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About the Company

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 include the Cedar Rapids and Iowa City Railway Company, Industrial Energy Applications, Inc., and Iowa Land and Building Company. IE Industries also has a 30 percent equity interest in Teleconnect Company.

Iowa Electric, in its 105th year of operation, remains the primary source of revenue and earnings for the holding company. Iowa Electric provides electric, natural gas, and steam energy for about 279,000 residential, commercial, and industrial customers in over 400 communities in Iowa, Minnesota, and Nebraska.

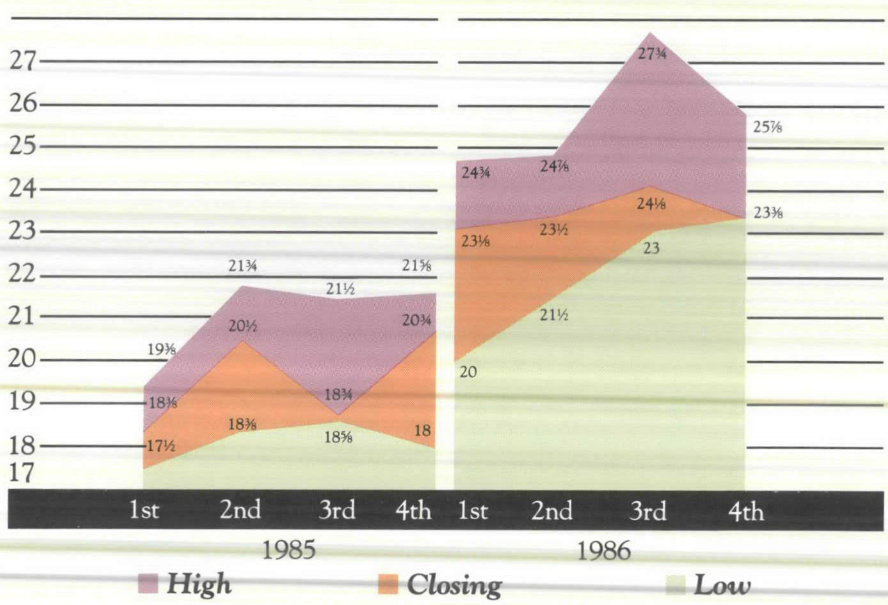
1986 HIGHLIGHTS

	1986	1985	Increase (Decrease)	Percent Increase (Decrease)
Operating revenues (000's)	**$ 429,245**	$ 461,798	$(32,553)	(7)
Net income (000's)	**$ 28,536**	$ 19,056	$ 9,480	50
Earnings per average common share	**$ 2.13**	$ 1.47	$ .66	45
Dividends declared per common share	**$ 1.95**	$ 1.91	$ .04	2
Construction expenditures (000's)	**$ 42,618**	$ 47,866	$ (5,248)	(11)
Funds provided internally (000's)	**$ 48,863**	$ 33,834	$ 15,029	44
Sales of electricity to customers (Kwh) (000's)	**4,344,324**	4,194,634	149,690	4
Sales of gas to customers (dekatherms) (000's)	**29,831**	33,928	(4,097)	(12)
Number of common stockholders	**29,869**	32,348	(2,479)	(8)
Number of full-time employees	**1,551**	1,606	(55)	(3)

QUARTERLY HIGH, LOW AND CLOSING PRICES OF COMMON STOCK (DOLLARS)

COMMON STOCK

Quarterly common stock dividends of $.485 and $.475 were paid by the Company during 1986 and 1985, 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.



SHAREHOLDER INFORMATION

ANNUAL MEETING

The annual meeting of the shareholders will be held at 2:00 p.m., Central Daylight Time on Tuesday, May 19, 1987 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 8, 1987. 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 Records Dates for 1987 are:

Record Dates	Payment Dates
March 13, 1987	April 1, 1987
June 12, 1987	July 1, 1987
Sept. 11, 1987	Oct. 1, 1987
Dec. 11, 1987	Jan. 1, 1988

Dividends paid on common stock in 1986 were fully taxable for federal income tax purposes.

1986 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 1986 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

Peoples Bank and Trust Company
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
Mortgage and Deed of Trust

DEAR SHAREHOLDER:

The year 1986 marked the beginning of a new direction for our company. The plan to create a new holding company, as proposed by the Board of Directors, was overwhelmingly approved by the shareholders. The new company, IE Industries Inc., became the parent company of Iowa Electric Light and Power Company and its subsidiaries.

The holding company formation is a giant step forward as we position ourselves strategically for long-term growth and prosperity. The new company provides clear separation between our regulated utility business and other ventures. It has the freedom to expand, to compete, and to diversify. The profits from unregulated operations will flow directly to the shareholders. It is a company well positioned to survive and to grow in the rapidly changing socio-economic environment.

We realize that our core business, the supply of electricity, natural gas, and steam, will continue to be the mainstay of our enterprise for some time to come. Therefore, it is essential for us to keep it strong and viable while diversifying selectively into other business opportunities.

The financial results for 1986 reflect a brighter year than 1985. Earnings per common share were up 45 percent from the previous year. Our stock price reached a 20-year high of $27¾ on September 2, 1986, and closed at $23⅜, up 12.7 percent. Our stock was trading above $27 per share in March, 1987. These positive results are reflective of several factors including our continued cost containment program, a strong increase in electric sales, and an increase in the margins made from both electricity and natural gas.

In November, 1986, the Board of Directors increased the yearly cash dividend to $1.98 per share from the $1.94 per share paid a year earlier. This marks the eleventh consecutive year the dividend has been increased.

In 1983 we put in motion an action plan to revitalize our utility business. A rate stabilization program was adopted to forego any electric rate increase for three years. An aggressive cost containment program was also put into effect with the participation of virtually every employee.

I am happy to report that our major goals have been achieved. The operation and maintenance expenses in 1986 have been contained at the same level as in 1985, and, at the same time, the efficiency of our production facilities has vastly improved.

The Duane Arnold Energy Center, a 500-megawatt nuclear station, operated 234 days without interruption, the longest continuous run since it became operational in 1974. Also, more kilowatt-hours were produced in our fossil plants in 1986 than in the preceding thirteen years.

In 1986 we also experienced more favorable energy prices by carefully managing spot market purchases of coal and natural gas. Our persistent effort to stabilize prices not only benefited our customers, but also put us in a better competitive position in the energy marketplace.

Another significant action in 1986 was the creation of a centralized, computer-directed customer service center, staffed by specially trained customer service representatives. This center, which will soon operate 24 hours a day, is a vital link with our customers. Center employees have the capability to answer a wide range of customer inquiries in areas such as billing, energy management, utility rates, and service interruption. Of course, customer complaints can be answered as well.

The new customer service center has been in operation for a short time and, so far, we are very pleased with the results. As we continue to integrate it company-wide, we will monitor progress carefully to assure customer satisfaction and acceptance.

