IE INDUSTRIES

1988 ANNUAL REPORT

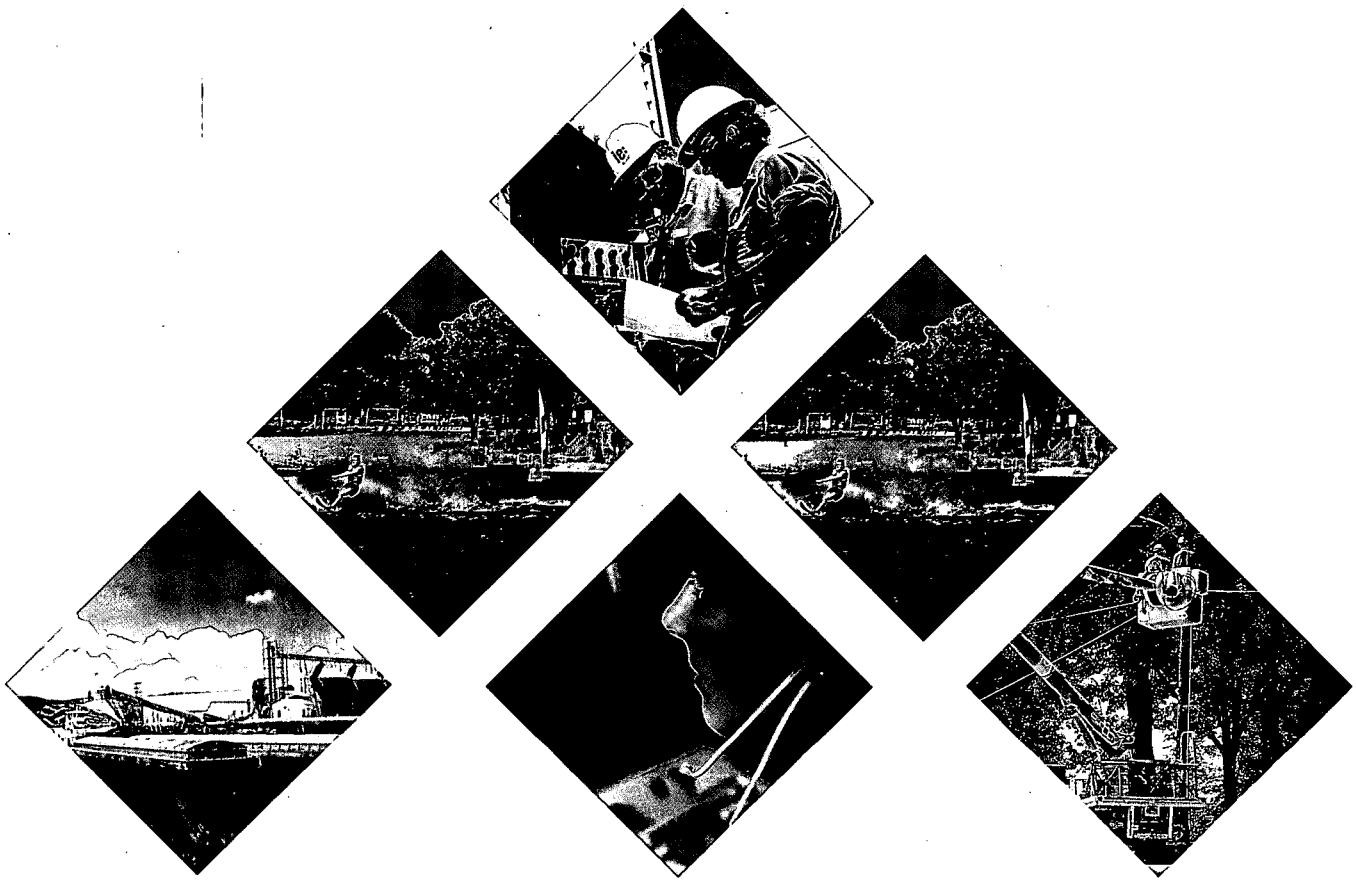


Table of Contents

About the Company

IE Industries was formed in July 1986 to accelerate diversification outside the utility business. Its principal subsidiary, Iowa Electric Light and Power Company, provides electric, natural gas and steam energy to residential, commercial and industrial customers, in Iowa. Iowa Electric is in its 107th year of operation.

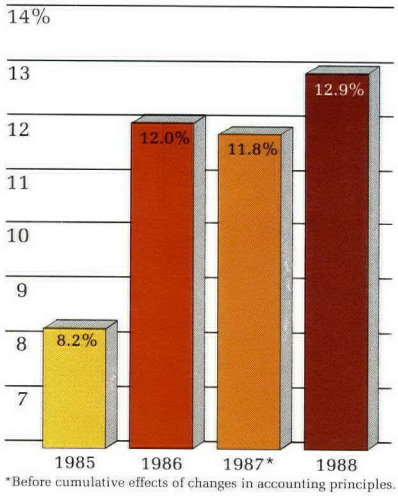
IE Industries' diversification efforts have resulted in development of subsidiaries in telecommunications, transportation and utility-related businesses. IE Industries also has a 9-percent equity interest in Telecom★USA, the fourth-largest telecommunications company in the United States.◆

Financial Highlights

	1988	1987	Increase (Decrease)	Percent Increase (Decrease)
Operating revenues (000's)	**$ 438,252**	$ 412,778	$ 25,474	6
Net income (000's)	**$ 34,154**	$ 29,529*	$ 4,625	16
Earnings per average common share	**$ 2.43**	$ 2.14*	$ .29	14
Dividends declared per common share	**$ 2.025**	$ 1.99	$ .035	2
Construction expenditures (000's)	**$ 65,271**	$ 52,887	$ 12,384	23
Cash flows from operating activities (000's)	**$ 34,644**	$ 34,042	$ 602	2
Sales of electricity to customers (Kwh) (000's)	**4,704,329**	4,418,005	286,324	6.5
Total gas sales, including transported volumes (dekatherms) (000's)	**30,762**	27,291	3,471	13
Number of common shareholders	**26,353**	27,414	(1,061)	(4)
Number of full-time employees	**1,719**	1,591	128	8

* Before cumulative effects of changes in accounting principles.

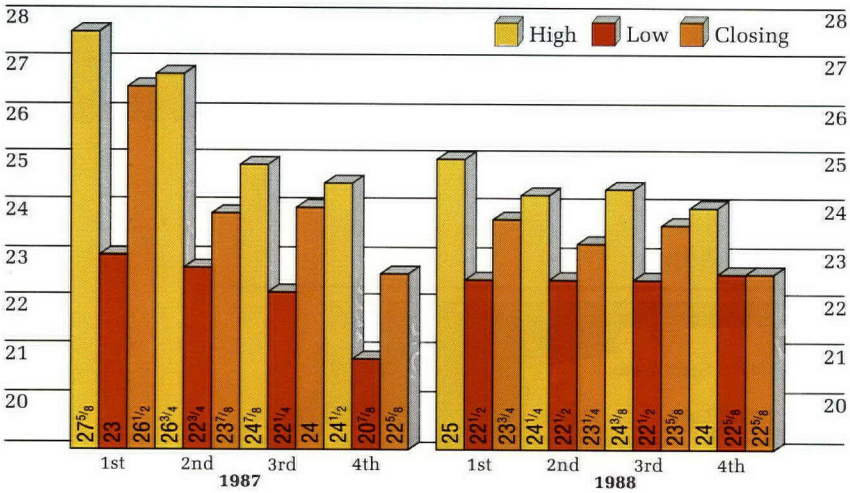
Return on Average Common Equity



*Before cumulative effects of changes in accounting principles.

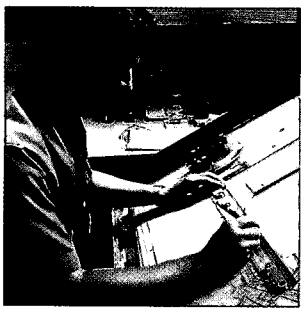
The Company's return on average common equity has continued to improve since 1985.

Quarterly High, Low, and Closing Prices of Common Stock (Dollars)

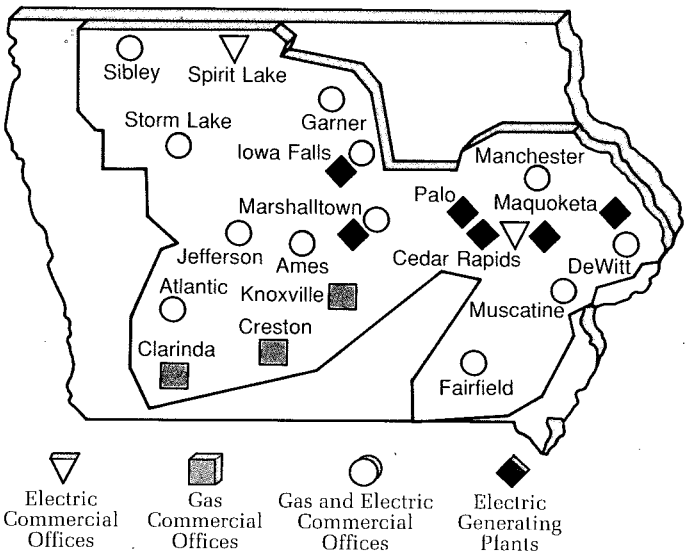


Quarterly common stock dividends of $.505 and $.495 were paid by the Company during 1988 and 1987, respectively. The Company's common stock is traded on the New York Stock Exchange. The accompanying chart shows the range of trading prices for the last two years.

IE Industries at a Glance



ie System Map



IE Industries Description

IE Industries Inc., is a diversified holding company with a broad range of businesses in telecommunications, transportation and utility-related areas. The principal subsidiary, Iowa Electric Light and Power Company, provides electric, natural gas and steam energy to about 275,000 residential, commercial and industrial customers in more than 400 communities in Iowa. Fossil fuel units provide 70 percent of Iowa Electric's 1,143 megawatts of generating and purchased power capacity with nuclear providing the remaining 30 percent.

Vision Statement

Our vision is to become a profitable, diversified, growing, vibrant business which is recognized for its sensitivity to customer, employee and shareholder needs. This business would:

- Retain and expand the core electric and gas utilities;
- Selectively invest in other businesses;
- Maintain a strong customer service orientation;
- Provide significant opportunity for employee growth in an environment that promotes their ideas, self-esteem and financial well-being and
- Provide continuing increases in shareholder value.

Strategy

Having considered the corporate vision, IE Industries developed its "New Directions" strategy that is customer, employee and shareholder oriented. Key ingredients are:

- Customer-oriented electric and gas utility businesses, with expansion to other opportunities as they arise;
- Intensified efforts to control costs in the utility business;
- Profitable growth of IE Industries' non-regulated businesses and
- Selective diversification into investments consistent with business capabilities, where profit potential exists at acceptable risks.

Diversified Businesses

Telecom★USA: As a result of the merger between the Teleconnect Company and SouthernNet, Inc., IE Industries holds a 9-percent equity interest in the new entity, Telecom★USA. The new company is the fourth largest long-distance carrier in the United States.

Long Lines, Ltd.: IE Industries has a 23.5-percent equity interest in this telemarketing, telephone switching and resort business. The company has demonstrated dramatic growth and has excellent future potential.

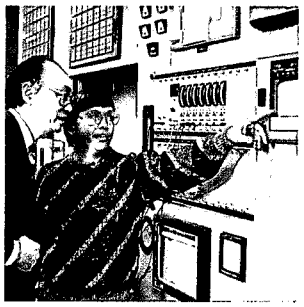
Cedar Rapids and Iowa City Railway (CRANDIC): This wholly owned short-line railroad subsidiary moves and switches more than 34,000 carloads of freight per year, benefiting from the growth of major grain processors.

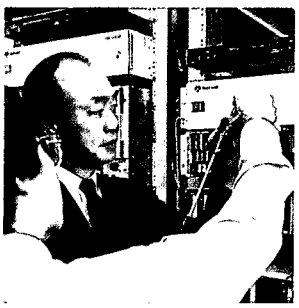
IEI Container Services Corp.: This subsidiary opened in 1988 to wash and repair railroad cars. Specializing in sanitizing the insides of rail cars used to haul food and food products, the company has experienced rapid growth.

Industrial Energy Applications, Inc.: IEA owns and operates standby generating units. Its joint venture subsidiary, EnDYNA Power Corp., is penetrating the national co-generation market.

MicroFuel Corporation: A joint venture subsidiary, this company developed the technology to micronize coal for burning in coal-fired generating facilities. The process is currently undergoing full-scale testing.

Chairman's Message





Dear Shareholder:

For IE Industries, 1988 was a year of progress.

- Utility business experienced significant increase in energy sales.
- Diversified investments showed marked progress in expansion and growth.
- Earnings per share posted gain from the previous year.
- Iowa's economy continued its accelerated growth, with manufacturing and food processing leading the way.

Financial Performance

From a financial viewpoint, 1988 was a good year. Earnings per share rose from $2.14 (prior to the cumulative effects of changes in accounting principles) in 1987 to $2.43. Sales growth was strong, aided by the strengthening of the economy and benefits received from economic development efforts. Electric sales increased almost 7% and gas sales improved 13%. Earnings for 1988 were assisted by a significant contribution from our diversified investments, which provided 16% of consolidated earnings.

