National Interstate CORP
Form 10-Q
May 12, 2005

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ **Quarterly Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2005
OR

o **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 000-51130

National Interstate Corporation

(Exact name of registrant as specified in its charter)

Ohio	**34-1607394**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

3250 Interstate Drive
Richfield, Ohio 44286-9000
(330) 659-8900
(Address and telephone number of principal executive offices)

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. þ Yes £ No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). £Yes þ No

The number of shares outstanding of the registrant s sole class of common shares as of May 1, 2005 was 18,965,200.

National Interstate Corporation
Table of Contents

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. *Financial Statements*

National Interstate Corporation and Subsidiaries

Consolidated Balance Sheets
(Dollars in thousands, except per share data)

	March 31, 2005 (Unaudited)	December 31, 2004
ASSETS		
Investments:		
Fixed maturities available-for-sale, at fair value (amortized cost $236,911 and $205,711, respectively)	$ 234,096	$ 206,221
Equity securities available-for-sale, at fair value (cost $20,197 and $16,522, respectively)	20,114	16,841
Short-term investments, at cost which approximates fair value	27,773	5,280
Total investments	281,983	228,342
Cash and cash equivalents	8,931	10,609
Accrued investment income	2,490	2,344
Premiums receivable, net of allowance for doubtful accounts of $371 and $361, respectively	87,262	45,129
Reinsurance recoverables on paid and unpaid losses	68,911	63,128
Prepaid reinsurance premiums	32,449	16,190
Deferred policy acquisition costs	15,902	11,606
Deferred federal income taxes	8,578	6,400
Property and equipment, net	11,578	11,738
Funds held by reinsurer	2,844	3,599
Other assets	961	2,151
Total assets	$ 521,889	$ 401,236
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and loss adjustment expenses	$ 185,343	$ 171,031
Unearned premiums	127,623	80,928
Long-term debt	17,235	17,547
Note payable to affiliate		15,000
Amounts withheld or retained for account of others	17,083	14,911
Reinsurance balances payable	21,889	3,429
Other accounts payable	19,685	14,432
Commissions payable	7,017	4,719
Assessments and fees payable	7,821	6,450

Total liabilities		403,696		328,447
Shareholders equity:				
Preferred shares no par value				
Authorized 10,000,000 shares				
Issued 0 shares				
Common shares $0.01 par value				
Authorized 50,000,000 shares				
Issued 23,350,000 and 20,000,000 shares, including 4,384,800 and 4,470,400, respectively, shares in treasury		234		200
Additional paid-in capital		41,800		1,264
Retained earnings		84,241		77,102
Accumulated other comprehensive (loss) income		(1,885)		539
Treasury shares		(6,197)		(6,316)
Total shareholders equity		118,193		72,789
Total liabilities and shareholders equity	$	521,889	$	401,236

See notes to consolidated financial statements.

1

Table of Contents

National Interstate Corporation and Subsidiaries

Consolidated Statements of Income
(Unaudited)
(In thousands, except per share data)

	Three months ended March 31,	
	2005	**2004**
Revenue:		
Premiums earned	$ 43,177	$ 32,996
Net investment income	2,667	1,757
Realized gains on investments	115	692
Other	2,044	1,781
Total revenues	48,003	37,226
Expenses:		
Losses and loss adjustment expenses	26,067	19,898
Commissions and other underwriting expense	8,788	7,878
Other operating and general expenses	1,984	1,619
Interest expense	401	254
Total expenses	37,240	29,649
Income before federal income taxes	10,763	7,577
Provision for federal income taxes	3,608	2,594
Net income	$ 7,155	$ 4,983
Net income per common share basic	$ 0.40	$ 0.33
Net income per common share diluted	$ 0.39	$ 0.32
Weighted average of common shares outstanding, basic	17,941	15,024
Weighted average of common shares outstanding, diluted	18,199	15,379

See notes to consolidated financial statements.