The commitment to our customers also extends to active participation in local economic development. We have provided financial resources and people to promote economic development in the communities we serve. We have become the movers and shakers to encourage local initiative. Our company is one of the most ardent promoters of Iowa and its numerous assets.

Our stepped-up business development efforts have reaped significant benefits. In 1986 we helped over 37 companies to locate in our service territory, creating over 3,000 new jobs.

At the February, 1987, Board of Directors meeting, the Board voted to increase its membership from ten to eleven. Three new Board members were named: Robert D. Ray, President and Chief Executive Officer of Life Investors, Inc. in Cedar Rapids; J. Wayne Bevis, President and Chief Executive Officer of Rolscreen Company in Pella, Iowa; and Larry D. Root, Senior Vice President, Operations and Production of Iowa Electric Light and Power Company. We welcome them to the Board.

Additionally, William O. Gray and Dr. James A. Van Allen retired from the Board of Directors in early February, 1987, after many years of valuable service as board members. We are grateful for their past contribution and pleased that they have agreed to continue as Directors Emeritus.

Henrietta Dows Arnold, a member of our Board of Directors since 1983, passed away on June 5, 1986. Mrs. Arnold and her family have been associated with the management of this company for almost a century. We are saddened by her death.

Alan C. Courtney, Vice President and General Manager of the Cedar Rapids and Iowa City Railway Company, died February 9, 1987. Mr. Courtney was an innovative leader, instrumental in recent CRANDIC expansions. In 1986 he guided the CRANDIC business through one of its most successful years. We will miss him and remember him well.

This is only a brief look at 1986. In the following pages, we review the year's activities and accomplishments in much more detail. As you can see, our company has made significant progress in 1986; and its dedicated workforce is indeed on the move. We are pleased to submit this report on a successful and eventful year.

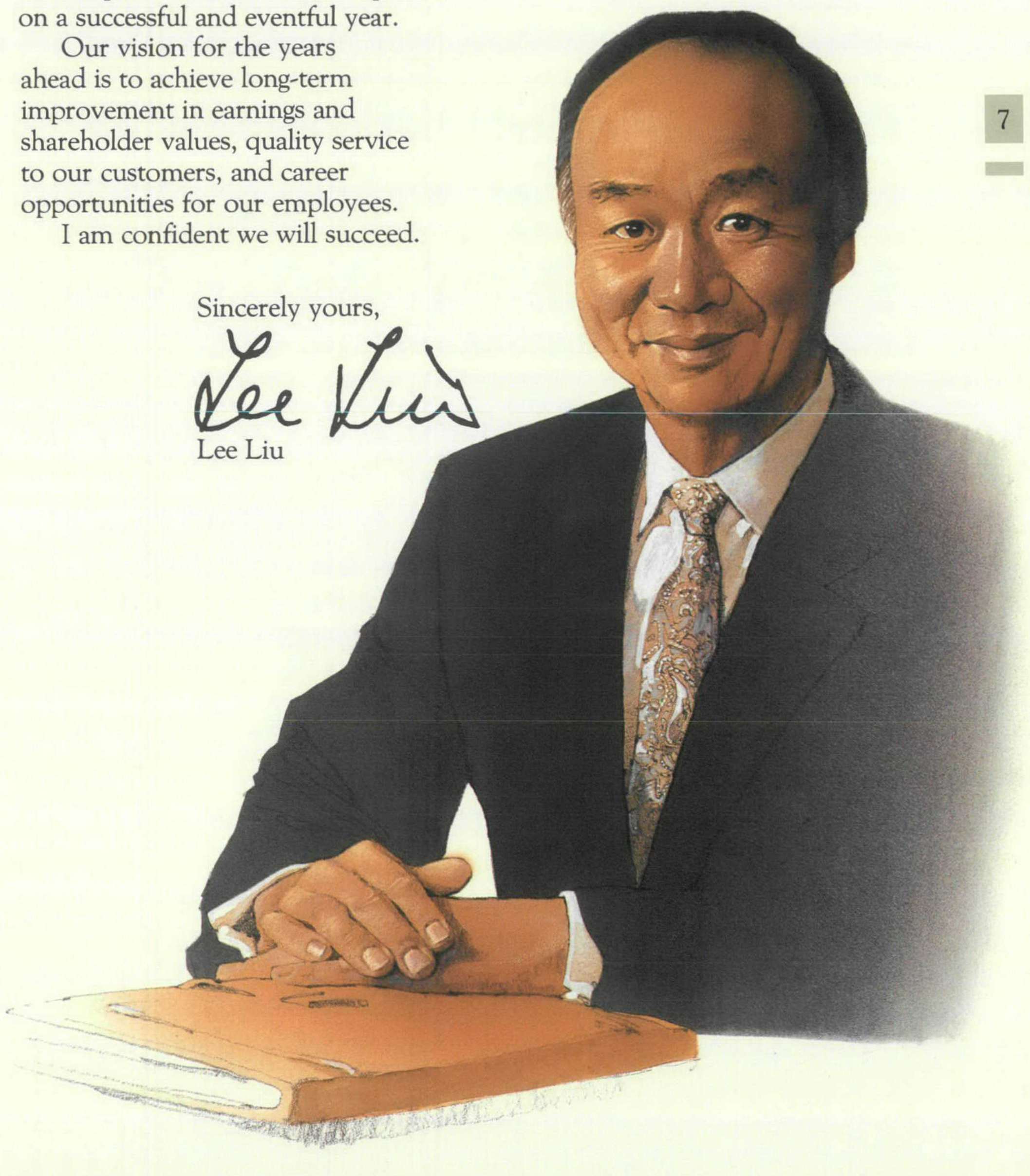
Our vision for the years ahead is to achieve long-term improvement in earnings and shareholder values, quality service to our customers, and career opportunities for our employees.

I am confident we will succeed.

Sincerely yours,

Lee Liu

Lee Liu



YEAR IN REVIEW

FINANCIAL RESULTS

Financial results in 1986 improved from a year ago. Economic conditions that affected our revenue base over the past few years showed distinct improvement. Sales volumes from our principal subsidiary, Iowa Electric Light and Power Company, increased substantially. As we enter our first full year as a diversified holding company, we have strong indications of continued growth in our principal areas of business.

Revenues in 1986 were off from the year before. This can be attributed to an eight percent reduction in Iowa Electric's gas and electric revenues. This reduction is primarily due to lower natural gas and coal prices. Net income for the year was up, from $19,056,000 in 1985 to $28,536,000 in 1986.

Earnings per share of common stock rebounded from a year ago, increasing to $2.13, up 45 percent from the $1.47 earned in 1985. And for the eleventh consecutive year, the company's cash dividend was increased. The Board of Directors increased dividends because of our future earnings and strong growth potential.