Utility Business

Utility business is our core business and it will continue to be the flagship of our company for some time to come. We must maintain its strength and viability in an increasingly competitive environment.

The aggressive program in business development launched in 1985 has reaped significant benefits, not only for our company, but also for the communities we serve and the state at large. In 1988 several of our large industrial customers announced major expansion plans. In

addition, the decisions by Eastman Kodak to locate a $50 million biotechnology facility in Cedar Rapids, and NSK Corporation to build the largest ball -bearing manufacturing facility in North America at Clarinda, are clear indications that Iowa's economy is indeed on the move.

The sales of electric energy and natural gas exceeded our forecasted goals. However,the record jump in energy consumption during the summer months signaled the need for us to review our production capacity to meet future demand. One of our major challenges in 1989 will be the increased effort in demand-side load management, and the promotion of innovative programs in the efficient use of energy. It is our goal to further delay major capital investment in new power plants.

Environmental issues such as acid rain and the greenhouse effect will merit our close attention in 1989. Federal legislation on acid rain is imminent, and it will almost certainly impact on our generation utilization and future planning.

The need to have stabilized energy prices to protect our market position cannot be achieved without a sustained effort in cost containment and cost reduction. Therefore, this strategy, initiated in 1984, will be refocused in 1989, and new programs will be pursued to optimize operational efficiency.

Diversified Activities

The goal of our diversification effort is to complement our utility operation and to enhance our shareholder values over the long term. The year of 1988 marked substantial progress in the targeted areas of telecommunications, transportation, and energy-related businesses.

Our investment in Teleconnect, the fast growing, Iowa-based telecommunications company, continues to increase in value.

In 1988 Teleconnect became a publicly traded company, and later merged with the Atlanta-based SouthernNet, Inc.. The resulting holding company, Telecom★USA, is now the fourth-largest long distance service company in the United States, with a customer base of 400,000 and revenue over $523 million.

In 1988 we also made a significant investment in Long Lines, Ltd., another telecommunications company with dramatic growth in its six years of operation. Currently, Long Lines employs more than 2,000 people. Its diversified resort business in the Iowa Lakes region has had a significant impact on our utility business and also on the economic growth of the area.

In the transportation sector, the Cedar Rapids and Iowa City Railway Company (CRANDIC) had another successful year. In a strategic move to expand its competitive position, the CRANDIC successfully acquired a controlling interest in the largest barge terminal north of St. Louis on the Mississippi River.

The development of IEI Container Services Corporation, a wholly-owned subsidiary in rail car repair and washing, is also on target. We are satisfied with its progress and expect continuing growth in 1989.

In the non-regulated energy business, we are active in two projects. One joint venture, MicroFuel Corporation, specializing in micronization of coal, continues to make good progress. EnDYNA Power Corporation, another joint venture subsidiary, is making inroads in the national cogeneration business.

Economic Resurgence

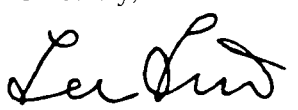
The economic recovery in Iowa, which began in 1987, gained additional strength last year. The unemployment rate is now at four percent. Farm and land values rose twenty percent, and manufacturing employment increased substantially for the first time in almost fifteen years.

This economic resurgence is even more evident in the service territory of our utility business. In eastern Iowa housing starts doubled from 1985 to 1988, and service industries such as data processing and telemarketing, almost non-existent a decade ago, now employ thousands of workers.

Indeed we are encouraged by the progress made thus far and enthusiastic about the future. In the environment of economic resurgence, we expect to find new markets for our products and services, and added opportunities for expansion. The past year's developments reaffirmed our belief in our vision and strategy. We look upon the year of 1989 with optimism, and we realize that our success will depend on meeting new challenges and capitalizing on new opportunities.

The progress made in 1988 could not have been achieved without the commitment and dedication of our employees, and the continuing encouragement and support of the shareholders. To all of you, our deepest appreciation and gratitude. ◆

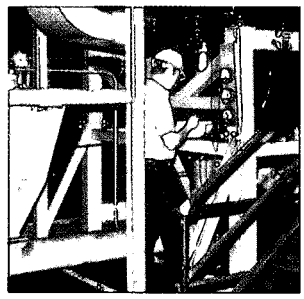
Sincerely,



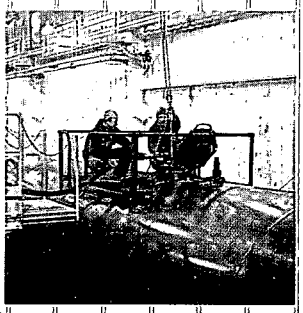
Lee Liu

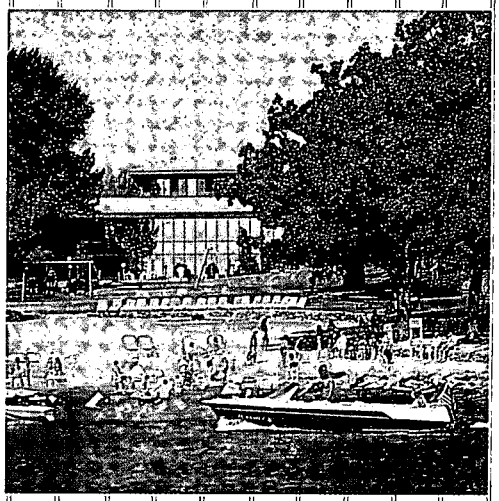
Corporate Commitment

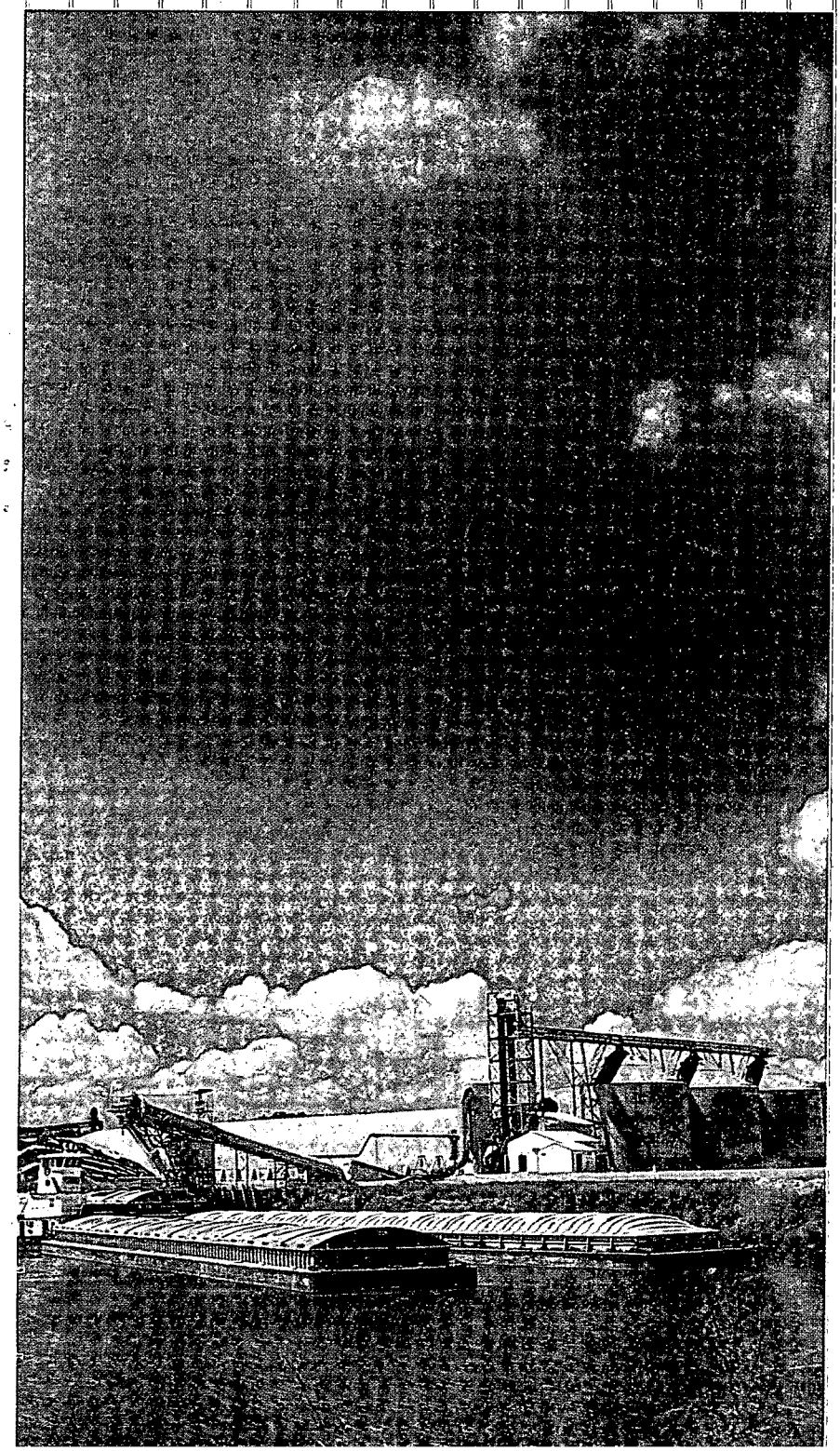
Year in Review



Year in Review







When IE Industries was formed in 1986, the "new directions" corporate strategy was adopted. That strategy built upon a core utility base to diversify into other businesses which are directly related to existing business and expertise. As a result, the diversification effort at IE Industries has been focused in the areas of energy, transportation and telecommunications.

◆ Energy

Iowa Electric Light and Power Company

The overall corporate strategy of IE Industries has, from the beginning, been anchored on a strong commitment to managing, strengthening and positioning the principal subsidiary, Iowa Electric Light and Power Company, to take advantage of emerging opportunities while controlling costs and offering customers superior service.

Electric Operations

1988 was a record-breaking year for the utility business. In August, the company hit a new record for electric demand. For the year, electric sales grew by 6.5 percent over 1987, with actual sales of 4.7 billion kilowatt hours. Although the hot summer weather was responsible for about half of this load growth, the continued growth of the economy in Iowa has created real sales increases among all major classes, particularly with industrial and commercial customers. After normalizing for weather, that's a 3.9 percent increase from 1987, and 3.5 percent above forecast.

The challenge associated with the increased load demand is the apparent need for additional generation capacity in the future. Iowa Electric has an aggressive demand-side load management program which emphasizes time-of-day and interruptible service pricing, as well as a seasonal pricing structure. These programs produce total load savings in the 150 to 200 megawatt range, which would be equivalent to plant expansion costing in excess of $200 million. To meet the increasing energy demand, our least-cost planning strategy calls for an acceleration of this demand-side program and new energy efficiency programs while new plant construction is delayed.

Gas Operations

The natural gas business continues to experience healthy volume growth. Iowa Electric's aggressive and innovative strategy on the gas spot market and in the contract carriage business has placed us in a position to look for opportunities to expand our gas operations.

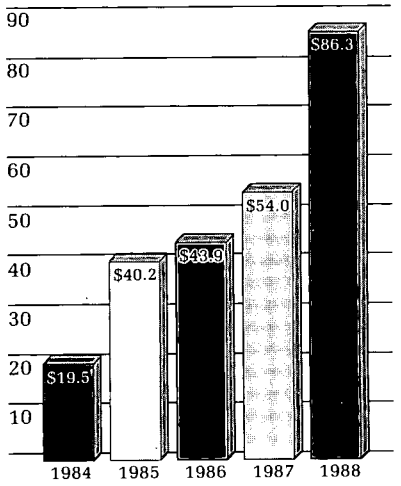
In December, in an effort to consolidate the gas business, Iowa Electric sold its Nebraska gas operations, which included service to five small eastern Nebraska communities.

Challenges

The utility business will face a number of challenges in the near future with generation planning, environmental issues, cost containment and an increasingly competitive marketplace. These areas will be the focus of our planning for 1989 and beyond.

Year-End Investment in Diversified Companies

In millions of dollars



The increase in the investment in diversified companies in 1988 is related to the Telecom★USA and Long Lines, Ltd. investments.

Industrial Energy Applications, Inc.

In 1988, Industrial Energy Applications, Inc. (IEA) and its joint venture subsidiary, EnDYNA Power Corporation, moved to capture a share of the nationwide cogeneration business. An East Coast office was established to move into the burgeoning independent power market in the East.

MicroFuel Corporation

A new concept on the cutting edge of technology in the coal

business is the focus of the MicroFuel Corporation, based in Ely, Iowa. MicroFuel has developed the technology and equipment to efficiently micronize coal for burning in electric utility coal-fired generating facilities.

The milling process has wide potential application in the electric utility business. For fossil fuel generating facilities, it holds promise for both limiting environmental emissions and for providing greater flexibility using coal.

Tests are under way at Duke Power Company in North Carolina. A newly-constructed test facility in Ely is in operation to simulate varying coal quality and operating conditions. IE Industries has made a venture capital investment in MicroFuel, and holds a majority interest.

◆ Transportation

Cedar Rapids and Iowa City Railway Company

The Cedar Rapids and Iowa City Railway Company (CRANDIC) continued its track record as a profitable short-line freight carrier. Over the last six years, revenues grew from $7.6 million to $10.7 million in 1988, while earnings increased from $2 million to $3 million.

CRANDIC expanded its business in 1988 to include a barge terminal on the Mississippi River in East Dubuque, Illinois. The purchase of the Dubuque barge terminal provides CRANDIC customers access to the Mississippi River for transporting coal and grain.