Table of Contents

National Interstate Corporation and Subsidiaries

Consolidated Statement of Shareholders Equity
(Unaudited)
(Dollars in thousands)

	Common Shares	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Shares	Total
Balance at January 1, 2005	$ 200	$ 1,264	$ 77,102	$ 539	$ (6,316)	$ 72,789
Net Income			7,155			7,155
Unrealized depreciation of investment securities, net of tax benefit of $1,305				(2,424)		(2,424)
Comprehensive income						4,731
Proceeds from initial public offering	34	40,410				40,444
Issuance of 85,600 treasury shares upon exercise of stock options		33	(16)		119	136
Tax benefit realized from exercise of stock options		93				93
Balance at March 31, 2005	$ 234	$ 41,800	$ 84,241	$ (1,885)	$ (6,197)	$ 118,193

See notes to consolidated financial statements.

Table of Contents

National Interstate Corporation and Subsidiaries

Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

	Three months ended March 31,	
	2005	**2004**
Operating activities		
Net income	$ 7,155	$ 4,983
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of bond premiums and discounts	196	136
Provision for depreciation and amortization	293	293
Net realized gain on investment securities	(115)	(692)
Tax benefit realized from exercise of stock options	93	
Deferred federal income taxes	(874)	(1,337)
Increase in deferred policy acquisition costs, net	(4,296)	(2,558)
Increase in reserves for losses and loss adjustment expenses	14,312	8,844
Increase in premiums receivable	(42,133)	(33,826)
Increase in unearned premiums and service fees	46,695	56,600
Increase in interest receivable, prepaid reinsurance premiums and other assets	(14,481)	(32,562)
Increase in accounts payable, commissions and other liabilities, premiums and other funds collected from others and assessments and fees payable	11,094	7,301
Increase in reinsurance recoverable	(5,783)	(3,848)
Increase in reinsurance balances payable	18,460	17,243
Other	(2)	
Net cash provided by operating activities	30,614	20,577
Investing activities		
Purchases of investments	(77,380)	(53,964)
Proceeds from sale or maturity of investments	19,929	40,646
Purchases of property and equipment	(109)	(215)
Net cash used in investing activities	(57,560)	(13,533)
Financing activities		
Proceeds from IPO of common shares	40,444	
Repayment of note payable to affiliate	(15,000)	
Repayment of mortgage loan and notes payable	(312)	(416)
Issuance of common shares from treasury upon exercise of stock options	136	
Net cash provided by (used in) financing activities	25,268	(416)
Net (decrease) increase in cash and cash equivalents	(1,678)	6,628
Cash and cash equivalents at beginning of period	10,609	21,610
Cash and cash equivalents at end of period	$ 8,931	$ 28,238

See notes to consolidated financial statements.

Table of Contents

NATIONAL INTERSTATE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)
(Dollars in thousands, except share data)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of National Interstate Corporation and its subsidiaries (the Company) have been prepared in accordance with Form 10-Q and Article 10 of Regulation S-X instructions. Accordingly, the financials do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2004. The interim financial statements reflect all adjustments which are, in the opinion of management, necessary for the fair presentation of the results for the periods presented. Such adjustments are of a normal recurring nature. Operating results for the three-month period ended March 31, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005.

Historical financial statements have been adjusted to reflect the 200-for-1 common share split effective December 6, 2004 and the reclassification of all Class A common shares as common shares effective immediately prior to the Company s February 2005 initial public offering (IPO). The Company has neither paid nor declared dividends for the three months ended March 31, 2005 and 2004.

The preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Changes in circumstances could cause actual results to differ materially from those estimates.

2. Quarterly Operating Results As Corrected (Unaudited)

The Quarterly Operating Results that were stated in Note 18 in the 2004 Form 10-K Notes to Consolidated Financial Statements contained a clerical error. The net earnings, net income per share basic and net income per share diluted amounts for the first three quarters of 2004 were incorrectly stated due to this clerical error. The same error occurred in Note 17 in the Form S-1 Notes to Consolidated Financial Statements. The Consolidated Statements of Income for both the year ended December 31, 2004 and the nine months ended September 30, 2004 were correctly stated in the Form 10-K and Form S-1, respectively. The 2004 quarterly results will be correctly presented on a prospective basis. The original amounts from the Form 10-K Notes to Consolidated Financial Statements (Note 18) and the quarterly operating results as corrected are shown in the following table:

