

1981

**MESSAGE FROM THE CHAIRMAN
OF THE BOARD AND PRESIDENT:**

1981 was another year of continuing improvement in your Company's financial condition.

During the year the capitalization of the Company was substantially changed by (i) the retirement, at discount, of the Company's 8- $\frac{3}{4}$ % Senior Note, (ii) the Exchange Offer whereby 656,301 Series E \$1.85 Cumulative Preferred Shares were issued in exchange for an equal number of common shares, (iii) the cash tender offer for 6% Convertible Subordinated Debentures which was started in 1981 and completed in 1982 and (iv) the substantial reductions in bank and short-term debt more fully described below. Perhaps most importantly, we have fully digested the acquisition of American Investment Company ("AIC"), which took place on December 3, 1980, and have positioned the Company to take advantage of opportunities as they appear.

Shortly after the AIC acquisition was consummated, we concluded that it was not desirable to finance consumer finance receivables (which are essentially long-term, fixed rate obligations) with bank borrowings (which are essentially volatile, variable rate obligations). Accordingly, we determined to reduce the investment in consumer finance receivables by approximately \$125,000,000. This was principally accomplished by sales of receivables completed in March and April 1981 and the recently completed sale to an affiliate of Manufacturers Hanover Trust Company. Since completion of that sale, our consumer finance operations have been essentially free of variable rate indebtedness and principally financed by long-term indebtedness that had an average stated interest rate of 6.58%. We are also very pleased that during 1981 AIC, for the first time

in many years, was able to sell a substantial amount of commercial paper. This form of temporary financing is much less expensive than bank borrowings. Although AIC has no current need to issue commercial paper, we believe it has the ability to issue commercial paper at any time if desired.

As you know, prior to the acquisition of AIC we were not involved in non-credit related insurance operations. During 1981, we studied the industry in detail, had actuarial studies pertaining to our insurance operations prepared and engaged an investment banker to advise us. We then concluded that the potential sales value of the life insurance operations was sufficiently attractive for us to pursue a sale. To date, no sales agreement has been entered into and no assurance can be given that any sale will result.

We also determined to sell the casualty insurance operations since the risks inherent in that type of business are greater than we care to assume. The sale of these operations, which is scheduled to close in early April, will result in a gain which will be reflected in 1982 results of operations.

Our real estate operations, which are classified for financial reporting purposes as a discontinued operation, had an operating loss in 1981. However, we did receive over \$11,000,000 in proceeds from the sale of properties. We also reinvested over \$7,200,000 in a New York City commercial office building which we have been involved with for many years and which, because of the booming New York City commer-

cial real estate market, has increased in value. We are now in the process of leasing available space in that building which should further increase its value. To date in 1982 we have sold properties which had a book value of \$1,900,000 for \$9,300,000. The gain on these sales will be reflected in 1982 results of discontinued operations.

Consolidated net income for the year ended December 31, 1981 was \$7,835,000 compared to net income for the year ended December 31, 1980 of \$1,892,000. Income from continuing operations in 1981 was \$5,056,000 compared to \$662,000 in 1980. The 1981 results include AIC for the entire year but for 1980 AIC is only included for approximately one month. Discontinued operations had a loss of \$1,700,000 in 1981 and income of \$477,000 in 1980. The 1980 discontinued operations include the gain on the sale of James Talcott Factors, Inc. Extraordinary credits totaled \$4,479,000 in 1981 and \$753,000 in 1980. The 1981 extraordinary credits included a gain of \$1,021,000 on repurchase of the Company's Senior Note and \$1,100,000 representing a portion of the gain resulting from the cash tender offer for 6% Convertible Subordinated Debentures. In 1982, the Company will report an additional extraordinary gain resulting from that offer. Other extraordinary items result from utilization of tax loss carryforwards.

We are very optimistic about the future of our Company. We believe that the consumer finance operations are efficiently managed and, in this period of record high interest rates, properly financed; that our insurance operations should, if


not sold, continue to be profitable and to offer innovative products; and that the Company is prepared to take advantage of opportunities.