IEI Container Services Corp.

The first rail cars rolled into this new state-of-the-art rail car washing and repair facility in 1988. This wholly-owned subsidiary is a natural extension of our transportation business. Its specialty is sanitizing the insides of rail cars used to haul food or food products. In addition, Container Services is developing a car repair business substantially exceeding expectations.

◆ Telecommuncations

Teleconnect

The shining star of our diversification program continues to be our investment in the Teleconnect Company, now Telecom★USA. 1988 was a very big year for this rapidly expanding telecommunications company. Teleconnect went public in the spring and soon after that, announced plans to merge with the Atlanta-based SouthernNet, Inc. The resulting holding company, Telecom★USA, is the fourth-largest long distance carrier in the United States with combined revenues in excess of $523 million.

The merger was completed on a share for share basis. Both companies had essentially the same number of shares outstanding, so IE Industries retains a 9 percent interest in Telecom★USA and holds a seat on the board of directors.

Because of accounting rules concerning the extent of ownership interest, IE Industries will no longer be able to record Telecom★USA's income, as was done with Teleconnect. Currently, the market value of Telecom★USA's stock is substantially in excess of our $32 million carrying value.

Long Lines, Ltd.

Another rapidly growing telecommunications company based in Sergeant Bluff, Iowa caught our attention in 1988. Long Lines, Ltd. operates in the telephone switching, telemarketing and resort businesses. It has grown from 22 employees in 1983, to more than 2,000 today. Most of this growth has been in the telemarketing company, Pioneer Teletechnologies.

Long Lines attracted our interest because its management team has demonstrated a real ability to identify and seize opportunities in rapidly changing markets.

The resort business of Long Lines has been focused in the Lakes region of northwest Iowa. The area has become the premier tourist and convention center in Iowa. The resorts, Village East, Village West and Manhattan Beach have developed into one of Iowa Electric's largest northwest Iowa customers.◆

Diversification Timeline

On July 1, 1986, IE Industries became the parent company of Iowa Electric Light and Power Company. IE Industries later acquired Iowa Electric's subsidiaries. Those included the Cedar Rapids and Iowa City Railway Company, Industrial Energy Applications, Inc. and Iowa Land and Building Company. IE Industries also held a 30 percent equity interest in Teleconnect Company of Cedar Rapids.

Since its inception, IE Industries has moved forward with an aggressive, yet focused diversification program. That focus is in businesses where IE Industries has a developed expertise, like energy, transportation and telecommunications. Since 1986, IE Industries has added several companies to its list of investments and subsidiaries. This timeline provides information on what investments and acquisitions have been made in the short history of IE Industries' diversification effort.

IE INDUSTRIES

July 1986

IOWA ELECTRIC LIGHT AND POWER COMPANY

Iowa Electric Light and Power Company provides electric, gas and steam service to 275,000 customers in 55 Iowa counties.

(8/87) 24-hour centralized IE Customer Service Center fully operational.

Cedar Rapids and Iowa City Railway Company (CRANDIC) provides freight services in the Midwest.

Industrial Energy Applications Inc., sells, installs and operates standby generating units for large industrial and commercial energy customers.

(1/88) IEA and the Des Moines, Iowa-based Brown Engineering Co. announce the formation of a joint venture subsidiary, EnDYNA Power Corp. to develop cogeneration systems nationwide.

Iowa Land and Building Company acquires and sells real estate for the utility company.

February 1988

Container Services Corp

IE held a 30 percent equity interest in this fast-growing telecommunications company based in Cedar Rapids, Iowa.

(5/88) IE Industries acquires an equity interest in this Ely, Iowa-based research and development company focused on developing the technology and equipment to micronize coal for burning in electric utility coal-fired generating facilities.

(4/88) IE Industries acquires an equity interest in **Long Lines Ltd.**, a telephone switching, telemarketing and real estate holding company based in Sergeant Bluff, Iowa.

(5/88) Long Lines announces the purchase of Village East, located in Okoboji, Iowa.

(9/88) Pioneer Teletechnologies, Long Lines' telemarketing and telcommunications business expands to eastern Iowa with a facility in Iowa City.

(2/88) **IEI Container Services Corp.**, a wholly-owned subsidiary of IE Industries begins operations as a rail car washing and repair facility. The new plant, located in Cedar Rapids, Iowa, employs state-of-the-art technology in its operation.

(5/88) Teleconnect offers 2.2 million shares of common stock on the New York Stock Exchange.

(12/88) Teleconnect shareholders approve a merger with the Atlanta, Georgia-based SouthernNet,Inc., under the holding company, Telecom★USA.

(8/88) IE recognized by Iowa Community Action Association for development of Project Share, IE's energy assistance program.

(6/88) CRANDIC purchases a controlling interest in Dubuque barge terminal to provide rail customers with access to the Mississippi River.

(12/88) EnDYNA Power Corp. opens an East Coast office to develop cogeneration systems.

April 1988 | **May 1988** | **January 1989**

Management's Discussion and Analysis of the Results of Operations and Financial Condition

The following discussion analyzes changes in the components of net income during the calendar years 1988 and 1987 for lE Industries Inc. (Industries) and its wholly-owned subsidiaries (the Company).

Resnlts of Operations

Income before cumulative effects of changes in accounting principles increased in both 1988 and 1987 compared to prior years. The reasons for the increases are explained in the following discussion.

Electric revenues changed because of the following factors:

	Electric Revenues Increase (Decrease) from Prior Year	
	1988	1987
	(in millions)	
Rate changes	**$ (2.6)**	$11.3
Recovery of fuel costs	**1.0**	3.4
Kwh sales and other	**12.9**	3.3
	$11.3	$18.0
Increase in sales (in Kwh)	**6.5%**	1.7%

In 1988, approximately one-half of the increased Kwh sales resulted from unseasonably warm summer weather and the remaining one-half from the strengthening of the Iowa economy. Iowa Electric's largest electric customer is constructing a co-generation plant, a portion of which is now in service. An agreement has been signed with that customer through June 1, 1990 which provides for a minimum billing demand of approximately 50% of its historical monthly usage. While the ultimate impact of losing the customer is uncertain, it is not expected to have a significant impact on earnings.

The increase in 1987 revenue was primarily the result of increases in electric rates which were placed into effect in July, 1986 on an interim basis and May, 1987 on a final basis.

Offsetting the revenue increases during both years was an electric tariff decrease, effective July 1, 1987, filed with the Iowa Utilities Board (IUB) in order to reflect the effects of the Tax Reform Act of 1986. (See Note 2 of the Notes to Consolidated Financial Statements for further discussion of these rate matters.)

Iowa Electric's tariffs include an energy adjustment clause which is designed to currently recover the costs of fuel and the energy portion of purchased power in billings to customers.

Gas revenues changed because of the following factors:

	Gas Revenues Increase (Decrease) from Prior Year	
	1988	1987
	(in millions)	
Rate changes	**$ —**	$0.5
Recovery of gas costs	**11.5**	(29.6)
Sales and other	**1.5**	(5.9)
	$13.0	$(35.0)
Increase (decrease) in sales, including transported volumes (in therms)	**12.7%**	(10.6)%

As reflected above, Iowa Electric's gas tariffs include purchased gas adjustment clauses designed to recover the cost of gas purchased for resale on a current basis. Gas revenues increased during 1988 primarily due to increased sales volumes and the recovery of increased gas purchases. The decrease during 1987 resulted primarily from reductions in the cost of gas purchased and decreases in gas sales.

Gas margins were $15.7 million and $20.2 million for the years 1988 and 1987, respectively. The 1988 margin was adversely effected by the recording of a $5.0 million estimated liability to pipeline suppliers, included in gas purchased for resale. The 1987 gas margin decreased from 1986 by $5.7 million, primarily due to mild weather.

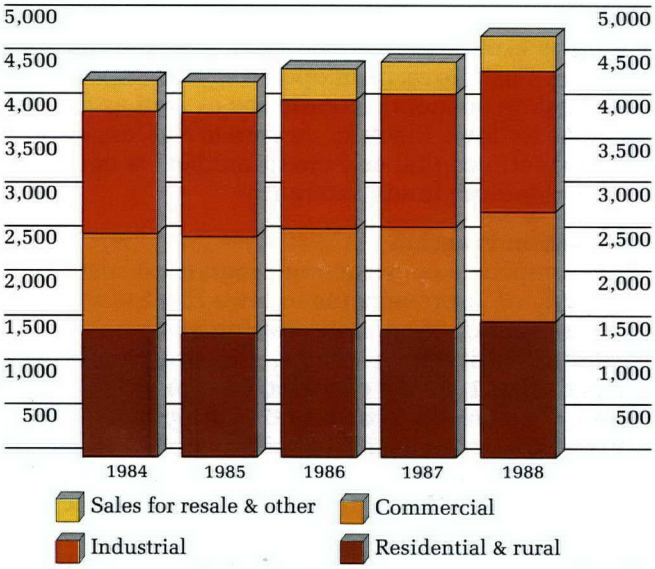
Fuel for production increased during 1988 and decreased during 1987. The 1988 increase was primarily due to increased electric generation and a full year's amortization of coal contract termination costs, which are being recovered through rates. (See Note 11 of the Notes to Consolidated Financial Statements.) The decrease during 1987 is primarily due to decreases in the cost of coal, partially offset by increases in fossil-fueled generation and a partial year's amortization of coal contract termination costs. The primary factor causing the increase in fossil-fueled generation was the nuclear refueling outage at the Duane Arnold Energy Center (DAEC); there was no refueling outage during 1986.

Purchased power decreased during 1988 as a result of increased electric generation as discussed above, as well as reduced capacity purchase charges under a long-term power purchase contract. Purchased power costs increased during 1987 primarily because of energy purchases made during the refueling outage at the DAEC and decreased sales to other utilities. A reduction in the cost of capacity purchases under the long-term power purchase contract partially offset the increases.

Combined other operation and maintenance expenses increased during 1988 and 1987. Such increases resulted primarily from increased costs incurred at the DAEC during the refueling in both

Electric Sales

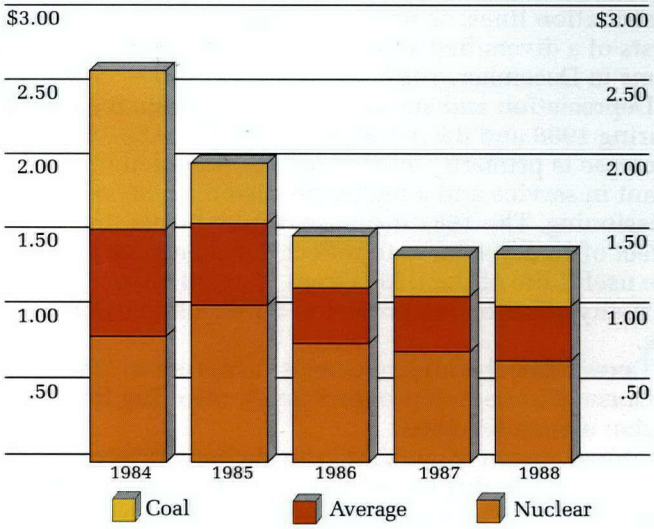
In billions of kilowatt-hours



Electric sales increased 6.5% from 1987 to 4,704,329,000 kilowatt-hours. Residential sales increased 7% and rural sales increased 4%. Commercial sales increased 7% while industrial sales increased 6%. Sales for resale and other increased 6%. The 5-year compound rate of growth is 2%.

Fuel Cost

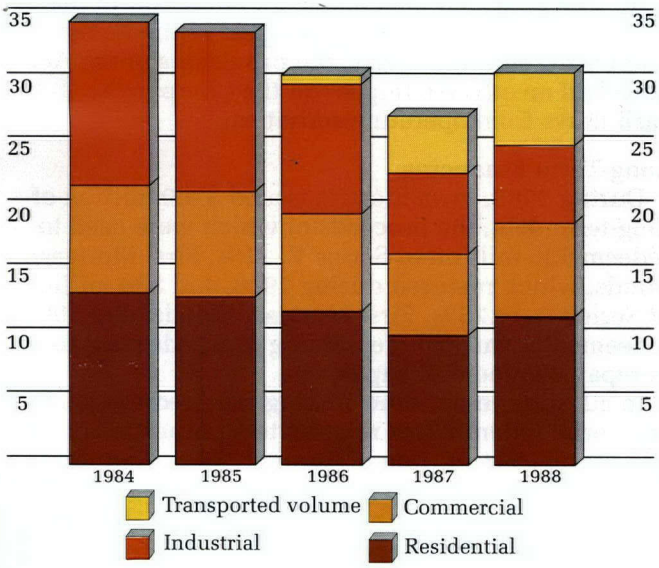
Per million Btu's burned



Coal prices have decreased 47% since 1984, primarily as a result of the termination of two long-term coal contracts. In 1988, average fuel costs decreased 6% because of greater nuclear-fueled generation.