2004 (*As stated in Form 10-K)*	**1st Quarter**	**2nd Quarter**	**3rd Quarter**	**4th Quarter**	**Total Year**
Revenues	$ 37,226	$ 44,992	$ 43,309	$ 46,181	$ 171,708
Net earnings	4,138	6,046	5,931	6,653	22,768
Net income per share basic	0.28	0.40	0.39	0.43	1.50
Net income per share diluted	0.27	0.39	0.38	0.42	1.47

2004 (*As corrected*)	**1st Quarter**	**2nd Quarter**	**3rd Quarter**	**4th Quarter**	**Total Year**
Revenues	$ 37,226	$ 44,992	$ 43,309	$ 46,181	$ 171,708
Net earnings	4,983	6,411	4,721	6,653	22,768
Net income per share basic	0.33	0.43	0.31	0.43	1.50
Net income per share diluted	0.32	0.42	0.31	0.42	1.47

3. Initial Public Offering

In February 2005, National Interstate Corporation (NIC) completed an IPO in which it issued 3,350,000 shares and selling shareholders sold 1,074,000 shares at an initial offering price of $13.50 per share. Proceeds from the offering totaled approximately $40.4 million after a deduction for the underwriting discount and offering expenses. Net proceeds were used to repay a loan from NIC s majority shareholder,

Table of Contents

Great American Insurance Company (Great American), with the remainder to be used for other general corporate purposes.

4. Stock-Based Compensation

The Company applies the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25 (APB No. 25), *Accounting for Stock Issued to Employees*, and its related interpretations for its accounting of stock compensation plans for employees. In accordance with the intrinsic value method prescribed by APB No. 25, compensation cost is measured as the excess, if any, of the fair value of the equity instrument awarded at the measurement date over the amount an employee must pay to acquire the equity instrument. Since options are granted at exercise prices equal to the fair value of the shares at the date of grant, no compensation expense is currently recognized.

Statement of Financial Accounting Standard (SFAS) No. 148 , *Accounting for Stock-Based Compensation Transition and Disclosure*, permits entities to continue to apply the provisions of APB No. 25 and provide pro forma net income and pro forma earnings per share disclosures for employee stock option grants as if the fair-value-based method, as defined in SFAS No. 123, *Accounting for Stock-Based Compensation*, had been applied. SFAS No. 148 provides alternative methods of transitioning to SFAS No. 123 s fair value method of accounting for stock-based employee compensation, but does not require companies to account for employee stock options using the fair value method. The Company has elected to continue to apply provisions of APB No. 25 and provide the pro forma disclosures required by SFAS No. 148.

The following table illustrates the effect on net income and earnings per share if the fair value based method described by SFAS No. 148 had been applied to all outstanding and unvested awards in each period. The fair value was calculated using the Black-Scholes option pricing method for options granted during 2005 and the minimum value option pricing method for all prior grants. Both the Black-Scholes method and the minimum value method reflect the value of the right to defer payment of the exercise price until the end of the option s term but the Black-Scholes method also factors in the right to benefit from increases in the price of the underlying share without being exposed to losses beyond the premium paid (volatility value). Therefore, the Black-Scholes method is deemed more appropriate for a publicly traded company than the minimum value method. Due to the change in valuation methods, the computations of the effect on net income and earnings per share for the three months ended March 31, 2005 and 2004 are not comparable.

	Three months ended March 31,	
	2005	**2004**
Net income, as reported	$ 7,155	$ 4,983
Less: Proforma stock option expense, net of tax	200	14
Proforma net income	$ 6,955	$ 4,969
Earnings per share:		
Basic as reported	$ 0.40	$ 0.33
Basic proforma	0.39	0.33
Diluted as reported	0.39	0.32

Diluted proforma	0.38	0.33

The following assumptions were used for grants in the three months ended March 31, 2005 and March 31, 2004.

