual funds. A decrease in the net assets of our mutual funds would adversely affect our revenues.

-We depend upon Neil J. Hennessy to manage our business. The loss of Mr. Hennessy may adversely affect our business and financial condition.

Our success is largely dependent on the skills, experience and performance of key personnel, particularly Neil J. Hennessy, our chairman of the board, chief executive officer and president. Mr. Hennessy is primarily responsible for the marketing and management of the portfolio of each of our mutual funds, developing new investment strategies and executing each existing fund's investment program. Mr. Hennessy is also our spokesperson and spearheads our marketing and public relations campaign. The loss of Mr. Hennessy could have an adverse effect on our business, financial condition and results of operations.

-Our business is extensively regulated and our