Gas Volumes Delivered

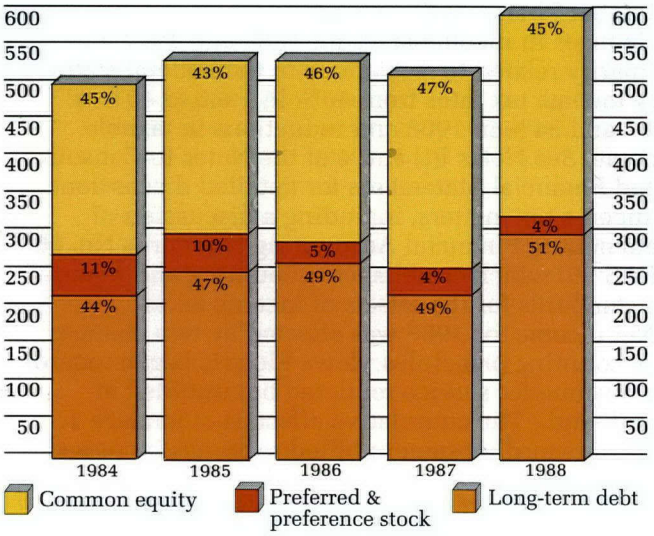
In millions of dekatherms



Total volumes delivered, including transported volumes, were 30,762,000 dekatherms, a 13% increase from 1987. Residential and commercial sales both increased 15%. Industrial sales decreased 4% but industrial volumes delivered, including transported volumes, increased 10%.

Year-End Capitalization

In millions of dollars



The Company's capitalization ratios for the last five years are presented above. These ratios are consistent with the Company's long-term capital structure objectives.

years. Also contribnting to the increase in 1988 were increased costs associated with maintenance on distribution lines, as well as increased operating costs of a diversified subsidiary which began operations in December, 1987.

Depreciation and amortization expense increased during 1988 and decreased during 1987. The 1988 increase is primarily attributable to increased utility plant in service and a higher provision for decommissioning. The 1987 decrease resulted from the effect of an adjustment to reflect the change in the useful life of the DAEC from 28 to 36 years, partially offset by the provision for decommissioning.

Taxes other than income taxes increased in 1988 because of increased property taxes, resulting from higher assessed values.

Interest expense increased during both 1988 and 1987 primarily due to increases in the average amount of debt outstanding during the year partially offset by decreased average interest rates.

Income from stock transactions of affiliate of $5.8 million and $2.3 million for 1988 and 1987, respectively, is explained in Note l(c) of the Notes to Consolidated Financial Statements.

Miscellaneous, net for 1987 reflects the write-off of disallowed allowance for funds used during construction (AFC) recorded for the Guthrie County generating station. (See Note 2 of the Notes to Consolidated Financial Statements.)

Changes in income taxes for 1988 and 1987 are primarily related to reductions in the Federal statutory income tax rates from 46% in 1986 to 40% in 1987 and 34% in 1988 and reductions in taxable income. See Notes l(i) and 4 of the Notes to Consolidated Financial Statements for detailed discussions of income tax matters, including a discussion of Statement of Financial Accounting Standards No. 96 (SFAS 96) which establishes accounting and reporting standards for the effects of income taxes.

Net income for 1987 was affected by two changes in accounting principles. Iowa Electric began recording revenue for service rendered but unbilled at month-end. The cumulative effect as of January 1, 1987 of recording such unbilled revenues increased net income by $6,894,000. In addition, pursuant to a rate order of the IUB, Iowa Electric was allowed to recover the cost (after the AFC write-off referred to above) associated with cancelled projects, but without rate base treatment. In accordance with SFAS 90, an adjustment of $2,347,000, net of income taxes, was recorded to discount the future revenues associated with such recoverable costs. Both adjustments were presented as changes in accounting principles in the Consolidated Statements of Income. (See Notes l(e) and 2, respectively, of the Notes to Consolidated Financial Statements.)

Liquidity aud Capital Resources

The Company's capital requirements are primarily attributable to Iowa Electric's construction program, Indnstries' diversification activities and maturing debt and sinking fund requirements. It is anticipated that future capital requirements will be met by both cash flows from operating activities and external financing. Cash flows from operating activities is dependent on economic conditions as well as timely rate relief for Iowa Electric. Access to the long-term and short-term capital and credit markets is necessary for obtaining funds externally.

Constrnction Program

The Company's construction program consists principally of improvements to Iowa Electric's existing electric production, transmission and distribution facilities in service. Construction expenditures during 1989 are expected to approximate $60 million. The levels of construction are projected to decrease 20% in 1990 and remain relatively stable through the early 1990's. It is estimated that approximately 85% of construction expenditures will be provided by cash flows from operating activities (after dividends and decommissioning, and excluding capital lease obligations and other changes in assets and liabilities) for the five year period 1989-1993. The construction program will be modified as necessary for changing economic conditions, timeliness of rate relief and other relevant factors.

The Tax Reform Act of 1986 (the Act) significantly modified many provisions of the Federal income tax law. The modifications include a reduction in the corporate income tax rate and repeal of the investment tax credit. Generally, the provisions of the Act have had an adverse impact on the Company's cash flows from operating activities.

Long-Term Financing

During 1988, Iowa Electric issued $100 million of long-term debt, the proceeds of which were used to redeem $35 million of Series V, 11%, First Mortgage Bonds, which matured during 1988, and $30 million of Series T, 14.75%, First Mortgage Bonds, due 1991, redeemed at par. The remaining proceeds were used to repay commercial paper.

In addition to periodic sinking fund requirements and serial redemptions relating to a pollution control bond issue, $45 million of Series 1986 Debentures and two First Mortgage Bond issues totaling $16.8 million will mature prior to 1994. Refer to the table shown in Note 8 of the Notes to Consolidated Financial Statements for more details.

The Indenture pursuant to which Iowa Electric's First Mortgage Bonds are issued contains covenants restricting the amount of additional bonds which may be issued thereunder. At December 31, 1988, such restrictions would have allowed Iowa Electric to issue $109 million of First Mortgage Bonds.

The Articles of Incorporation of Iowa Electric authorize and limit the aggregate amount of additional shares of Cumulative Preferred Stock and Cumulative Preference Stock which may be issued. At December 31, 1988, under applicable limitations,

Iowa Electric could issue shares in excess of the number currently authorized for both classes of stock.

Short-Term Financing

For interim financing, Iowa Electric is authorized by the Federal Energy Regulatory Commission to issue up to $75,000,000 of short-term notes, of which a maximum of $65,000,000 can be in the form of commercial paper. This availability of short-term financing provides Iowa Electric flexibility in the issuance of long-term securities.

At December 31, 1988, Iowa Electric had lines of credit aggregating $51,000,000, of which $24,800,000 was being used to support commercial paper. Additionally, Industries had a $10,000,000 line of credit.

Diversified Activities

The Company's investment in Telecom★USA and other diversified companies increased significantly in 1988 as compared with 1987. Refer to Note (l)(c) of the Notes to Consolidated Financial Statements for further information.

Effects of Inflation

Under the rate making principles prescribed by the regulatory commissions to which Iowa Electric is subject, only the historical cost of plant is recoverable in revenues as depreciation. As a result, Iowa Electric has experienced a loss equivalent to the current year's impact of inflation on utility plant.

In addition, the regulatory process imposes a substantial time lag between the time when operating and capital costs are incurred and when they are recovered. During periods of inflation, this lag, coupled with rates based on historical costs and inadequate rates of return allowed on common equity, produce revenues which do not recover the cost, in terms of purchasing power, of the productive facilities used to provide services to current customers. While the inflation gain related to debt and preferred stock financing reduces the effect of this loss, the common shareholders still experience a net erosion in their investment due to inflation. Since 1984, the inflation rate has ranged from 1% to 4%.

Selected Consolidated Quarterly Financial Data (Unaudited)

The following unaudited consolidated quarterly data, in the opinion of the Company, includes all adjustments necessary for the fair presentation of such amounts.

	Quarter Ended			
	March 31	June 30	September 30	December 31
	(in thousands)			
1988				
Revenues	**$119,542**	$86,418	$124,081	$108,211
Operating income	**16,709**	9,224	33,128	4,847
Net income	**8,408**	6,855	16,872	2,019
Earnings per average common share	**0.60**	0.49	1.20	0.14
1987				
Revenues	**$105,271**	$89,980	$120,443	$ 97,084
Operating income	**17,479**	8,730	36,946	9,644
Income before cumulative effects of changes in accounting principles	**5,225**	3,701	17,290	3,313
Cumulative effects of changes in accounting principles	**4,547**	—	—	—
Net income	**9,772**	3,701	17,290	3,313
Earnings per average common share before cumulative effects of changes in accounting principles	**0.38**	0.27	1.25	0.24
Cumulative effects of changes in accounting principles	**0.34**	—	—	—
Earnings per average common share	**0.72**	0.27	1.25	0.24

Because the Iowa Electric results of operation are a significant portion of the consolidated results, the above amounts are affected by seasonal weather conditions and the timing of utility rate changes.

Electric kilowatt-hour sales increased 11%, 3.6%, 8% and 3.6% during the four quarters of 1988 compared to the comparable quarters in the prior year. These increases were influenced by abnormal weather conditions and the strengthening of the Iowa economy. Additionally, Iowa Electric experienced increases in gas sales, including transported volumes, of 20%, 13%, 5% and 7% during the four quarters of 1988 primarily as a result of a colder heating season than in 1987.

Net income for the second quarter of 1988 was benefited from the initial public offering of Teleconnect Company. The transaction increased Industries' share of Teleconnect's net assets and resulted in a $5.8 million pre-tax credit to "Interest expense and other - Income from stock transactions of affiliate."

Auditor's Report

To the Board of Directors of IE Industries Inc.:

We have audited the accompanying consolidated balance sheets and statements of capitalization of IE Industries Inc. (an Iowa corporation) and subsidiary companies as of December 31, 1988 and 1987, and the related consolidated statements of income, retained earnings and cash flows for each of the three years in the period ended December 31, 1988. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of IE Industries Inc. and subsidiary companies as of December 31, 1988 and 1987, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1988, in conformity with generally accepted accounting principles.

As discussed in Notes l(e) and 2 to the consolidated financial statements, during 1987 IE Industries Inc.'s wholly-owned subsidiary, Iowa Electric Light and Power Company, changed its methods of accounting for revenues and for regulatory disallowances of cancelled plant costs.

Arthur Andersen & Co.

Chicago, Illinois
February 3, 1989

Consolidated Statements of Income

	Year Ended December 31		
	1988	1987	1986
		(in thousands)	
Revenues:			
Electric	**$314,769**	$303,491	$285,448
Gas	**103,165**	90,171	125,158
Other	**20,318**	19,116	18,639
	438,252	412,778	429,245
Expenses:			
Gas purchased for resale	**84,153**	71,995	99,867
Fuel for production	**60,093**	56,011	57,234
Purchased power, net	**44,697**	49,667	46,565
Operation —			
Change in adjustment clause balances	**3,020**	(2,048)	(107)
Other	**92,066**	88,098	79,019
Maintenance	**27,728**	24,046	21,188
Depreciation and amortization	**38,704**	31,784	34,226
Taxes other than income taxes	**23,883**	20,426	18,982
	374,344	339,979	356,974
Operating income	**63,908**	72,799	72,271
Interest expense and other:			
Interest expense	**27,828**	26,193	25,305
Allowance for funds used during construction	**(1,455)**	(1,198)	(2,375)
Preferred and preference dividend requirements of subsidiary	**1,641**	1,812	3,410
Income from stock transactions of affiliate	**(5,826)**	(2,344)	—
Miscellaneous, net	**(1,147)**	4,237	(1,187)
	21,041	28,700	25,153
Income before income taxes and cumulative effects of changes in accounting principles	**42,867**	44,099	47,118
Federal and state income taxes	**8,713**	14,570	18,582
Income before cumulative effects of changes in accounting principles	**34,154**	29,529	28,536
Cumulative effect of discounting recoverahle cancelled plant costs, net of $1,177,000 income tax benefit	—	(2,347)	—
Cumulative effect of change in method of accounting for revenues, less income taxes of $4,599,000	—	6,894	—
Net income - As reported	**$ 34,154**	$ 34,076	$ 28,536
- Pro forma (Notes 1 (e) and 2)	**$ 34,154**	$ 29,529	$ 23,641
Average number of common shares outstanding	**14,053**	13,748	13,408
Earniugs per average common share before cumulative effects of cbauges in accounting principles	**$ 2.43**	$ 2.14	$ 2.13
Cumulative effect of discounting recoverable cancelled plant costs	—	(.17)	—
Cumulative effect of change in method of accounting for revenues	—	.51	—
Earnings per average common sbare -As reported	**$ 2.43**	$ 2.48	$ 2.13
-Pro forma (Notes 1 (e) and 2)	**$ 2.43**	$ 2.14	$ 1.76

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Consolidated Balance Sheets

Assets	December 31 1988	1987
	(in thousands)	
Property, plant and equipment, at original cost:		
Utility —		
Plant in service —		
Electric	**$ 943,541**	$ 905,252
Gas	**72,010**	70,842
Other	**31,586**	27,639
	1,047,137	1,003,733
Less - Accumulated depreciation	**410,178**	378,635
	636,959	625,098
Leased nuclear fuel, net of amortization	**66,200**	33,866
Construction work in progress	**26,461**	15,373
	729,620	674,337
Other property, net of accumulated depreciation of $4,635,000 and $3,066,000, respectively	**29,979**	23,000
	759,599	697,337
Current assets:		
Cash	**1,714**	1,407
Accounts receivable —		
Customer, less reserve	**36,589**	35,587
Other	**9,581**	4,816
Unbilled revenues	**12,546**	11,224
Income tax refunds receivable	**2,694**	582
Production fuel, at average cost	**18,114**	15,220
Materials and supplies, at average cost	**12,947**	11,625
Adjustment clause balances	**—**	2,903
Prepayments and other	**13,661**	12,816
	107,846	96,180
Deferred charges and other (Note 11)	**34,425**	41,360
Investments:		
Telecom★USA (Market value at 12/31/88 — $46,125,000)	**31,939**	24,490
Other diversified companies	**15,587**	2,200
Nuclear decommissioning trust fund	**3,671**	1,223
Other	**3,799**	2,272
	54,996	30,185
	$ 956,866	$ 865,062