	Three Months Ended March 31,	
	2005	**2004**
Dividend yield	0.3%	
Volatility	31.0%	
Risk-free interest rate	4.18% - 4.50%	4.37%
Expected Life of grant	10 years	10 years

The estimated weighted-average date of grant fair value of options granted were $6.77 and $1.20 for the three months ended March 31, 2005 and 2004, respectively.

Table of Contents

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123R , *Share-Based Payment*, which replaces SFAS No. 123, *Accounting for Stock-Based Compensation*, and supercedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123R requires compensation costs related to share-based payment transactions to be recognized in the financial statements over the period that an employee provides service in exchange for the award. Public companies are required to adopt the new standard using a modified prospective method and may elect to restate prior periods using the modified retrospective method. Under the modified prospective method, companies are required to record compensation cost for new and modified awards over the related vesting period of such awards prospectively and record compensation cost prospectively for the unvested options, at the date of adoption, of previously issued and outstanding awards over the remaining vesting period of such awards. No change to prior periods presented is permitted under the modified prospective method. Under the modified retrospective method, companies record compensation costs for prior periods retroactively through restatement of such periods using the exact pro forma amounts disclosed in the companies footnotes. Also, in the period of adoption and after, companies record compensation cost based on the modified prospective method. On April 14, 2005, the Securities and Exchange Commission modified the implementation of SFAS No. 123R to be effective for the annual period beginning after June 15, 2005 effectively delaying implementation for the Company until January 1, 2006. Early application of SFAS 123R is encouraged, but not required.

The Company intends to use the modified prospective method to adopt SFAS No. 123R. If the Company were to adopt SFAS No. 123R on January 1, 2006, using the modified prospective method, the Company estimates that total stock-based compensation expense, net of related tax effects, will increase by $668 for the year ending December 31, 2006.

5. Comprehensive Income

Comprehensive income includes the Company s net income plus the changes in the unrealized gains or losses (net of income taxes) on the Company s available-for-sale securities. The details of comprehensive income are reported in the Consolidated Statement of Shareholders Equity. Total comprehensive income was $4,731 and $5,843 for the three months ended March 31, 2005 and 2004, respectively.

6. Note Payable and Long-term Debt

Long-term debt consisted of the following:

	March 31, 2005	December 31, 2004
Junior subordinated debentures	$ 15,464	$ 15,464
Term note payable to bank	1,771	2,083
Note payable to affiliate		15,000
Total notes payable and long-term debt	$ 17,235	$ 32,547

A portion of the net proceeds from the IPO was used to repay the note payable to affiliate during the first quarter of 2005.

7. Premiums, Reinsurance and Transactions with Related Parties

The Company s principal insurance subsidiary, National Interstate Insurance Company (NIIC) is involved in both the cession and assumption of reinsurance. NIIC is a party to a reinsurance agreement, and National Interstate Insurance Agency (NIIA), a wholly-owned subsidiary, is a party to an underwriting management agreement with Great American. The reinsurance agreement calls for the assumption by NIIC of all of the risk on Great American s net premiums written for public transportation and recreational vehicle risks. NIIA provides administrative services to Great American in connection with Great American s underwriting of public transportation risks.

The table below summarizes the reinsurance balance and activity with Great American:

	Three Months Ended March 31,	
	2005	**2004**
Written premiums assumed	$ 2,579	$ 2,757
Assumed premiums earned	2,230	1,805
Assumed losses and loss adjustment expense incurred	1,458	1,621
Payable to Great American as of period end	1,009	2,523

Table of Contents

The Company also cedes premiums through reinsurance agreements with non-affiliated reinsurers to reduce exposure in certain of its property-casualty insurance programs. Ceded losses and loss adjustment expense recoveries recorded for the three months ended March 31, 2005 and 2004 were $7,642 and $3,310 , respectively. The Company remains primarily liable as the direct insurer on all risks reinsured and a contingent liability exists to the extent that the reinsurance companies are unable to meet their obligations for losses assumed. To minimize its exposure to significant losses from reinsurer insolvencies, the Company regularly evaluates the financial condition of its reinsurers.