REDUCED COSTS

One of the first actions taken after our reorganization was the restructuring of our capitalization. As reported in the third quarter shareholder bulletin, IE Industries sold $45 million of its eight and one-eighth percent debentures on August 27. Funds from the offering were used to acquire the non-regulated subsidiaries and equity interests from Iowa Electric. Those include the Cedar Rapids and Iowa City Railway Company (CRANDIC), Industrial Energy Applications, Inc., Iowa Land and Building Company, and a 30 percent equity interest in Teleconnect Company. Iowa Electric used the funds from the sale to retire two series of its high-interest bonds and five preference stock issues. The full impact of this reduction in financial costs has not yet been realized, but will be in 1987.

In addition to savings from financial restructuring, we concentrated on achieving real savings in daily operations. Operation and maintenance expenses were held at virtually the same level as last year. Capital expenditures were under target levels; and we have no plans for large utility capital outlays in the near future.

Iowa Electric and the CRANDIC offered a second early retirement plan in 1986. Sixty percent of the 126 employees eligible chose to retire early.

Not only were expenses held to acceptable levels, but our sales increased. In fact, for the first time in recent history, we both exceeded the electric sales forecast for our utility subsidiary and kept expenses at authorized levels. Our efforts to control operation and maintenance costs, reduce fuel costs, and meet the competition head on paid off. And we will continue our aggressive cost containment program.

IMPLICATIONS FOR THE FUTURE

Decisions made in 1986 have set the stage for our future direction. We placed special emphasis on streamlining operations, cutting costs and evaluating market position. New opportunities and challenges lie ahead.

We are examining our corporate strengths and matching future actions to those strengths. IE Industries has the opportunity to set its direction clearly for the next decade and beyond. The gas and electric utility will remain our core business, with selected expansion into other businesses as appropriate.

Our utility operations will grow and prosper by anticipating market changes, improving productivity, cutting losses, and exploring opportunities for expanding our gas, electric, and steam operations. We have a clear commitment to develop further our core utility business. We have also chosen a course of highly selective diversification. These general guidelines will focus our energies on well-developed courses of action.

We will build on the successes of 1986. The decision to proceed with the formation of the holding company, the approval by shareholders, and the financial restructuring signaled a significant change in strategy to become a diversified utility company. Actions taken in 1986 have positioned us to carry out the diversification strategy while we strengthen our core utility business. The future will see further moves in diversification efforts; but the primary emphasis will continue to be in achieving leaner, more efficient utility operations that are sensitive to customer needs.

IOWA ELECTRIC

Iowa Electric Light and Power Company is the principal subsidiary of IE Industries. Iowa Electric provides electric, natural gas, and steam services to nearly 279,000 customers, primarily in the state of Iowa. It serves a balanced mix of customers, with industrial customers accounting for one-third of energy sales. Our generation mix is also well balanced. In 1986, fossil units provided 70 percent of generating and purchased power capacity; nuclear 30 percent. Energy was provided from three different sources: 45 percent from nuclear, 39 percent from fossil, and 16 percent from purchased power. Gas customers received service from the Northern Natural Gas, Natural Gas, and ANR pipelines.


Westinghouse

ELECTRIC OPERATIONS

Electric sales in 1986 increased 3.6 percent over 1985. Kilowatt-hour sales grew in all customer classes: up 3.5 percent in residential, 4.3 percent in commercial, and 3.5 percent in industrial. This clearly indicates real economic progress in our service territory.

Electric revenues received a boost from an increase in the sales margins. Iowa Electric filed an electric rate case in April requesting an increase in annual revenues of $43.9 million or 16 percent. In July, the Iowa Utilities Board granted an interim increase of $19 million. In March, 1987, the Board issued a final order in the case granting Iowa Electric a $20.5 million increase in annual revenues. Iowa Electric requested a rehearing since we believe the Board's staff erroneously handled an item which understated our revenue requirement by approximately $7 million. (See Note 3)

Although the Board's final decision set rates lower than we had hoped, several key issues were decided in our favor. The Board allowed us to recover $24.3 million for the cost of cancelling two long-term coal contracts. The Board recognized the prudency of our decision to buyout those contracts, saving our customers over $20 million in 1986. Customer savings are expected to reach $300 million throughout the next decade.

We also were allowed partial recovery of costs associated with planning the 650-megawatt, coal-fired Guthrie County Generating Station. Iowa Electric announced the cancellation of that project in 1986.

Two other significant events took place in 1986. We signed ten-year agreements with all our municipal and other resale prices. We increased sales to other utilities, which in turn increased our electric margins and reduced our net energy purchases by nearly 60 percent.

GAS OPERATIONS

Gas margins for 1986 were not significantly changed from 1985 even though revenues and sales volumes were lower. Three key reasons for this were: lower purchased gas costs, our gas rate case settlement, and our entry into the gas contract carriage business.

Purchased gas costs declined dramatically in 1986. Gas costs were eleven percent lower than in 1985. Increased competition in gas markets and our efforts to purchase cheaper gas on the spot market accounted for considerable savings in our purchased gas costs. These savings were passed along to customers in the form of lower bills while our margins were maintained.

In October, 1986, Iowa Electric received a final order from the Iowa Utilities Board in a gas rate case allowing an increase in annual revenues of $1.5 million. One important provision of this rate case was the adoption of seasonal pricing. Seasonal pricing for electric sales has been in effect since 1984, but was implemented in gas operations for the first time in November of 1986.

Iowa Electric is actively involved in transporting gas for several large users. This contract carriage option allows customers to purchase low cost gas and have it transported for them. Because of this carriage arrangement, those customers have not switched to alternate fuels and are receiving cheaper spot market gas, while

plans. By sending appropriate pricing signals to customers and charging less for energy when demand is lower, we are matching customer prices with costs. We have had tremendous success in our demand-side management program for electricity. The company is a nationwide leader in the number of customers on time-of-use and interruptible prices. These two factors have helped us delay the need for additional generation facilities until the 1990s.

Our system capacity in 1986 at the time of the peak load was 1147 megawatts, including 100 megawatts of power purchased under a long-term arrangement. The peak load was 954 megawatts on July 18, 1986, a slight increase from 1985, but still below the all-time peak of 985 megawatts set in 1983.

Because we have energy available to sell, we are aggressively pursuing ways to bring new customers into our service territory and encouraging expansion among our existing customers. These efforts have met with success. Communities have responded positively to our help in development efforts.

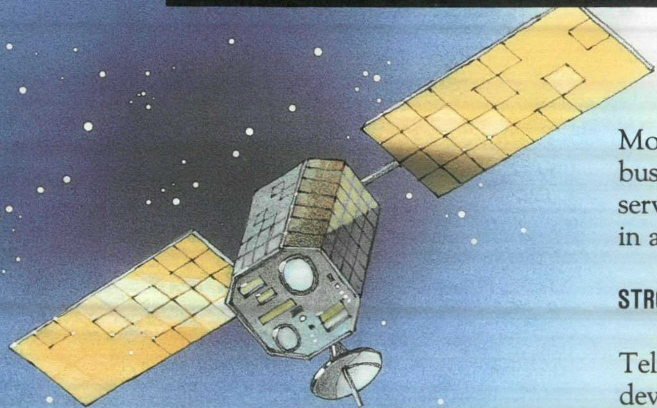
CUSTOMER SERVICE

Iowa Electric also took a leading role to set a new standard in customer service. In August we announced the establishment of a customer service center. The center will provide around-the-clock service to all of our customers by May, 1987. Center consultants take an eight-week training program to make sure all customers receive consistent and complete information.