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Capitalization and Liabilities

	December 31 1988	1987
	(in thousands)	
Capitalization (See Consolidated Statements of Capitalization):		
Common stock	**$193,640**	$187,383
Retained earnings	**77,283**	71,273
Total common equity	**270,923**	258,656
Preferred stock of subsidiary	**18,320**	18,320
Redeemable preference stock of subsidiary	**6,000**	8,000
Long-term debt	**302,849**	230,471
	598,092	515,447
Current liabilities:		
Commercial paper	**24,800**	30,430
Capital lease obligations	**14,507**	12,937
Long-term debt maturities	**832**	36,073
Debt sinking fund requirements	**1,033**	1,033
Preference stock sinking fund requirements	**1,000**	1,000
Accounts payable	**47,767**	33,865
Accrued interest	**5,344**	4,670
Accrued taxes	**21,878**	16,586
Adjustment clause balances	**117**	—
Accumulated refueling outage provision	—	2,437
Other	**19,914**	12,183
	137,192	151,214
Other long-term liabilities:		
Capital lease obligations	**56,645**	26,454
Other	**13,957**	12,006
	70,602	38,460
Deferred credits:		
Accumulated deferred income taxes	**107,100**	115,042
Accumulated deferred investment tax credits	**43,880**	44,899
	150,980	159,941
Commitments and contingencies (Note 10)		
	$956,866	$865,062

Consolidated Statements of Capitalization

	December 31 1988	1987
	(in thousands)	
Common equity:		
Common stock — no par value — authorized 24,000,000 shares; outstanding 14,164,049 and 13,883,161 shares, respectively	**$193,640**	$187,383
Retained earnings ($20,414,000 restricted as to payment of cash dividends)	**77,283**	71,273
	270,923	258,656
Cumulative preferred stock:		
Iowa Electric Light and Power Company — par value $50 per share — authorized 466,406 shares; outstanding 366,406 shares —		
6.10% - Outstanding 100,000 shares	**5,000**	5,000
4.80% - Outstanding 146,406 shares	**7,320**	7,320
4.30% - Outstanding 120,000 shares	**6,000**	6,000
	18,320	18,320
Redeemahle cumulative preference stock:		
Iowa Electric Light and Power Company — par value $100 per share — authorized 700,000 shares —		
8.55% - Outstanding 70,000 and 90,000 shares	**7,000**	9,000
Less - Amount to be redeemed within one year	**1,000**	1,000
	6,000	8,000
Long-term deht:		
Series 1986 debentures, 8-1/8%, due 1993	**45,000**	45,000
Iowa Electric Light and Power Company — First mortgage bonds —		
Series I, 5-1/8%, due 1991	**16,000**	16,000
Series J, 6-1/4%, due 1996	**15,000**	15,000
Series K, 8-5/8%, due 1999	**20,000**	20,000
Series L, 7-7/8%, due 2000	**15,000**	15,000
Series M, 7-5/8%, due 2002	**30,000**	30,000
Series O, 9.80%, due 1991	**2,855**	3,888
Series P & Q, 6.70%, due 2006	**9,200**	9,200
Series R, 8-1/4%, due 2007	**25,000**	25,000
Series T, 14-3/4%, due 1991	**—**	30,000
Series U, 9-7/8%, due 2000	**5,300**	5,300
Series V, 11%, due 1988	**—**	35,000
Series W, 9-3/4%, due 1995	**50,000**	—
Series X, 9.42%, due 1995	**50,000**	—
	238,355	204,388
Guarantee of pollution control bonds, 5.73%, $600,000 due annually 1989-1994; $10,200,000 due 2003	**13,800**	14,600
	252,155	218,988
Other subsidiaries' debt maturing through 1993	**8,431**	4,599
	305,586	268,587
Unamortized debt premium and (discount), net	**(872)**	(1,010)
	304,714	267,577
Less — Amount due within one year	**1,865**	37,106
	302,849	230,471
	$598,092	$515,447

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Consolidated Statements of Cash Flows

	Year Ended December 31		
	1988	1987	1986
	(in thousands)		
Cash flows from operating activities:			
Net income before dividends on preferred and preference stock of subsidiary	**$35,795**	$35,888	$31,946
Items not requiring cash —			
Depreciation and amortization	**38,704**	31,784	34,226
Principal payments under capital lease obligations	**12,304**	9,963	12,080
Deferred taxes and investment tax credits	**(8,945)**	3,045	3,462
Amortization of deferred charges	**7,122**	6,210	5,658
Refueling outage provision	**(2,437)**	(3,948)	4,494
Cumulative effect of recording unbilled revenues	**—**	(11,493)	—
Discount of recoverable cancelled plant costs	**—**	3,524	—
Disallowed costs associated with Guthrie County generating station	**—**	3,615	—
Income from stock transactions of affiliate	**(5,826)**	(2,344)	—
Allowance for equity funds used during construction	**(594)**	(195)	(1,271)
Other	**3,387**	(983)	(2,685)
Other changes in assets and liahilities —			
Account receivable, including unbilled revenues	**(7,089)**	4,959	2,550
Accounts payable	**13,784**	(3,387)	(4,200)
Accrued taxes	**3,181**	(1,665)	1,429
Other	**2,703**	1,059	(271)
Net cash flows from operating activities	**92,089**	76,032	87,418
Cash flows from financing activities:			
Dividends on common stock	**(28,473)**	(27,370)	(26,156)
Dividends on preferred and preference stock of subsidiary	**(1,641)**	(1,812)	(3,410)
Proceeds from issuance of common stock	**6,562**	7,805	8,106
Proceeds from issuance of long-term debt	**100,253**	2,550	46,633
Net change in commercial paper and short-term notes payable	**(5,673)**	11,730	(2,580)
Sinking fund requirements and reduction in long-term debt and preference stock	**(69,443)**	(3,884)	(60,897)
Principal payments under capital lease obligations	**(15,523)**	(9,619)	(12,584)
Other	**(88)**	(50)	(3,056)
Net cash flows from financing activities	**(14,026)**	(20,650)	(53,944)
Cash flows for investing activities:			
Construction expenditures	**(65,271)**	(52,887)	(42,618)
Decommissioning trust fund	**(2,448)**	(1,223)	—
Other	**(10,037)**	(1,446)	2,482
Net cash flows for investing activities	**(77,756)**	(55,556)	(40,136)
Net increase (decrease) in cash and temporary cash investments	**307**	(174)	(6,662)
Casb and temporary cash investments at beginning of period	**1,407**	1,581	8,243
Cash and temporary cash investments at end of period	**$ 1,714**	$ 1,407	$ 1,581
Supplemental cash flow information:			
Cash paid during the period for —			
Interest	**$29,914**	$28,606	$28,028
Income taxes	**$16,452**	$17,286	$13,241

Capital lease obligations of $44,064,000, $2,013,000 and $14,117,000, respectively, for 1988-1986 were incurred for nuclear fuel.

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Consolidated Statements of Retained Earnings

	Year Ended December 31		
	1988	1987	1986
		(in thousands)	
Balance at beginning of year	**$ 71,273**	$64,192	$62,161
Add:			
Net income	**34,154**	34,076	28,536
Tax benefit resulting from the deduction of ESOP dividends	**329**	375	585
	105,756	98,643	91,282
Deduct:			
Cash dividends declared on common stock, at per share rates of $2.025, $1.99, and $1.95, respectively	**28,473**	27,370	26,156
Preference stock redemption premiums of subsidiary	**—**	—	934
	28,473	27,370	27,090
Balance at end of year ($20,414,000 restricted as to payment of cash dividends)	**$ 77,283**	$71,273	$64,192

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies:

(a) Basis of Consolidation —

The consolidated financial statements include the accounts of IE Industries Inc. (Industries) and its wholly-owned subsidiaries (the Company), of which the principal operating companies are Iowa Electric Light and Power Company (Iowa Electric) and the Cedar Rapids and Iowa City Railway Company (CRANDIC). All significant intercompany balances and transactions have been eliminated from the consolidated financial statements.

(b) Regulation —

Industries is currently exempt from regulation under the Public Utility Holding Company Act of 1935. Iowa Electric is subject to regulation by the Iowa Utilities Board (IUB) and the Federal Energy Regulatory Commission (FERC).

(c) Investments in Diversified Companies —

In December, 1988, the stockholders of Teleconnect Company (Teleconnect) approved the merger of Teleconnect and SouthernNet, Inc. Pursuant to the terms of the merger, Teleconnect became a wholly-owned subsidiary of Telecom★USA (Telecom). Each share of Teleconnect common stock outstanding immediately prior to the merger was converted into one share of Telecom common stock. Industries owns 2,460,000 shares or 9% of Telecom. Industries has accounted for the Teleconnect investment using the equity method; the cost method will be used to account for the Telecom investment.

In May, 1988, Teleconnect sold 3,200,000 shares of its common stock in an initial public offering at $18.00 per share. The transaction increased Industries' share of Teleconnect's net assets and resulted in a $5,826,000 pre-tax credit to "Interest expense and other - Income from stock transactions of affiliate."

In 1987, Teleconnect privately placed 1,554,000 shares of original issue common stock at a price significantly in excess of book value. As a result, Industries' share of Teleconnect's net assets increased resulting in a $2,344,000 pre-tax credit to "Interest expense and other - Income from stock transactions of affiliate."

In April, 1988, Industries purchased a 23.5% equity investment in Long Lines, Ltd. (Long Lines), a rapidly growing telecommunications company headquartered in Sergeant Bluff, Iowa. Long Lines is also involved in developing real estate for recreational purposes. At December 31, 1988, Industries' investment exceeded its equity ownership in the net assets of Long Lines by $6,600,000. This amount is being amortized over a forty year period.

(d) Depreciation —

Iowa Electric's provision for depreciation, except for the Duane Arnold Energy Center (DAEC), is based on straight-line composite rates. The average rate was 3.4%, 3.3% and 3.7% of the cost of depreciable electric property for 1988-1986, respectively. The average rate for gas property was 3.0% for 1988-1986.

The DAEC is currently being depreciated over a 36 year life using a remaining life method. Based on a study completed in 1985, Iowa Electric's 70% share of the cost to decommission the DAEC approximated $107 million in 1985 dollars. Iowa Electric began external funding of revenues collected for future decommissioning costs in 1987. The total decommissioning funds accumulated at December 31, 1988 were $25,380,000 including $21,709,000 of an internal decommissioning reserve recorded as accumulated depreciation.

(e) Revenues —

In 1987, Iowa Electric began accruing revenue for service rendered but unbilled at month-end in order to more properly match monthly revenue with the cost of service provided to customers. The cumulative effect of this change and pro forma effects on income are shown in the Consolidated Statements of Income. The pro forma information presents the financial results which would have been experienced had Iowa Electric been accounting for revenues under its current method throughout the periods.

(f) Allowance for Funds Used During Construction —

The allowance for funds used during construction (AFC), which represents the cost during the construction period of funds used for construction purposes, is capitalized by Iowa Electric as a component of the cost of utility plant. The amount of AFC applicable to debt funds and to other (equity) funds, a non-cash item, is computed in accordance with the formula prescribed by FERC. The aggregate gross rates for 1988-1986 were 9.3%, 8.2% and 10.8%, respectively.

(g) Adjustment Clauses —

Iowa Electric's electric tariffs include an energy adjustment clause (EAC) designed to reflect the current costs of fuel, including nuclear fuel and an estimated cost associated with nuclear waste disposal, and the energy portion of purchased power in billings to customers. The clause is based on the estimated cost of fuel consumed and the estimated energy cost of purchased power for the current and immediately preceding months. A correction factor is included to reflect previous over-or-under collections of revenue resulting from variances between the actual cost of fuel consumed and the amount included in billings to customers. Iowa Electric records the change in over-or-under collections by charging or crediting operation expense. The cumulative effect is reflected in the Consolidated Balance Sheets as a current asset or current liability, pending automatic reflection in future billings to customers.

Iowa Electric's gas tariffs include clauses designed to reflect changes in the cost of gas purchased for resale on a current basis. These clauses are accounted for in a manner similar to the EAC.

(h) Accumulated Refueling Outage Provision —

The IUB allows Iowa Electric to collect, as part of its base revenues, funds to offset operation and maintenance expenditures incurred during refueling outages at the DAEC. As these revenues are collected, an equivalent amount is charged to other operation and maintenance expenses with a corresponding credit to the reserve. During a refueling outage, the reserve is reversed to offset the increased expenditures.

(i) Income Taxes —

Federal income tax expense includes provisions for deferred taxes to reflect the tax effects of timing differences between when certain costs are recorded in the accounts and are deducted for tax return purposes. As these timing differences reverse, the related accumulated deferred income taxes are reversed to income.