Premiums and reinsurance activity consisted of the following:

	Three Months Ended March 31,			
	2005		2004	
	Written	**Earned**	**Written**	**Earned**
Direct	$ 100,678	$ 54,037	$ 84,771	$ 43,131
Assumed	2,899	2,829	4,169	3,281
Ceded	(29,948)	(13,689)	(32,449)	(13,416)
Net Premium	$ 73,629	$ 43,177	$ 56,491	$ 32,996

Great American, or its parent American Financial Group, Inc., performs certain services for the Company without charge including, without limitation, actuarial and internal audit services. Management believes, based on discussions with Great American, that these services will continue to be provided by the affiliated entity in future periods and the relative impact on operating results is not material.

8. Commitments and Contingencies

From time to time, the Company is subject to other legal proceedings and claims in the ordinary course of business. In the opinion of management, the effects, if any, of such litigation are not expected to be material to the Company s consolidated financial condition or results of operations. In addition, regulatory bodies, such as state insurance departments, the Securities and Exchange Commission, the Department of Labor and other regulatory bodies may make inquiries and conduct examinations or investigations concerning our compliance with insurance laws, securities laws, labor laws and the Employee Retirement Income Security Act of 1974, as amended, among other things.

Our insurance companies have lawsuits pending where by the plaintiff seeks extra-contractual damages from the Company in addition to damages claimed under an insurance policy. These lawsuits generally mirror similar lawsuits filed against other carriers in the industry. Although we are vigorously defending these lawsuits, the lawsuits are in the early stages of litigation and their outcomes cannot be determined at this time. However, management does not believe these lawsuits will have a material adverse effect on the Company s business, financial condition or results of operations based on management s belief that any adverse outcomes have either been provided for in the loss reserves or such unfavorable result would be immaterial.

The number of insurance companies that are under regulatory supervision has increased, which is expected to result in an increase in assessments by state guaranty funds to cover losses to policyholders of insolvent or rehabilitated companies. These mandatory assessments may be partially recovered through a reduction in future premium taxes in some states. At March 31, 2005 and December 31, 2004, the liability for such assessments was $7,821 and $6,450, respectively, and will be paid over several years as assessed by the guaranty funds.

Table of Contents

9. Earnings Per Common Share

The following table sets forth the computation of basic and diluted income per share:

	Three Months Ended March 31,	
	2005	2004
Net income	$ 7,155	$ 4,983
Weighted average shares outstanding during period	17,941	15,024
Additional shares issuable under employee common stock option plans using treasury stock method	258	355
Weighted average shares outstanding assuming exercise of stock options	18,199	15,379
Net income per share:		
Basic	$ 0.40	$ 0.33
Diluted	0.39	0.32

10. Segment Information

The Company operates its business as one segment, property and casualty insurance. The Company manages this segment through a product management structure. The following table shows revenues summarized by the broader business component description. These business components were determined based primarily on similar economic characteristics, products and services:

	Three Months Ended March 31,	
	2005	2004
Revenue:		
Premiums earned:		
Transportation	$ 16,306	$ 15,168
Alternate Risk Transfer	12,753	7,451
Specialty Personal Lines	8,665	5,547
Hawaii	3,766	3,717
Other	1,687	1,113
Total	43,177	32,996
Net investment income	2,667	1,757
Realized gains on investments	115	692
Other	2,044	1,781
Total revenues	$ 48,003	$ 37,226

(1) Based upon the closing market price of the

Company s common shares on the American Stock Exchange on September 30, 2008, which was $8.00.

Table of Contents

DIRECTOR COMPENSATION

The following table sets forth information regarding fiscal 2008 compensation for each director other than Mr. J. P. Gotschall, whose compensation is set forth above under the heading Executive Compensation .