In connection with the

Our customer service does not stop with routine customer inquiries. In 1986 Iowa Electric hosted several gas and electric seminars for commercial and industrial customers to keep them up-to-date on energy matters. We will continue such seminars in 1987.

We recognize in order to remain profitable we must be sensitive to and meet the needs of our customers, respond to market forces, and strike a proper balance between external conditions and internal strengths. With streamlined operations we are ready to provide excellent customer service, respond to changes in the environment, and remain a leader in the dynamic energy business.



TELECONNECT

Teleconnect has proven to be a viable investment. In its short history, the Teleconnect Company has established itself as a leader in the telecommunications industry.

President Clark McLeod helped found and organize Teleconnect in late 1979 to sell and install internal phone systems to businesses. Headquartered in Cedar Rapids, the company's revenues have grown from $1 million in 1980 to more than $110 million in 1986.

Iowa Electric made its investment in Teleconnect in May, 1985. In the past two years, Teleconnect expanded significantly in revenues, services, and areas served. Teleconnect now has a much larger base and a broader line of business operations. We expect its progress to continue.

In December, 1986, "Inc." magazine ranked Teleconnect 46th on its list of the 500 fastest growing and most productive private companies in the United States. The magazine also listed Teleconnect's employment as the 13th fastest growing in the country.

Teleconnect's growth and diversification began in 1982. At that time Teleconnect became the first company to offer discounted long distance service to medium-sized midwestern communities. More than 150,000 residential and business subscribers now use this service in nearly 50 communities in a seven-state area.

STRONG WORKFORCE

More than 1,200 people work at Teleconnect in telephone system development and sales, long distance sales and services, digital network services, telemarketing services, and telephone directory publishing.

Teleconnect operates 25 long distance and directory branch offices in seven states. After outgrowing several buildings in a short time, Teleconnect recently moved its headquarters into a ten-story building in downtown Cedar Rapids.

WAVE OF THE FUTURE

Teleconnect is not resting on its laurels. It is searching for new ways and new technology to meet the changing needs of its customers.

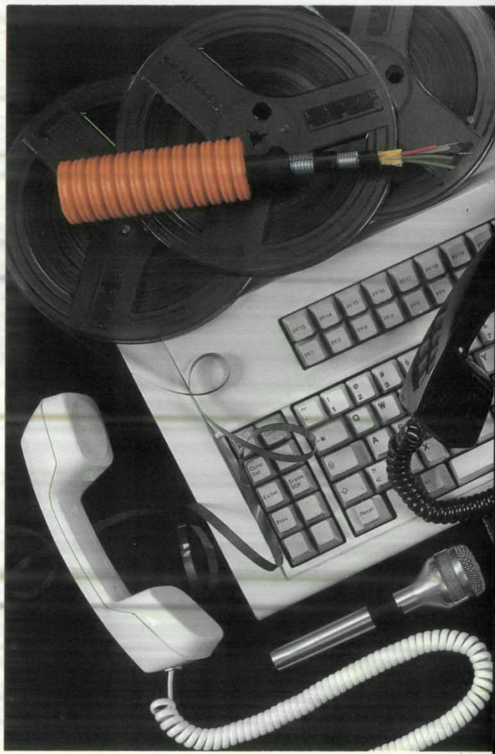
Teleconnect has invested in fiber optics. Digital fiber technology is the most precise method of telecommunications today. Fiber optics mean clearer communications for Teleconnect customers.

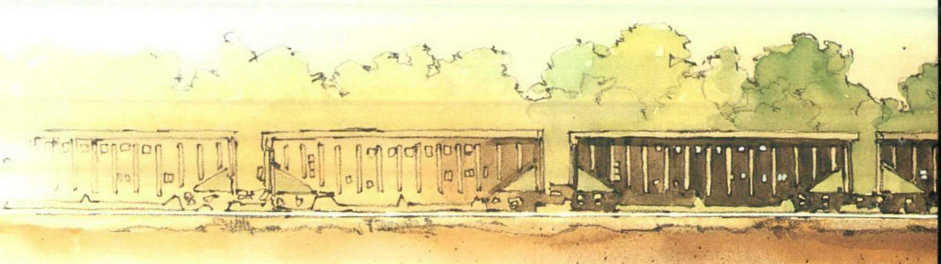
Teleconnect has installed hundreds of miles of fiber optics in Iowa. In cooperation with Williams Telecommunications Company, Teleconnect utilizes capacity from a large fiber optic network stretching from Kansas City to Minneapolis and from Omaha to Chicago. Another leg leads westward from Kansas City to California and the Pacific Northwest. Through the National Telecommunications Network, Teleconnect has access to 12,000 miles of coast-to-coast fiber optic lines.

VITAL ROLE: TELEMARKETING

Telemarketing plays a vital role at Teleconnect. Telemarketers use the latest computer systems and software designed specifically for Teleconnect. They can complete calls more quickly and accurately than ever before. Others have recognized the success and value of Teleconnect's telemarketing services. As a result, these services are now available outside the company on a contractual basis.

The telecommunications field is always changing and moving ahead with new technology. Teleconnect develops products and services to satisfy tomorrow's more sophisticated demands.

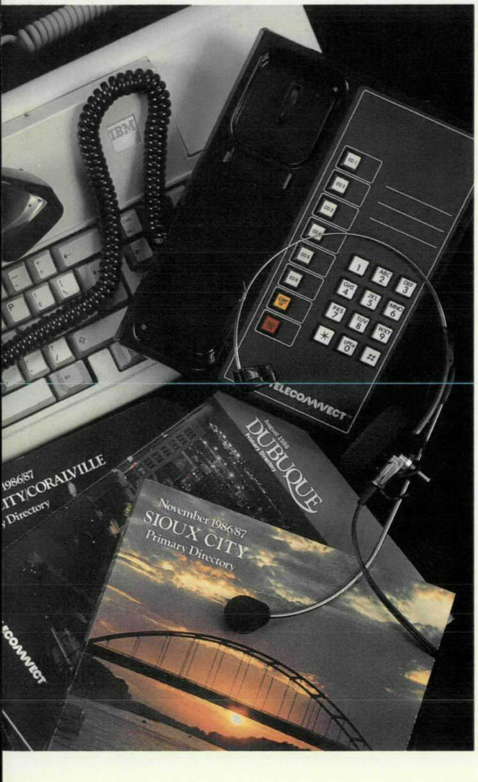




CEDAR RAPIDS AND IOWA CITY RAILWAY

The Cedar Rapids and Iowa City Railway Company enjoyed an outstanding year in 1986. For the first time in its history, the Railway moved more than 50,000 carloads of freight. With this heavy volume, the CRANDIC realized sizable increases in both line-haul and switching revenues. The strong activity by the various grain processors located on the CRANDIC line was somewhat offset by the continuing decline of the heavy machinery manufacturers.