Consistent with rate making practices, deferred taxes are not provided on certain timing differences. At December 31, 1988 Federal and state deferred income taxes have not been provided on cumulative net tax timing differences of $80,000,000 and $192,000,000, respectively. Iowa Electric believes that the income taxes payable in the future, due to the reversal of such timing differences, will be recovered through the rate making process.

The Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96 (SFAS 96) which establishes accounting and reporting standards for the effects of income taxes. The Company is required to adopt the new accounting and disclosure requirements of SFAS 96 prior to 1991. When adopted, the Company will record the cumulative effect of SFAS 96. Adjustments to accumulated deferred income taxes will be recorded for (1) additional deferred income tax liabilities not provided as a result of rate making practices and (2) the effects of income tax rate changes. It is expected that such adjustments will be essentially offset by regulatory assets and liabilities. Although the amount of such adjustments has not yet been determined, the Company does not anticipate a significant impact on the Consolidated Statements of Income.

Investment tax credits are utilized to offset Federal income taxes which otherwise would be currently payable. Such credits are deferred and are subsequently credited to income over the lives of the property which gave rise to the credits.

(j) Consolidated Statements of Cash Flows —

The Company has adopted SFAS 95, "Statement of Cash Flows". Prior years Consolidated Statements of Changes in Financial Position have been reclassified to conform to the 1988 presentation.

(2) Rate Matters:

Tax Reform Act of 1986

In order to reflect the effects of the Tax Reform Act of 1986, Iowa Electric filed with the IUB to reduce electric rates on an annual basis by $5.6 million; the reduction went into effect on July 1, 1987. Although the IUB allowed the reduction to be placed into effect, it rejected Iowa Electric's electric filing asserting that such rate reduction was deficient and should be approximately $3.0 million greater. Iowa Electric filed with the Iowa District Court for Linn County (Linn County District Court) for judicial review of the alleged deficiency. On June 28, 1988, the Linn

County District Court issued an order which affirmed the IUB order. Iowa Electric has appealed to the Iowa Supreme Court and a decision is not expected until mid-1989. Iowa Electric has reserved for the amount in dispute, including interest.

1986 Electric Rate Case

On April 25, 1986, Iowa Electric applied to the IUB for an electric rate increase to be charged to Iowa retail customers. Of the amount requested, $43.9 million on an annual basis, an interim increase of $19.2 million was allowed by the IUB effective July 24, 1986. On April 2, 1987, the IUB issued its final Order establishing rates based on an increase of $25.1 million. Such rates were placed into effect on May 8, 1987.

In its Order, the IUB disallowed $5.2 million of AFC recorded for the cancelled Guthrie County generating station. The disallowed AFC, net of an amount reserved in prior years, was written-off in March, 1987 and is reflected in "Interest expense and other - Miscellaneous, net." The disallowance was based on an interpretation of state law regarding when construction began. Iowa Electric believes that the IUB is in error on this matter and has appealed to the Iowa District Court for Polk County for relief from this finding. On September 30, 1988 the District Court issued an order affirming the IUB on this matter. Iowa Electric has filed a Notice of Appeal with the Iowa Supreme Court.

The IUB Order did allow recovery of the remaining costs associated with cancelled generating projects, but without rate base treatment. In accordance with SFAS 90, Iowa Electric recorded an adjustment in March, 1987 to discount the future revenues associated with such costs. The cumulative effect of such discounting and pro forma effect on income, assuming the change would have been applied retroactively, are shown in the Consolidated Statements of Income for the year ended December 31, 1987. The pro forma information presents the financial results which would have been experienced had Iowa Electric discounted the recoverable cancelled plant costs at the date of cancellation in February, 1986.

The Office of Consumer Advocate filed a Notice of Appeal to the Iowa District Court for Polk County on certain issues including recovery of a portion of the coal contract termination costs, recovery of certain future nuclear decommissioning costs, and recovery of a portion of the cancelled Guthrie County generating station costs. On September 30, 1988, the Polk County District Court issued its Order denying the Consumer Advocate's appeal and affirming the IUB on all matters. The Consumer Advocate has filed a Notice of Appeal with the Iowa Supreme Court. Iowa Electric believes the probability that the Consumer Advocate will be successful in its appeal is remote. Accordingly, no refund liabilities have been recorded.

1983 Electric Rate Case

In August, 1988, the Iowa Supreme Court issued its Order affirming the IUB rate order as orginally issued and, as a result, no refund liabilities exist.

(3) Leases:

Iowa Electric has a nuclear fuel lease covering its 70% undivided interest in the nuclear fuel purchased for the DAEC. Future purchases of fuel may also be added to the fuel lease. This capital lease provides for annual one year extensions which Iowa Electric presently intends to exercise to a date not later than December 31, 2023. Interest costs under the lease are based on costs incurred by the lessor on commercial paper. Iowa Electric is responsible for the payment of taxes, maintenance, operating cost, risk of loss and insurance relating to the leased fuel.

The lessor has a credit agreement with a bank supporting the nuclear fuel lease. The agreement is scheduled to terminate December 31, 1991, but will continue on a year to year basis unless either party provides at least a three year notice of termination. The maximum amount of financing available under the agreement is currently $80 million.

Annual nuclear fuel lease expenses include the cost of fuel, based on the quantity of heat produced for the generation of electric energy, plus the lessor's interest costs related to fuel in the reactor and administrative expenses. These expenses (included in fuel for production) for 1988-1986 were $13,684,000, $11,541,000 and $13,708,000, respectively.

Iowa Electric is operating the Prairie Creek Generating Station Units 1, 2 and 3, under a ten year capital lease agreement. Iowa Electric expects to purchase the units in 1989 for approximately $5,000,000. The lease payments (included in other operation expenses) for 1988-1986 were $1,101,000 annually.

Operating lease rental expenses were $7,648,000, $7,852,000 and $7,444,000 for 1988-1986, respectively.

Future minimum lease payments, which include the estimated annual expenses for fuel currently under Iowa Electric's nuclear fuel lease, are as follows:

Year	Capital Leases	Operating Leases
	(in thousands)	
1989	$ 15,598	$ 4,169
1990	12,607	3,633
1991	10,925	3,328
1992	11,511	3,175
1993	8,236	3,248
1994-2005	44,875	29,631
	103,752	$47,184
Less: Amount representing interest	32,600	
Present value of net minimum lease obligations	$ 71,152	

(4) Income Taxes:

Federal and state income taxes as set forth in the Consolidated Statements of Income are comprised of the following:

	Year Ended December 31		
	1988	1987	1986
	(in thousands)		
Federal income taxes:			
Current	**$12,671**	$11,060	$11,786
Deferred —			
Unbilled revenues	**(1,196)**	3,590	—
Coal contract termination costs	**(3,142)**	(3,615)	(963)
Plant abandonments	**(231)**	(676)	3,998
Refueling outage provision	**879**	2,058	(2,067)
Internal decommissioning	**—**	(6,176)	—
Depreciation	**1,313**	6,700	3,561
Other	**(1,503)**	1,489	6,984
Prior years	**(2,215)**	(1,777)	(7,153)
Investment tax credits —			
Deferred	**987**	1,911	1,645
Amortization and other	**(2,005)**	(1,941)	(1,847)
Total Federal income taxes	**5,558**	12,623	15,944
State income taxes:			
Current	**4,987**	3,905	3,289
Deferred —			
Unbilled revenues	**(273)**	817	—
Coal contract termination costs	**(717)**	1,771	—
Plant abandonments	**(53)**	681	—
Refueling outage provision	**240**	(223)	—
Internal decommissioning	**—**	(1,685)	—
Depreciation	**(395)**	(484)	(484)
Other	**(311)**	846	666
Prior years	**(323)**	(259)	(833)
Total state income taxes	**3,155**	5,369	2,638
Total income taxes	**$ 8,713**	$17,992	$18,582
Included in Consolidated Statements of Income as:			
Federal and state income taxes	**$ 8,713**	$14,570	$18,582
Cumulative effects of changes in accounting principles	**—**	3,422	—
	$ 8,713	$17,992	$18,582

The overall effective income tax rates shown below were computed by dividing total income tax expense by income before income taxes.

	Year Ended December 31		
	1988	1987	1986
Statutory Federal income tax rate	**34.0%**	40.0%	46.0%
Add (deduct):			
Allowance for funds used during construction	**(1.2)**	(0.9)	(2.3)
Amortization of investment tax credits	**(4.7)**	(3.7)	(4.0)
Amortization through tariffs of certain accumulated deferred income taxes over five and seven years	**(6.9)**	(6.3)	(7.5)
Preferred and preference dividend requirements of subsidiary	**1.3**	1.4	3.3
State income taxes, net of Federal benefits	**6.8**	5.1	4.0
Adjustment of prior period taxes	**(4.1)**	(2.1)	(1.4)
Reversal through tariffs of deferred taxes provided at rates in excess of the current statutory Federal income tax rate	**(3.5)**	(.8)	—
Other items, net	**(1.4)**	1.9	1.3
Overall effective income tax rate	**20.3%**	34.6%	39.4%

(5) Retirement Plan:

The Company has a non-contributory retirement plan which covers substantially all of its employees. Plan benefits are based on years of service and compensation during the employees' latter years of employment. Payments made from the pension fund to retired employees and beneficiaries during 1988 totaled $5,727,000.

The Company's policy is to expense and fund the pension cost determined using the frozen entry age actuarial cost method, provided that this amount is at least equal to the minimum funding requirements mandated by the Employee Retirement Income Security Act (ERISA) and does not exceed the maximum tax deductible amount for the year.

The Company adopted the provisions of SFAS 87 effective January 1, 1987. However, Industries' major subsidiary is Iowa Electric, a public utility subject to the provisions of SFAS 71. Therefore, certain adjustments are necessary in order to reflect the amount of annual pension cost allowed in Iowa Electric's most recent rate case.

The components of the 1988 and 1987 pension provision are as follows:

	1988	1987
	(in thousands)	
Service cost	**$2,142**	$2,226
Interest cost on projected benefit obligation	**5,854**	5,558
Assumed return on plan assets (actual return on plan assests were $10,603,000 and $4,723,000, respectively)	**(6,527)**	(6,449)
Amortization of unrecognized plan asset as of January 1, 1987	**(261)**	(261)
SFAS 87 pension cost	**1,208**	1,074
Adjustment to funding level	**1,433**	1,442
Total pension costs paid to the Trustee	**$2,641**	$2,516

Total pension cost paid to the Trustee was $2,786,000 for 1986.

A reconciliation of the funded status of the Plan under SFAS 87 to the amounts recognized in the Consolidated Balance Sheets is presented below:

	December 31	
	1988	1987
	(in thousands)	
Fair market value of plan assets	**$91,168**	$83,650
Actuarial present value of benefits rendered to date —		
Accumulated benefits based on compensation to date, including vested benefits of $55,839,000 and $52,893,000, respectively	**62,876**	58,436
Additional benefits based on estimated future salary levels	**17,429**	13,420
Projected benefit obligation	**80,305**	71,856
Plan assets in excess of projected benefit obligation	**10,863**	11,794
Remaining unrecognized net asset existing at January 1, 1987, being amortized over 20 years	**(4,695)**	(4,956)
Unrecognized net gain	**(3,293)**	(5,396)
Prepaid pension cost recognized in the Consolidated Balance Sheets	**$ 2,875**	$ 1,442
Assumed rate of return	**8.00%**	8.00%
Weighted average discount rate of projected benefit obligation	**7.75%**	8.25%
Assumed rate of increase in future compensation levels	**5.75%**	5.75%

In addition to providing pension benefits, the Company provides certain health care benefits for retired employees. The costs of such benefits are expensed as claims are paid. Such costs totaled $1,134,000, $914,000 and $754,000 for 1988-1986, respectively.

(6) Changes in Outstanding Shares of Common Stock:

The following table presents information relating to the issuance of common stock:

	Common Stock	
	Number of Shares	Amount
		(in thousands)
Balance, December 31, 1985	13,172,893	$171,472
Stock plan issuances*	375,548	8,106
Balance, December 31, 1986	13,548,441	179,578
Stock plan issuances*	334,720	7,805
Balance, December 31, 1987	13,883,161	187,383
Stock plan issuances**	280,888	6,257
Balance, December 31, 1988	14,164,049	$193,640

** Dividend Reinvestment and Stock Purchase Plan, Employee Stock Purchase Plan, Employees' Stock Ownership Plan*
*** Dividend Reinvestment and Stock Purchase Plan, Employee Stock Purchase Plan, Long-Term Incentive Plan of 1987*

Shares reserved for issuance pursuant to the stock plans totaled 1,478,438 at December 31, 1988.

(7) Preferred and Preference Stock:

Industries has 5,000,000 shares of Cumulative Preferred Stock, no par value, authorized for issuance, of which none is issued and outstanding at December 31, 1988.

The 6.10%, 4.80% and 4.30% Series of Iowa Electric Cumulative Preferred Stock are redeemable at the option of Iowa Electric upon 30 days' notice at $51.00, $50.25 and $51.00 per share, respectively, plus accrued dividends.

Iowa Electric Cumulative Preference Stock aggregating $2,000,000 in both 1988 and 1987 and $4,094,000 in 1986 was redeemed at par under mandatory and optional sinking fund provisions. Annual sinking fund redemptions of $1,000,000 will be required in 1989-1993. The Series 8.55% is redeemable at the option of Iowa Electric upon 30 days' notice at $104.28 through October 1, 1993 and at $102.14 thereafter.