Director Compensation for Fiscal 2008

Name	Fees Earned or Paid in Cash ($)	All Other Compensation ($) (1)	Total Compensation ($)
Hudson D. Smith	20,000	361,732	381,732
P. Charles Miller, Jr.	23,000	-0-	23,000
Frank N. Nichols	23,000	-0-	23,000
Alayne L. Reitman	29,000	1,000	30,000
J. Douglas Whelan	26,000	-0-	26,000

(1) All other compensation consists of (i) with respect to Mr. H. D. Smith, payments made to Forged Aerospace Sales, LLC during fiscal 2008 under the Sales Representative Agreement, further described below, for services other than as director, and (ii) with respect to all directors, amounts contributed by the Company s charitable foundation to educational organizations on

behalf of such
directors.

For fiscal 2008, each director of the Company (other than directors who are employed by the Company) received an annual retainer fee of $12,000 and an attendance fee of $2,000 per Board of Directors meeting and $1,000 per committee meeting. Committee Chairpersons received an additional $3,000 annual retainer for such service. The Company has determined its directors compensation structures based on targeting a competitive level of pay as measured against similarly situated companies.

Mr. H. D. Smith previously held the position of Executive Vice President and Treasurer of the Company. In connection with his resignation from the Company, Mr. Smith entered into a Sales Representative Agreement with the Company, the terms of which are substantially the same as the terms of other agreements the Company maintains with its third-party sales representatives. Compensation under the Sales Representative Agreement, which resulted in payments of $360,500 in fiscal 2008, is based strictly upon earned sales commissions with no guaranteed minimum obligation to Mr. Smith and/or to Forged Aerospace Sales, LLC.

Table of Contents

COMPENSATION COMMITTEE REPORT

The Compensation Committee has reviewed and discussed the above Compensation Discussion and Analysis with management, and based on such review and discussions, has recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement and in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2008 for filing with the SEC.

Compensation Committee
J. Douglas Whelan, Chairperson
Frank N. Nichols
P. Charles Miller, Jr.
Alayne L. Reitman

AUDIT COMMITTEE REPORT

The Audit Committee reviewed and discussed the audited financial statements of the Company, for the fiscal year ended September 30, 2008, with the Company s management and with the Company s independent registered public accounting firm, Grant Thornton LLP. The Audit Committee also discussed with Grant Thornton LLP the matters required to be discussed by the Statement of Auditing Standards No. 61, as amended (Communication with Audit Committees).

The Audit Committee received the written disclosures and the letter from Grant Thornton LLP pursuant to the applicable requirements of the Public Company Accounting Oversight Board certifying the firm s independence and the Audit Committee discussed the independence of Grant Thornton LLP with that firm.

The Audit Committee and the Board of Directors of the Company operate under a written charter as last amended in July 2004.

Based upon the Audit Committee s review and discussions noted above, the Audit Committee recommended to the Board of Directors that the Company s audited financial statements be included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2008 for filing with the SEC.

Audit Committee
Alayne L. Reitman, Chairperson
Frank N. Nichols
P. Charles Miller, Jr.
J. Douglas Whelan

Table of Contents

PRINCIPAL ACCOUNTING FEES AND SERVICES

Audit Fees

Fees paid or payable to Grant Thornton LLP for the audits of the annual financial statements included in the Company s Form 10-K and for the reviews of the interim financial statements included in the Company s Forms 10-Q for the years ended September 30, 2008 and 2007 were $150,500 and $149,000, respectively. The Audit Committee has sole responsibility for determining whether and under what circumstances an independent registered public accounting firm may be engaged to perform audit-related services and must pre-approve any non-audit related service performed by such firm. In fiscal 2008, audit and non-audit related fees, to the extent they were incurred, were pre-approved by the Audit Committee.

Audit-Related Fees

Fees paid or payable to Grant Thornton LLP for audit-related services for the years ended September 30, 2008 and 2007 were $6,000 and $3,000, respectively.

Tax Fees

There were no fees paid or payable during fiscal 2008 or 2007 to Grant Thornton LLP for tax compliance or consulting services.

All Other Fees

There were no fees paid or payable during fiscal 2008 or 2007 to Grant Thornton LLP for products or services other than the professional services described above.