Further, in March 1982, we acquired, principally through a cash tender offer, 57% of the outstanding common shares of TFI Companies, Incorporated ("TFI"). TFI is an American Stock Exchange listed company primarily engaged in the manufacture and distribution of building materials and the processing and distribution of meat products. Although, we are just becoming familiar with TFI, we believe we have made a wise investment in that company.

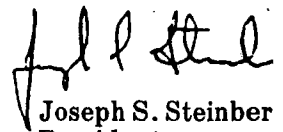
The comments of our chief operating officers are included in this portion of our annual report. We have also included the Form 10-K as filed with the Securities and Exchange Commission, which includes the annual audited consolidated financial statements and statistical and other data.

During the year we again made many requests of our bankers, often on very short notice. Again, they responded in a timely, efficient and positive manner. Many of our accomplishments would not have happened without their support.

The demands made on our officers and employees during 1981 were extreme and we cannot thank them enough for their efforts on behalf of our Company.



Ian M. Cumming
Chairman



Joseph S. Steinber
President

REPORT ON CONSUMER FINANCE OPERATIONS:

In looking back at the operations of the consumer finance group in 1981, one thing becomes crystal clear—it will not be quickly forgotten by this writer.

The acquisition of AIC on December 3, 1980 increased our consumer finance operation from 103 offices operating in 8 states with net receivables of approximately \$124 million at December 31, 1979 to 358 offices operating in 25 states with approximately \$427 million in receivables at December 31, 1980. Moreover, the consumer finance group entered 1981 operating from two home office locations, with different operating and financial reporting staffs and different operating procedures and philosophies.

As we entered 1981, we became convinced that we could no longer make consumer loans (which have long-term maturities and fixed rates) by funding them with bank loans particularly in a period of extremely volatile interest rates. From this conclusion our operating policy for 1981 was developed. That was to reduce our dependence upon expensive debt through a reduction in our outstanding receivables. Additionally, we determined to reduce our home office operating expenses by consolidating the two separate home office locations under City Finance and to implement the operating policies throughout all our operations that had made City Finance so successful in the past.

To achieve the reduction in such debt, we immediately set upon a program that would reduce receivables by approximately \$125 million. This reduction was accomplished primarily through the sale of receivables to four different companies in a program which has only recently been completed. Upon the completion of the sale of our West Coast offices to Manufacturers Hanover Consumer Services, Inc. on February 1, 1982, our consumer finance receivables had been reduced from \$427 million at the beginning of 1981 to \$199 million.

Consolidation of the two home offices was accomplished in two stages. First, in early 1981, operational control of consumer finance offices in several Southeastern states was transferred from Saint Louis to City Finance in Memphis. Then, in July, the remaining operations were transferred to Memphis. The consolidation resulted in a substantial reduction in home office

personnel and overhead expenses. Of at least equal importance, this consolidation enabled us to blend the operations and achieve greater uniformity and improved operating control.

Our operating and financial results for 1981 are difficult to compare to 1980 due to the acquisition of AIC; however, the following should be noted:


- contractual delinquency of 60 days or more stated as a percentage of outstanding receivables was down 30%, from 8.00% in 1980 to 5.56% in 1981,
- credit losses increased from 2.11% in 1980 to 3.35% in 1981 and
- earnings in the acquired AIC offices increased substantially.

The heavy credit losses are continued evidence of a depressed economy with an ever increasing percentage of unemployed in our nation's work force. Also adversely affecting our credit losses is the continuing high number of bankruptcies filed as a result of the liberal exemptions allowed under the bankruptcy code.

We will continue to reduce receivables principally through liquidations in our generally less profitable Northeastern offices. The remaining receivables will be used as a solid base for our ongoing operations. New growth through acquisitions will be pursued as opportunities arise provided we obtain acceptable financing.

With the reduction in receivables, with some recovery in our economy and with encouragement that the abuses permitted by the bankruptcy code will be corrected I am optimistic about the potential improvement in all phases of our operations for 1982. We should then be positioned to enter 1983 with receivables of excellent quality and high yields and should produce an outstanding profit contribution for the Company.

Our efforts will be dedicated toward that end.


Robert P. Brock
Chairman of the Board
City Finance Company