(8) Long-Term Debt:

Iowa Electric's Indenture securing its First Mortgage Bonds constitutes a direct first mortgage lien upon substantially all tangible public utility property of Iowa Electric.

Total sinking fund requirements and debt maturities for 1989-1993 are as follows. The table pertains to Iowa Electric unless otherwise noted.

		Debt Maturities			
Year	Sinking Fund Requirements*	Debt Issue	Maturity Date	Amount	Total
1989	$2,243,000	Pollution Control	11/1/89	$ 600,000	
		Other Subsidiaries' Debt	Various	1,794,000**	$4,637,000
1990	2,083,000	Pollution Control	11/1/90	600,000	
		Other Subsidiaries' Debt	Various	4,122,000**	6,805,000
1991	1,050,000	Series I	1/1/91	16,000,000	
		Series O	7/1/91	790,000	
		Pollution Control	11/1/91	600,000	
		Other Subsidiaries' Debt	Various	197,000	18,637,000
1992	1,050,000	Pollution Control	11/1/92	600,000	
		Other Subsidiaries' Debt	Various	197,000	1,847,000
1993	1,050,000	Industries' Series 1986 Debentures	9/1/93	45,000,000	
		Pollution Control	11/1/93	600,000	
		Other Subsidiaries' Debt	Various	2,121,000	48,771,000

** Includes annual sinking fund requirements of $1,210,000 for 1989 and $1,050,000 for the years 1990-1993 which, by terms of the Indenture under which Series I, J, K, L, M and R Ronds have been issued, may be satisfied by the pledging of additional property. Iowa Electric intends to meet the 1989 requirements for these issues by this means.*

*** Company intends to refinance the majority of this debt with long-term debt.*

The Series P, Q and U Bonds secure tbe obligation of Iowa Electric with respect to three series of pollution control revenue bonds issued by three Iowa municipalities.

(9) Sbort-Term Borrowings:

At December 31, 1988, Industries had an unused line of credit in the amount of $10,000,000. Iowa Electric had lines of credit totaling $51,000,000, of which $24,800,000 was being used to support commercial paper. Commitment fees are paid to maintain these lines. There are no contractual restrictions placed on the withdrawal of these funds.

(10) Commitments and Contingencies:

Construction Program

The Company's construction program for 1989 anticipates expenditures aggregating approximately $60,000,000 for which substantial commitments have been made.

Long-Term Power Purchose Contract

Iowa Electric has a power purchase contract, as amended, with the City of Muscatine, Iowa for capacity purchases of 90 Mw through May, 1991 and 70 Mw for the final two years ending May, 1993. The cost of such capacity purchases, along with Iowa Electric's proportionate share of operating and maintenance costs, are reflected in purchased power in the Consolidated Statements of Income and will approximate $30,000,000 in 1989.

Nuclear Fuel

In September, 1985, the U.S. District Court in Colorado issued a decision holding that the Department of Energy's (DOE) Utility Services Contract which provides for the enrichment of uranium fuel

for U.S. nuclear power plants violates the DOE's uranium enrichment criteria and is "null and void." That ruling was ultimately appealed to the U.S. Supreme Court and on August 4, 1988, that Court issued its decision which allows the DOE to enrich foreign supplied uranium pending matters remanded to the District Court. On February 1, 1989, the District Court ordered the matters dismissed without prejudice. The Company believes the probability of new litigation being filed is remote.

In January, 1988, Iowa Electric took delivery of foreign uranium hexaflouride for future processing into nuclear fuel. Such quantities are expected to fulfill Iowa Electric's nuclear fuel requirements through 1994.

Nuclear Insurance Programs

The Price-Anderson Amendments Act of 1988 (1988 Act) provides Iowa Electric with the benefit of $7.3 billion of public liability coverage consisting of $200,000,000 of insurance and $7.1 billion of potential retroactive assessments from the owners of each nuclear power plant.

Pursuant to provisions in various nuclear insurance policies, Iowa Electric could be assessed retroactive premiums in connection with a future accident at a nuclear facility owned by a utility participating in the particular insurance plan. Under the 1988 Act, Iowa Electric could be assessed a maximum of $63,000,000 per nuclear incident, with a maximum of $10,000,000 per year (of which Iowa Electric's 70% ownership portion would be $44,100,000 and $7,000,000, respectively), if losses relating to the accidents exceeded $200,000,000. With respect to excess property damage and replacement power coverages, Iowa Electric could be assessed a maximum of $5,000,000 and $929,000, respectively, if the insurer's losses relating to an accident exceeded its reserves. No such assessments have been made under these policy provisions.

IRS Audit

Iowa Electric's Federal income tax returns for the years 1982-1984 were audited by the Internal Revenue Service. The Revenue Agent's Report includes certain proposed adjustments with which Iowa Electric disagrees. The most significant proposed adjustment relates to payments made in 1984 for the termination of a coal contract. The agent has disallowed a deduction in that year, contending that an intangible asset was created by the payments. Iowa Electric disagrees with that position and has filed a protest with the District Director of Internal Revenue in Des Moines, Iowa. Iowa Electric believes that it will be successful and the proposed adjustment will be dismissed. Should this adjustment be upheld, Iowa Electric would not anticipate a material adverse impact on the income statement. The contested tax amounts have been deferred and such deferrals would be credited to income at the time the current tax liability would be recorded. There would, however, be a significant impact on cash flow since Iowa Electric would have to pay a tax assessment of approximately $9 million for the three year period as well as interest.

(11) Deferred Charges:

Cool Contract Termination

In 1984 and 1985, Iowa Electric terminated coal contracts with two suppliers at a cost of $27,511,000. The termination payments are being recovered in rates; the retail portion over a four year period commencing in 1987. Recovery of related interest costs and inclusion of the unrecorded costs in rate base was disallowed by the IUB. At December 31, 1988, unamortized coal contract termination costs were $11,683,000.

Cancelled Plant

The costs of cancelled plant ($11,252,000) are being amortized over 10 years, commencing in 1987, as they are collected in rates. Refer to Note 2 for more information. At December 31, 1988, unamortized costs of cancelled plant were $9,401,000.

(12) Guarantees:

At December 31, 1988, Industries or its subsidiary, Iowa Electric, have guaranteed $1,339,000 of loans primarily in connection with economic development activities.

(13) Jointly-Owned Electric Utility Plant:

Under joint ownership agreements with other Iowa utilities. Iowa Electric has undivided ownership interests in two electric generating stations and related transmission facilities. Each of the respective owners was responsible for the issuance of its own securities to finance its portion of the construction costs. Kilowatt-hour generation and operating expenses are divided on the same basis as ownership with each owner reflecting its respective costs in its Statements of Income. Information relative to Iowa Electric's ownership interest in these facilities at December 31, 1988 is as follows:

	DAEC	Ottumwa Unit 1
	(in thousands)	
Utility plant in service	$392,582	$62,110
Accumulated depreciation	$129,767	$14,832
Construction work in progress	$ 13,962	$ 119
Plant capacity — Mw	500	675
Iowa Electric's share	70%	15%
In-service date	1974	1981

(14) Segments of Business:

The principal subsidiary of Industries is Iowa Electric, a utility engaged primarily in the generation, transmission, distribution and sale of electric energy and in the purchase, distribution and sale of natural gas. Certain financial information relating to Industries' segments of business is presented below:

	Year Ended December 31		
	1988	1987	1986
		(in thousands)	
Operating results:			
Revenues —			
Electric	**$314,769**	$303,491	$285,448
Gas	**102,524**	90,401	125,441
Railroad	**10,689**	10,270	11,037
Operating income —			
Electric	**$61,191**	$64,185	$55,851
Gas	**(2,349)**	3,605	9,112
Railroad	**4,283**	4,590	5,818
Other information:			
Depreciation —			
Electric	**$35,774**	$29,159	$31,758
Gas	**2,105**	2,048	2,021
Railroad	**165**	157	146
Construction expenditures —			
Electric	**$54,255**	$41,045	$34,788
Gas	**2,735**	2,729	1,843
Railroad	**1,788**	1,696	835
Assets—			
Identifiable assets* —			
Electric	**$751,325**	$691,110	$689,327
Gas	**55,005**	58,622	54,152
Railroad	**21,414**	25,285	22,090
	827,744	775,017	765,569
Other corporate assets	**129,122**	90,045	85,641
Total consolidated assets	**$956,866**	$865,062	$851,210

** Includes net utility plant, leased nuclear fuel, production fuel, materials and supplies, and other identifiable assets.*

Selected Consolidated Financial Data

	1988	1987	1986	1985	1984	1983
Income statement data (000's):						
Operating revenue	**$438,252**	$412,778	$429,245	$461,798	$476,706	$452,925
Operating income	**63,908**	72,799	72,271	56,286	71,966	66,334
Net income	**34,154**	29,529*	28,536	19,056	30,023	23,289
Common stock data:						
Average number of shares outstanding (000's)	**14,053**	13,748	13,408	12,973	12,445	10,901
Earnings per average common share	**$ 2.43**	$ 2.14*	$ 2.13	$ 1.47	$ 2.41	$ 2.14
Return on average common equity	**12.9%**	11.8%*	12.0%	8.2%	13.5%	11.6%
Dividends declared per common share	**$ 2.025**	$ 1.99	$ 1.95	$ 1.91	$ 1.855	$ 1.795
Annual dividend rate at end of year	**2.04**	2.02	1.98	1.94	1.90	1.84
Market price per common share at year-end	**22.63**	22.63	23.38	20.75	18.00	14.88
Book value per common share at year-end	**19.13**	18.63	17.99	17.73	18.16	17.75
Ratio of market price to book value at year-end	**118%**	121%	130%	117%	98%	84%

		%		%		%		%		%		%
Capitalization (000,000's):												
Common equity	**$271**	**45**	$259	47	$244	46	$234	43	$230	45	$215	43
Preferred and preference stock	**24**	**4**	26	4	28	5	51	10	55	11	57	11
Long-term debt	**303**	**51**	230	49	265	49	252	47	220	44	233	46
	$598	**100**	$515	100	$537	100	$537	100	$505	100	$505	100

	1988	1987	1986	1985	1984	1983
Other selected financial data:						
Total assets (000's)	**$ 956,866**	$ 865,062	$ 851,210	$ 850,918	$ 831,202	$ 800,049
Investments in diversified companies	**86,305**	53,969	43,945	40,158	19,458	14,247
Construction expenditures including AFC (000's)	**$ 65,271**	$ 52,887	$ 42,618	$ 47,866	$ 39,404	$ 48,110
Percent of construction expenditures financed internally from operations	**54%**	65%	100%	72%	100%	99%
Times interest earned before income taxes	**2.60**	3.06	3.00	2.32	3.04	2.74
Number of Iowa Electric preferred and preference shareholders	**2,070**	2,161	2,222	2,802	3,006	3,121
Number of common shareholders	**26,353**	27,414	29,869	32,348	32,805	31,768

**Before cumulative effects of changes in accounting principles.*

Selected Financial Data—IE

	1988	1987	1986	1985	1984	1983
Utility plant in service (000's) —						
Electric	**$ 943,541**	$ 905,252	$870,818	$838,139	$787,500	$764,696
Gas	**72,010**	70,842	70,785	71,126	69,586	67,173
Other	**31,586**	27,639	22,761	22,512	20,021	14,902
	$1,047,137	$1,003,733	$964,364	$931,777	$877,107	$846,771
Accumulated depreciation (000's)	**$ 410,178**	$ 378,635	$354,641	$332,783	$303,233	$275,500
Ratio of accumulated depreciation to utility plant in service	**39%**	38%	37%	36%	35%	33%
AFC as a percent of net income	**4%**	3%	8%	9%	4%	14%
Times interest earned before income taxes	**2.65**	3.21	3.10	2.32	3.05	2.74
Construction expenditures including AFC (000's)	**$61,944**	$47,649	$40,111	$45,427	$38,793	$47,874
Percent of construction expenditures financed internally from operations	**56%**	69%	100%	69%	100%	94%