An aggressive marketing program and an ability to quickly meet the needs of its customers contributed to the CRANDIC's strong showing. The Railway secured freight contracts with shippers that allowed them some advantages yet guaranteed the Railway 70 percent of its line-haul revenue. An earlier investment in the Heartland Rail Corporation brought a close working relationship with the Iowa Interstate Railroad. In turn, this relationship allowed the CRANDIC to compete in Council Bluffs, Chicago, and Des Moines for longer haul business.



The CRANDIC's earnings in 1986 reflect the successful year it had in rail volume. Net income increased from $2.1 million in 1985 to $3.2 million in 1986, or 49 percent. While 1986 may have been an exceptionally good year, we feel the railroad business continues to offer excellent opportunities. And the CRANDIC has demonstrated that it can compete.

In 1986 the CRANDIC improved service and facilities with various capital improvements. New maintenance-of-way equipment accelerated track improvements. The Railway helped the Iowa Department of Transportation and local governments make significant improvements to grade crossings and crossing signals. In order to accommodate increased business, the Railway expanded its rolling stock.

One factor that helped the CRANDIC achieve its strong performance in 1986 was its ability to hold down expenses while traffic volume increased. Capital improvements played a big role, as well as utilizing other railroads' cars for our traffic.

Through its performance this year, it's clear that this lean, innovative, and aggressive Cedar Rapids and Iowa City Railway Company has what it takes to compete and prosper in today's transportation circles.

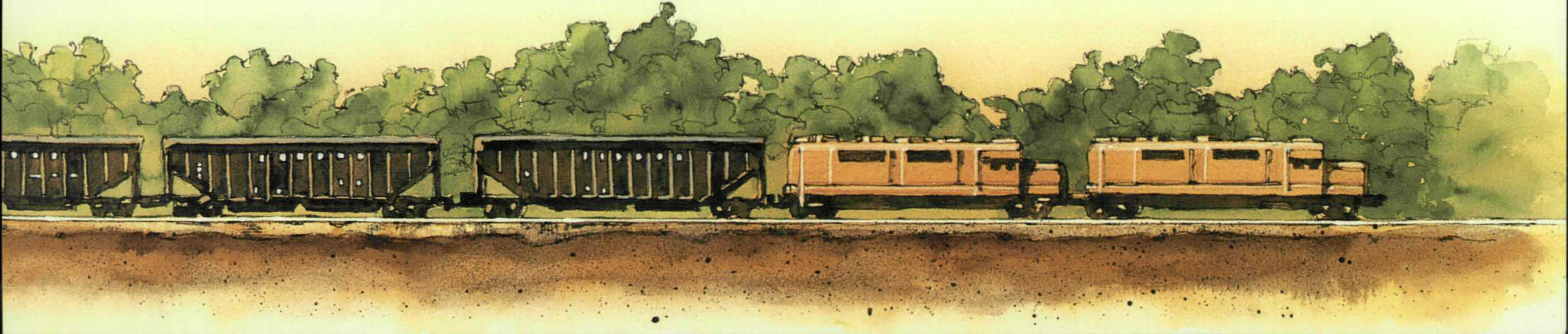
INDUSTRIAL ENERGY APPLICATIONS

Industrial Energy Applications, Inc. is primarily involved in selling, installing, and operating stand-by generating units for large users of electricity, allowing them to reduce their energy costs.

In its brief two and one-half year history, IEA has installed eight generating units. The units allow commercial and industrial customers to switch to lower cost interruptible utility energy rates by supplying electric capacity to customers during times of interruption.

IEA also performs economic feasibility studies on cogeneration units. These studies determine whether a cogeneration system can supply both electric and process steam needs for large energy users.

IEA is still in the developmental stage. It will soon offer a wider range of energy options to meet the growing needs of industrial and commercial customers. Look for future expansion in Iowa and the Midwest.



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 1984 through 1986 for IE Industries and its wholly-owned subsidiaries (Company).

RESULTS OF OPERATIONS

Iowa Electric has an electric energy adjustment clause (EAC) which is designed to currently recover the costs of fuel and the energy portion of purchased power in billings to customers. Also, Iowa Electric's gas tariffs include clauses designed to reflect changes in the cost of gas purchased for resale on a current basis. The fuel costs which Iowa Electric has recovered through its EAC and gas adjustment clauses (PGA) have declined in recent periods, as reflected in the following tables analyzing electric and gas revenues.

Electric revenues changed due to the following factors:

	Electric Revenues Increase (Decrease) from Prior Year		
	1986	1985	1984
	(in millions)		
Rate increases	**$ 10.3**	$ —	$ 25.7
Recovery of fuel costs	**(17.1)**	1.7	(1.1)
Kwh sales and other	**0.6**	(7.6)	(3.3)
	$ (6.2)	$ (5.9)	$ 21.3
Overall electric sales (in Kwh)	**3.6%**	(0.3)%	(0.3)%

As indicated in the above table, electric revenues decreased during both 1986 and 1985 but increased significantly during 1984. The decrease in 1986 revenues occurred despite an increase in electric rates effective in July. The primary reason for the decrease in 1986 revenues was the recovery of lower purchased power and fuel costs through the EAC.

Further contributing to the decline in revenues during 1986 and also in 1985 was the effect of an industrial price reduction in July 1985 and the impact of customers changing to time-of-day and interruptible rates.

The 1985 decrease in electric revenues was also attributable to several other factors. While overall sales of electricity decreased only 0.3% during 1985, revenues were adversely impacted by a shift in sales from residential and rural customers (at higher unit prices) to industrial customers (at lower unit prices). On August 1, 1984, electric tariffs were changed to yield more revenue during summer months (June-September) and less revenue during non-summer months (October-May). The timing of this change resulted in higher revenues for 1984 than for 1985.

Gas revenues changed due to the following factors:

	Gas Revenues Increase (Decrease) from Prior Year		
	1986	1985	1984
	(in millions)		
Rate increases	**$ 1.1**	$ —	$ —
Recovery of gas costs	**(27.5)**	(5.4)	(1.0)
Sales and other	**(3.4)**	(3.5)	2.7
	$(29.8)	$ (8.9)	$ 1.7
Overall gas sales (in therms)	**(12.1)%**	(2.0)%	2.0%

Gas revenues in 1986 decreased despite increased rates placed into effect in February, 1986. The principal factor which resulted in decreased revenues during all three years was reductions in the cost of gas purchased. Additionally, in 1986 and to a lesser extent in 1985, decreased gas sales reduced gas revenues.

Despite the 12% reduction in gas sales during 1986, the gas margin (revenues less cost of gas purchased and the change in the PGA balance) was maintained at the 1984 level. Such margins were $25,905,000, $20,782,000 and $25,861,000 for the years 1986, 1985 and 1984, respectively.