PROPOSAL 2 TO RATIFY THE DESIGNATION OF AUDITORS

The firm of Grant Thornton LLP has been the Company s independent registered public accounting firm since 2002. The Board of Directors has chosen that firm to audit the accounts of the Company and its consolidated subsidiaries for the fiscal year ending September 30, 2009, subject to the ratification of the shareholders for which the affirmative vote of a majority of the Common Shares present and voting at the 2009 Annual Meeting (in person or by proxy) is required. Grant Thornton LLP has advised the Company that neither the firm nor any of its members or associates has any direct or indirect financial interest in the Company or any of its affiliates other than as auditors. The Board of Directors recommends ratification of the selection of Grant Thornton LLP as the independent registered public accounting firm of the Company for the year ending September 30, 2009.

Representatives of Grant Thornton LLP are expected to be present at the 2009 Annual Meeting with the opportunity to make a statement if they desire to do so and to be available to respond to appropriate questions.

Table of Contents

SHAREHOLDER PROPOSALS FOR THE 2010 ANNUAL MEETING OF SHAREHOLDERS

A shareholder who intends to present a proposal at the 2010 Annual Meeting, and who wishes to have the proposal included in the Company s proxy statement and form of proxy for that meeting, must deliver the proposal to the Company no later than August 18, 2009. Any shareholder proposal submitted other than for inclusion in the Company s proxy materials for the 2010 Annual Meeting must be delivered to the Company no later than October 31, 2009 or such proposal will be considered untimely. If a shareholder proposal is received after October 31, 2009, the Company may vote, in its discretion as to the proposal, all of the Common Shares for which it has received proxies for the 2010 Annual Meeting.

OTHER MATTERS

The Company does not know of any other matters that will come before the meeting. In case any other matter should properly come before the 2009 Annual Meeting, it is the intention of the persons named in the enclosed proxy or their substitutions to vote in accordance with their best judgment in accordance with the recommendation of the Board of Directors or, in the absence of such a recommendation, in accordance with their judgment pursuant to the discretionary authority conferred by the enclosed proxy.

By order of the Board of Directors.

SIFCO Industries, Inc.

Daniel G. Berick, Secretary

December 15, 2008

Table of Contents

SIFCO Industries, Inc.

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned hereby appoints JEFFREY P. GOTSCHALL and HUDSON D. SMITH, and each of them, the proxies of the undersigned to vote the shares of the undersigned at the Annual Meeting of Shareholders of SIFCO Industries, Inc., to be held on January 27, 2009, and at any and all adjournments thereof.

Signature

Signature if held jointly

Dated:

NOTE: The signature of this proxy should correspond with the name (or names), as shown hereon, in which your stock is registered. Where stock is registered jointly in the name of two or more persons, all should sign.

(Proxy continued on other side)

Table of Contents

SIFCO Industries, Inc. **Proxy**

IF NO INSTRUCTION IS INDICATED, THIS PROXY WILL BE VOTED FOR THE ELECTION OF THE NOMINEES FOR DIRECTORS, FOR THE PROPOSAL TO RATIFY THE DESIGNATION OF THE INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM AND, IN THE DISCRETION OF THE PROXIES, ON SUCH OTHER BUSINESS AS MAY COME BEFORE THE MEETING OR ANY ADJOURNMENT.

(1) ELECT SIX (6) DIRECTORS. To elect the following persons for one-year terms expiring at the 2010 Annual Meeting of Shareholders:

Nominees:	Jeffrey P. Gotschall	Frank N. Nichols	P. Charles Miller, Jr.
	Alayne L. Reitman	Hudson D. Smith	J. Douglas Whelan

o FOR all nominees listed above *(except as noted below)*

o WITHHOLD AUTHORITY To vote for all nominees

(INSTRUCTIONS: If you wish to withhold authority to vote for any individual nominee, write that nominee s name in the space below.)

(2) RATIFY THE DESIGNATION OF GRANT THORNTON LLP as the independent registered public accounting firm for the year ending September 30, 2009.

o FOR o AGAINST o ABSTAIN

(3) Consider and take action upon such other matters as may properly come before the meeting or any adjournment thereof.

o GRANT AUTHORITY o WITHHOLD AUTHORITY

(continued from other side)