Electric Operating Comparison— ie

	1988	1987	1986	1985	1984	1983	Five Year Compound Rate of Growth
Operating revenue (000's):							
Residential	**$121,488**	$114,395	$100,067	$ 99,309	$ 98,882	$ 92,229	
Rural	**17,139**	16,826	16,801	16,858	17,233	16,106	
Commercial	**90,230**	87,996	86,111	86,059	89,500	83,019	
Industrial	**67,179**	66,448	65,537	70,562	73,629	66,332	
Street lighting and public authorities	**4,229**	4,268	4,161	4,346	4,367	4,150	
Total from ultimate consumers	**300,265**	289,933	272,677	277,134	283,611	261,836	
Sales for resale	**13,415**	12,556	11,641	13,282	12,883	13,447	
Other	**1,089**	1,002	1,130	1,208	1,044	911	
	$314,769	$303,491	$285,448	$291,624	$297,538	$276,194	
Energy sales (000's Kwh):							
Residential	**1,313,852**	1,232,622	1,215,722	1,174,150	1,209,678	1,272,030	0.6%
Rural	**201,877**	193,908	213,431	208,491	210,958	212,775	(1.1)
Commercial	**1,223,644**	1,143,103	1,118,493	1,072,674	1,071,934	1,066,847	2.8
Industrial	**1,579,569**	1,485,476	1,440,276	1,391,573	1,365,959	1,290,168	4.1
Street lighting and public authorities	**52,550**	50,572	48,643	51,117	52,952	55,030	(0.9)
Total to ultimate consumers	**4,371,492**	4,105,681	4,036,565	3,898,005	3,911,481	3,896,850	2.3
Sales for resale	**332,837**	312,324	307,759	296,629	294,047	322,436	0.6
	4,704,329	4,418,005	4,344,324	4,194,634	4,205,528	4,219,286	2.2
Sources of electric energy (000's Kwb):							
Generated —							
Fossil, primarily coal	**1,900,288**	1,946,916	1,844,564	1,524,106	1,079,576	1,608,895	
Nuclear	**2,214,243**	1,766,319	2,095,334	1,348,821	1,889,865	1,615,878	
Hydro	**3,300**	5,153	5,595	3,892	5,517	6,309	
	4,117,831	3,718,388	3,945,493	2,876,819	2,974,958	3,231,082	
Purchased and net interchange	**991,713**	1,076,115	751,634	1,705,080	1,588,615	1,377,310	
	5,109,544	4,794,503	4,697,127	4,581,899	4,563,573	4,608,392	
Operating statistics:							
Heat rate (Btu per Kwh generated)	**11,409**	11,359	11,212	11,495	11,657	11,591	
Net capability at time of peak load (Kw) —							
Net generating capability —							
Steam stations —							
Nuclear*	**350,000**	350,000	350,000	350,000	350,000	350,000	
Fossil	**535,250**	513,750	540,750	541,250	492,250	491,250	
Peaking turbines and others	**167,300**	155,900	155,900	156,500	155,900	157,800	
	1,052,550	1,019,650	1,046,650	1,047,750	998,150	999,050	
Purchase capability	**90,000**	90,000	100,000	100,000	149,000	201,250	
	1,142,550	1,109,650	1,146,650	1,147,750	1,147,150	1,200,300	
Net peak load (Kw) — 60 minutes integrated	**1,031,185**	978,322	953,926	922,190	966,935	985,456	0.9%
Number of customers at year-end	**206,935**	206,354	206,007	205,959	204,712	204,460	0.2%
Residential and rural service:							
Average number of customers	**176,079**	175,693	175,502	175,221	175,039	174,002	
Average annual Kwh sales per customer	**8,608**	8,169	8,143	7,891	8,116	8,533	
Revenue per Kwh sold	**9.15¢**	9.20¢	8.18¢	8.40¢	8.17¢	7.30¢	
Average annual revenue per customer	**$787.30**	$751.46	$665.91	$662.98	$663.37	$622.60	

** Represents Iowa Electric's 70% undivided interest in the Duane Arnold Energy Center which is operated by Iowa Electric.*

Gas Operating Comparison—

	1988	1987	1986	1985	1984	1983	Five Year Compound Rate of Growth
Operating revenues (000's):							
Residential	**$ 52,871**	$45,245	$ 59,153	$ 68,719	$ 73,089	$ 71,202	
Commercial — firm	**22,403**	18,475	23,986	27,466	28,995	28,123	
— interruptible	**7,211**	6,086	8,433	11,032	12,055	12,041	
Industrial — firm	**4,107**	3,883	11,961	16,324	17,868	19,815	
— interruptible	**14,698**	14,455	21,037	30,968	31,456	29,999	
Total from ultimate consumers	**101,290**	88,144	124,570	154,509	163,463	161,180	
Other	**1,049**	2,026	588	461	433	1,046	
	$102,339	$90,170	$125,158	$154,970	$163,896	$162,226	
Energy sales (000's dekatherms):							
Residential	**11,680**	10,166	12,092	13,147	13,444	13,015	(2.2)%
Commercial — firm	**5,046**	4,301	5,160	5,514	5,575	5,374	(1.3)
— interruptible	**2,236**	2,059	2,374	2,713	2,838	2,840	(4.7)
Industrial — firm	**607**	626	3,474	4,293	4,842	5,186	(34.9)
— interruptible	**5,490**	5,699	6,731	8,261	7,986	7,697	(7.0)
Total sales	**25,059**	22,851	29,831	33,928	34,685	34,112	(6.5)
Industrial — transported volumes	**5,703**	4,440	682	—	—	—	100+
Total volumes delivered	**30,762**	27,291	30,513	33,928	34,685	34,112	(2.1)
Operating statistics:							
Gas purchased for resale (000's dekatherms)	**24,920**	23,271	28,954	34,507	34,125	34,894	
Cost of gas purchased for resale (000's)	**$ 83,372**	$71,995	$ 99,867	$133,394	$136,603	$140,844	
Cost per dekatherm of gas purchased for resale	**$ 3.35**	$ 3.09	$ 3.45	$ 3.87	$ 4.00	$ 4.04	
Sendout capability at time of peak demand (dekatherms)	**218,224**	251,211	263,986	261,291	261,291	261,221	
Peak daily sendout (dekatherms)	**217,869**	195,682	220,836	264,772	246,384	272,727	(4.4)%
Number of customers at year-eud	**121,919**	122,351	126,951	132,986	133,165	132,587	(1.5)%
Residential service:							
Average number of customers	**105,363**	107,921	110,480	114,372	114,316	113,603	
Average annual dekatherm sales per customer	**111**	95	109	115	118	115	
Revenue per dekatherm sold	**$ 4.53**	$ 4.39	$ 4.89	$ 5.23	$ 5.44	$ 5.47	
Average annual revenue per customer	**$ 501.80**	$ 417.87	$ 535.42	$ 600.84	$ 639.36	$ 626.77	

Annual Report

This report is published to provide general information concerning the Company and is not in connection with any sale, offer for sale or solicitation of any offer to buy any securities.

The statements in this report are furnished solely for your information. The facts and figures presented, while accepted by the management as reliable in the operations of the property, are not, however, guaranteed by us against inaccuracy or omission of material fact and are not furnished by us nor to be used by you in any way which implies liability on our part or on the part of our officers and directors in connection with your dealings in the securities of this Company. The purpose of this paragraph is to protect you and this Company against any liability that may occur under any State or Federal Securities Act.

Directors and Officers

Board of Directors

IE Industries Inc. and Iowa Electric Light and Power Company

J. Wayne Bevis (C)
President, Chief Executive Officer and Director
Rolscreen Company
(Window and Door Manufacturing)
Pella, Iowa

Dr. George Daly (A)
Dean
College of Business Administration
The University of Iowa
Iowa City, Iowa

Dr. Salomon Levy (C)
President
S. Levy Incorporated
(Engineering/Management Consulting)
Campbell, California

Lee Liu (N) (E)
Chairman of the Board, President and Chief Executive Officer of the Company

Dr. Leo L. Nussbaum (A)
President Emeritus
Coe College,
Cedar Rapids, Iowa
St. Petersburg, Florida

Robert D. Ray (N)
President and
Chief Executive Officer
Blue Cross and Rlue Shield of Iowa (Insurance)
Des Moines, Iowa

David Q. Reed (N)
Attorney and Counselor at Law
Kansas City, Missouri

J. B. Rehnstrom
Senior Vice President—Finance and Secretary of the Company

Larry D. Root
Senior Vice President—
Operations and Production
Iowa Electric Light and Power Company

Henry Royer (C) (E)
Chairman of the Board and President
The Merchants National Bank of Cedar Rapids
Cedar Rapids, Iowa

Richard E. Scherling (A) (E)
Retired Merchant
Cedar Rapids, Iowa

Directors Emeritus

William O. Gray
Attorney at Law
Cedar Rapids, Iowa

Dr. James A. Van Allen
Carver Professor of Physics, Emeritus
The University of Iowa
Iowa City, Iowa

Walter E. Brown
Chairman of the Board
Kiowa Corporation
(Valve and Zinc Die Casting)
Marshalltown, Iowa

IE Industries Inc.
(E) Member Executive Committee
(A) Member Audit Committee
(N) Member Nominating Committee
(C) Member Compensation Committee

Officers

IE Industries Inc.

Lee Liu (55-31)
Chairman of the Board, President and Chief Executive Officer

J. B. Rehnstrom (58-29)
Senior Vice President—Finance and Secretary

Peter W. Dietrich (48-1)
Vice President—Corporate Development

Rohert J. Kucharski (56-14)
Vice President, Treasurer and Assistant Secretary

Thomas J. Pitner (47-10)
Vice President and General Counsel

William C. Jurgensen (48-30)
Assistant Secretary

Iowa Electric Light and Power Company

Lee Liu (55-31)
Chairman of the Roard, President and Chief Executive Officer

J. B. Rehnstrom (58-29)
Senior Vice President—Finance and Secretary

Larry D. Root (52-18)
Senior Vice President—Operations and Production

Robert J. Kucharski (56-14)
Vice President and Treasurer

Dr. Robert J. Latham (46-5)
Vice President—Corporate Affairs and Planning

Richard W. McGaughy (58-8)
Vice President—Production

Thomas J. Pitner (47-10)
Vice President and General Counsel

Harold W. Rehrauer (51-16)
Vice President—Technical Services

Thomas R. Seldon (50-1)
Vice President—Human Resources

William C. Jurgensen (48-30)
Assistant Secretary

Figures in parenthesis represent age and years of service.

Shareholder Information

Annual Meeting

The annual meeting of the shareholders will be held at 2:00 p.m., Central Daylight Time on Tuesday, May 23, 1989 at the ie: Tower, 6th floor, 200 First Street S.E. in Cedar Rapids, Iowa. A proxy statement with respect to this meeting will be mailed on April 11, 1989. All common shareholders are cordially invited to attend. However, those who are unable to attend in person are urged to promptly sign and return their proxy.

Stock Exchange Listing

IE Industries Inc. common stock is listed on the New York Stock Exchange under the symbol IEL. Newspaper listings often use the symbol IE IND.

General Inquiries

Shareholder inquiries, including the replacement of dividend checks, address changes, transfer or reissuance of stock certificates, and requests from the general public for any financial publications may be directed to:

IE Industries Inc.
Attn: Shareholder Services
P.O. Box 351
Cedar Rapids, Iowa 52406
1-800-247-9785 or 319-398-7755

Where to Buy and Sell Stock

Common stock may be purchased and sold privately or on the open market through a brokerage firm. A shareholder enrolled in the Company's Dividend Reinvestment and Stock Purchase Plan can purchase additional common stock with no brokerage fees through the optional cash feature of the Plan.

Shares held in the Dividend Reinvestment and Stock Purchase Plan can be sold through the Plan Administrator upon written request of the shareholder, who will receive all proceeds of the sale less any brokerage commission.

Dividend Reinvestment and Stock Purchase Plan

The Company has a Dividend Reinvestment and Stock Purchase Plan which allows shareholders to automatically reinvest their cash dividends in additional shares of common stock. The First National Bank of Chicago acts as the Plan Administrator. A prospectus describing the Plan can be obtained by writing to Shareholder Services.

Duplicate Accounts and Mailings

Shareholders sometimes receive more than one Annual Report because shares owned by one shareholder may be registered with slight variations in names. The Company is required to mail an Annual Report to each name on the shareholder list unless the shareholder requests that duplicates be eliminated. To eliminate duplicate mailings, please send a written request to Shareholder Services.

Dividend Payment Dates

Scheduled Dividend Payment and Record Dates for 1989 are:

Record Dates	Payment Dates
March 10, 1989	April 1, 1989
June 16, 1989	July 1, 1989
Sept. 15, 1989	Oct. 1, 1989
Dec. 15, 1989	Jan. 1, 1990

Dividends paid on common stock in 1988 were fully taxable for federal income tax purposes.

1988 Form 10-K Available on Request

The Company files annually with the Securities and Exchange Commission an Annual Report Form 10-K. This required report contains certain other information not made a part of this report. The Company will be happy to send you a copy of our 1988 Form 10-K without charge. Requests should be made to Shareholder Services.

Transfer Agents

The First National Bank of Chicago
Chicago, Illinois

The Merchants National Bank of Cedar Rapids
Cedar Rapids, Iowa

IE Industries Common Stock
Iowa Electric Light and Power Company Preferred and Preference Stock

Registrars

The First National Bank of Chicago
Chicago, Illinois

Norwest Bank Cedar Rapids, N.A.
Cedar Rapids, Iowa

IE Industries Common Stock
Iowa Electric Light and Power Company Preferred and Preference Stock

Trustee

The First National Bank of Chicago
Chicago, Illinois

IE Industries Indenture
Iowa Electric Light and Power Company

IE
INDUSTRIES
P. O. BOX 351 CEDAR RAPIDS, IOWA 52400

50-331 Duane-Arnold

-NOTICE-

THE ATTACHED FILES ARE OFFICIAL RECORDS OF THE RECORDS & REPORTS MANAGEMENT BRANCH. THEY HAVE BEEN CHARGED TO YOU FOR A LIMITED TIME PERIOD AND MUST BE RETURNED TO THE RECORDS & ARCHIVES SERVICES SECTION P1-122 WHITE FLINT. PLEASE DO NOT SEND DOCUMENTS CHARGED OUT THROUGH THE MAIL. REMOVAL OF ANY PAGE(S) FROM DOCUMENT FOR REPRODUCTION MUST BE REFERRED TO FILE PERSONNEL.

-NOTICE-

Rec'd w/ltr 6/1/89 #8906060076