Although fuel for production decreased slightly in 1986, the cost of coal used for generation decreased approximately $11,000,000. This decrease was offset by increased usage of coal and nuclear fuel for generation. The reduction in fuel for production during 1985 resulted from both reduced generation and the lower cost of coal.

Purchased power costs decreased in 1986 primarily due to decreases in energy purchases and increases in sales to other utilities. Cheaper fuel costs allowed Iowa Electric to generate more of its needs as well as to sell more power. Such costs decreased during 1985 primarily due to a reduction in demand charges which resulted from a power purchase contract which expired in 1984.

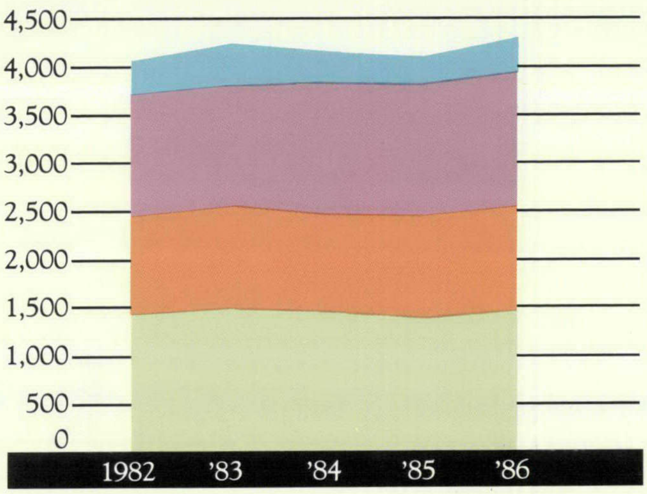
Combined other operation and maintenance expenses decreased during 1986 because of cost control measures implemented by the Company and reduced costs at the Duane Arnold Energy Center (DAEC). Partially offsetting such decreases were increases in insurance premiums and computer equipment costs. Increases in other operation and maintenance expenses during 1985 resulted from higher labor costs incurred primarily at the DAEC during the February 1 through July 20 refueling and maintenance outage and costs associated with leasing generating facilities.

Changes in current income taxes for the three years are primarily related to changes in taxable income. See Note 4 of the Notes to Consolidated Financial Statements for a detailed discussion of income tax matters.

Electric Sales

Electric sales increased 4% from 1985, to 4,344,324,000 kilowatt-hours. Residential sales increased 4% and rural sales increased 2%. Commercial sales increased 4% while industrial sales increased 3%. Sales for resale and other increased 2%. The 5-year historical average growth rate is 2%.

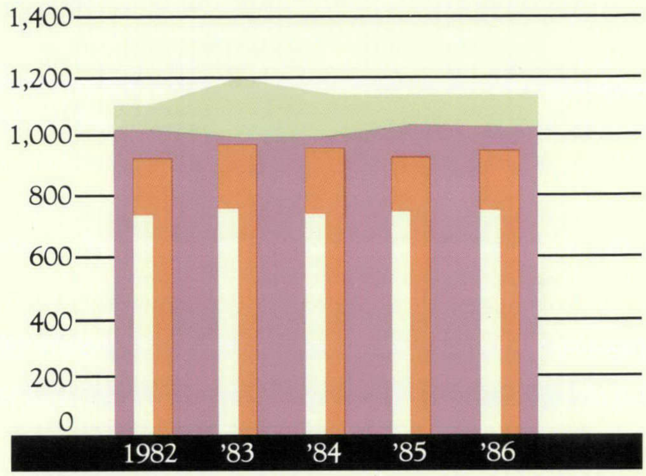
In millions of kilowatt-hours



Electric Capability and System Peak Load

Iowa Electric's 1986 peak load of 953,926 kilowatts occurred on July 18. Its additional reserve obligation was 143,089 kilowatts. Available generating capability at that time was 1,046,650 kilowatts, supplemented by 100,000 kilowatts of purchased capability.

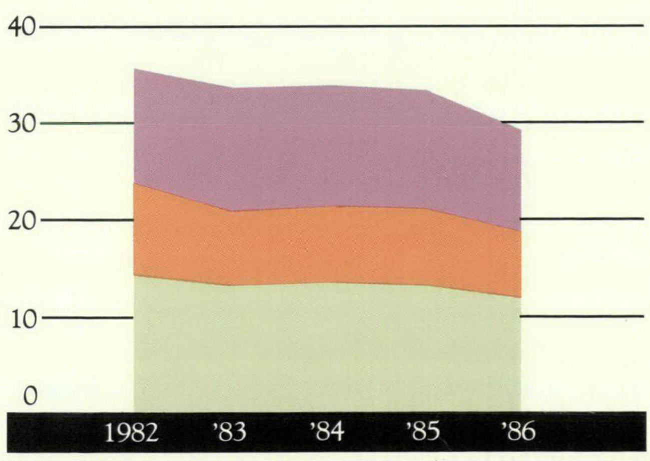
In thousands of kilowatt-hours



Gas Sales

Gas sales in 1986 totaled 29,831,000 dekatherms, a 12% decrease from 1985. Residential and commercial sales both decreased 8%. Both firm and interruptible industrial sales decreased 19%.

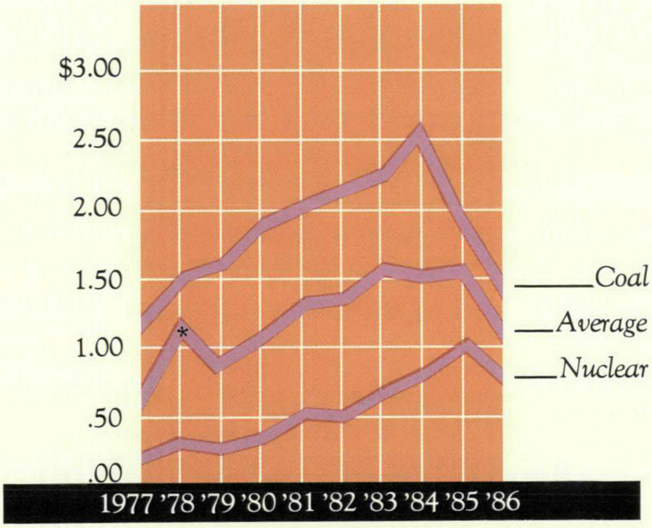
In millions of dekatherms



Fuel Cost

Coal prices decreased 24 percent in both 1986 and 1985 as the result of the termination of two long-term coal contracts.

Per million Btu's burned



**Influenced by unavailability of DAEC*

LIQUIDITY AND CAPITAL RESOURCES

The Company's liquidity is affected principally by the utility's construction program and by capital requirements relating to maturing debt, reacquisition of securities and sinking fund requirements. The capital resources available to meet these requirements are funds from both internal generation and external financing. Internally generated funds depend on economic conditions and the adequacy of timely rate relief for Iowa Electric. Access to the long-term and short-term capital and credit markets is necessary for obtaining funds externally.

CONSTRUCTION PROGRAM

The percentages of construction expenditures provided from internally generated funds were 100%, 72% and 100% for the years 1986-1984, respectively. Construction expenditures for 1987 will approximate $43,000,000, with substantially all of the funds expected to be internally generated. The levels of construction are expected to remain relatively stable into the 1990's. It is estimated that all construction will be funded with internally generated funds for the four year period 1988-1991.

LONG-TERM FINANCING

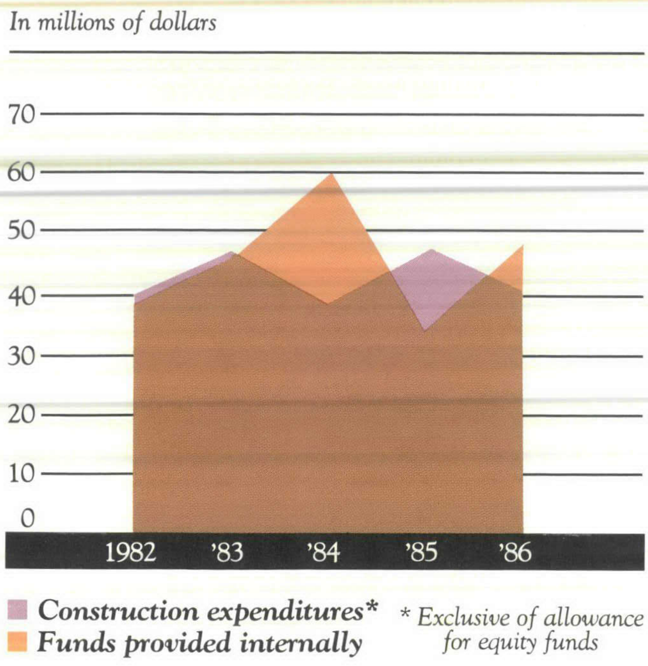
Industries raised $45,000,000 in 1986 through the sale of its Series 1986 Debentures, at 8⅛%. The debentures were sold publicly in September and will mature in 1993. The proceeds were used to purchase from Iowa Electric its wholly-owned subsidiaries and equity investment in Teleconnect Company. Iowa Electric used its proceeds from the sale to redeem certain high coupon bonds and preference stock. See Notes 1, 8 and 9 of the Notes to Consolidated Financial Statements for additional information regarding the sale of subsidiaries and redemption of securities.

In addition to periodic sinking fund requirements and serial redemptions relating to a pollution control bond issue, four First Mortgage Bond issues aggregating $81,790,000 will mature before 1992.

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. The Articles of Incorporation of Iowa Electric limit the aggregate amount of additional shares of Cumulative Preference Stock and Cumulative Preferred Stock which may be issued. At December 31, 1986, the most restrictive limitations would have permitted Iowa Electric to issue $113,000,000 of First Mortgage Bonds, $86,000,000 (860,000 shares) of Preference Stock and no additional Preferred Stock.

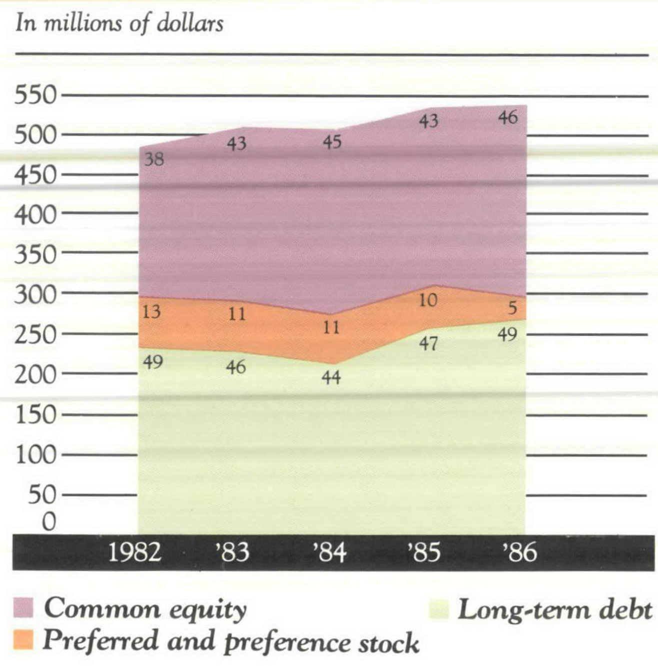
CONSTRUCTION EXPENDITURES AND FUNDS PROVIDED INTERNALLY

100% of funds for construction expenditures were provided internally in 1986.



YEAR-END CAPITALIZATION

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



SHORT-TERM FINANCING

For interim financing, Iowa Electric is authorized by the Federal Energy Regulatory Commission to issue up to $85,000,000 of short-term notes, of which a maximum of $75,000,000 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, 1986, Iowa Electric had lines of credit aggregating $52,000,000. Additionally, Industries had a $10,000,000 line of credit.

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 1981, the inflation rate has ranged from 4% down to 1% in 1986.

OTHER FACTORS AFFECTING LIQUIDITY

During 1985, the Financial Accounting Standards Board issued new standards on employers' accounting for pensions. Such rules will require the adoption of new expense and disclosure standards. The Company will adopt the new standards prospectively in 1987. No adverse impact is expected on either the financial position or results of operation.

The Tax Reform Act of 1986 was enacted on October 22, 1986. Among the many provisions impacting corporations are the reduction in corporate tax rates to 34% effective July 1, 1987, the repeal of the investment tax credit, less accelerated allowances for tax depreciation and other provisions that generally cause higher cash outflows. The effects of the Tax Reform Act will be reflected in rates charged Iowa customers effective July 1, 1987.

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. For periods prior to the corporate restructuring, the information has been restated and presented on a consolidated basis.

	Quarter Ended			
	March 31	June 30	September 30	December 31
	(in thousands)			
1986				
Revenues	$130,215	$ 86,739	$109,436	$102,855
Operating income	19,018	6,062	31,929	15,262
Net income	6,948	1,422	13,653	6,513
Earnings per average common share	0.52	0.11	1.02	0.48
1985				
Revenues	$140,074	$ 96,412	$110,177	$115,135
Operating income	18,143	5,190	24,985	7,968
Net income	6,997	670	9,755	1,633
Earnings per average common share	0.55	0.05	0.75	0.12

Because Iowa Electric's 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 increases. The gas and electric rate increases placed into effect during the first and third quarters of 1986, respectively, benefited the 1986 operating results. Additionally, during the four quarters of 1986, electric kilowatt-hour sales increased 4.0%, 4.5%, 5.4% and 0.6% compared to the prior year. Such increases in sales are primarily attributed to the strengthening of the Iowa economy.

AUDITORS' REPORT

TO THE BOARD OF DIRECTORS OF IE INDUSTRIES INC.:

We have examined the consolidated balance sheets and statements of capitalization of IE Industries Inc. (an Iowa corporation) and subsidiary companies as of December 31, 1986 and 1985, and the related consolidated statements of income, retained earnings and changes in financial position for each of the three years in the period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 3, the Office of the Consumer Advocate (Consumer Advocate) has appealed the Iowa Utilities Board's (IUB) order in the Iowa Electric Light and Power Company's (Iowa Electric) 1983 electric rate case. The ultimate outcome of the appeal and related refund obligation, if any, is uncertain at this time.

On March 4, 1987 the IUB issued an order approving an annualized increase in retail rates of $20,500,000. The order addressed, among other issues, whether certain of Iowa Electric's costs would be allowable for recovery in future rates. As discussed in Note 12, Iowa Electric has incurred $24,307,000 related to the terminations in 1985 and 1984 of contracts with coal suppliers. The order allowed recovery of these costs over a four year period. (See Note 3 for a discussion of Iowa Electric's petition for rehearing.) As also discussed in Note 12, Iowa Electric has deferred $16,466,000 of construction costs related to cancelled generation projects. The order disallowed recovery of the $5,214,000 allowance for funds used during construction recorded for one of the projects and allowed the balance of such construction costs to be recovered, without rate base treatment, over a ten-year period. The Consumer Advocate can also request a rehearing of the IUB's order. Consequentially, the ultimate outcome of these matters is uncertain at this time.

In our opinion, subject to the effect of such adjustments, if any, as might have been required to the financial statements had the outcome of the appeal and any refund obligation related to the 1983 electric rate case order been known, to the financial statements had a determination of the ultimate recovery of the coal contract termination costs been known, and to the 1986 and 1985 financial statements had a determination of the ultimate recovery of costs associated with the cancelled generation construction projects been known, the financial statements referred to above present fairly the financial position of IE Industries Inc. and subsidiary companies as of December 31, 1986 and 1985, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.

Arthur Andersen & Co.

Chicago, Illinois
March 13, 1987

CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31 1986	1985	1984
		(in thousands)	
Revenues:			
Electric	**$285,448**	$291,624	$297,538
Gas	**125,158**	154,970	163,896
Other	**18,639**	15,204	15,272
	429,245	461,798	476,706
Expenses:			
Gas purchased for resale	**99,867**	133,394	136,603
Fuel for production	**57,234**	57,660	60,698
Purchased power, net	**46,565**	61,996	63,499
Other operation	**78,912**	78,113	71,429
Maintenance	**21,188**	23,041	24,332
Depreciation and amortization	**34,226**	32,638	29,732
Taxes other than income taxes	**18,982**	18,670	18,447
	356,974	405,512	404,740
Operating income	**72,271**	56,286	71,966
Interest expense and other:			
Interest expense	**25,305**	25,581	24,823
Allowance for funds used during construction	**(2,375)**	(2,085)	(1,511)
Preferred and preference dividend requirements of subsidiary	**3,410**	4,145	4,409
Miscellaneous, net	**(1,187)**	(995)	(1,967)
	25,153	26,646	25,754
Income before income taxes	**47,118**	29,640	46,212
Federal and state income taxes	**18,582**	10,584	16,189
Net income	**$ 28,536**	$ 19,056	$ 30,023
Average number of common shares outstanding	**13,408**	12,973	12,445
Earnings per average common share	**$2.13**	$1.47	$2.41

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

	Year Ended December 31 1986	1985	1984
		(in thousands)	
Balance at beginning of year	**$ 62,161**	$ 67,743	$ 60,840
Add:			
Net income	**28,536**	19,056	30,023
Tax benefit resulting from the deduction of ESOP dividends	**585**	156	—
	91,282	86,955	90,863
Deduct:			
Cash dividends declared on common stock, at per share rates of $1.95, $1.91, and $1.855, respectively	**26,156**	24,794	23,106
Expenses in connection with sale of common stock	**—**	—	14
Preference stock redemption premiums of subsidiary	**934**	—	—
	27,090	24,794	23,120
Balance at end of year ($20,414,000 restricted as to payment of cash dividends)	**$ 64,192**	$ 62,161	$ 67,743

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

CONSOLIDATED BALANCE SHEETS

ASSETS	December 31 1986	1985
	(in thousands)	
Property, plant and equipment, at original cost:		
Utility—		
Plant in service—		
Electric	**$870,818**	$838,139
Gas	**70,785**	71,126
Other	**22,761**	22,512
	964,364	931,777
Less—Accumulated depreciation	**354,641**	332,783
	609,723	598,994
Leased nuclear fuel, net of amortization	**41,296**	38,788
Construction work in progress	**16,547**	23,590
	667,566	661,372
Other property, net of accumulated depreciation of $2,689,000 and $2,576,000, respectively	**18,200**	15,807
	685,766	677,179
Current assets:		
Cash	**1,581**	2,279
Temporary cash investments	**—**	5,964
Accounts receivable—		
Customer, less reserve	**37,957**	44,203
Other	**7,137**	3,441
Income tax refunds receivable	**1,711**	2,400
Production fuel, at average cost	**14,769**	17,777
Materials and supplies, at average cost	**9,289**	7,301
Adjustment clause balances	**855**	748
Prepayments and other	**13,532**	10,891
	86,831	95,004
Deferred charges and other (Note 12)	**56,184**	56,788
Investments:		
Teleconnect Company	**18,414**	18,328
Other	**4,015**	3,619
	22,429	21,947
	$851,210	$850,918

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

CAPITALIZATION AND LIABILITIES	December 31 1986	1985
	(in thousands)	
Capitalization (See Consolidated Statements of Capitalization):		
Common stock	$179,578	$171,472
Retained earnings	64,192	62,161
Total common equity	243,770	233,633
Preferred stock of subsidiary	18,320	18,320
Redeemable preference stock of subsidiary	10,000	33,063
Long-term debt	264,932	251,696
	537,022	536,712
Current liabilities:		
Commercial paper	2,500	20,862
Notes payable	16,200	418
Capital lease obligations	11,975	13,154
Long-term debt maturities	850	874
Debt sinking fund requirements	1,033	3,133
Preference stock sinking fund requirements	1,000	3,094
Accounts payable	37,681	42,105
Accrued interest	4,722	4,321
Accrued taxes	19,380	18,640
Accumulated refueling outage provision	6,385	1,891
Other	9,993	11,834
	111,719	120,326
Other long-term liabilities:		
Capital lease obligations	35,367	32,151
Other	10,206	8,295
	45,573	40,446
Deferred credits:		
Accumulated deferred income taxes	111,969	108,260
Accumulated deferred investment tax credits	44,927	45,174
	156,896	153,434
Commitments and contingencies (Note 11)		
	$851,210	$850,918

CONSOLIDATED STATEMENTS OF CAPITALIZATION

	December 31 1986	1985
	(in thousands)	
Common equity:		
Common stock — no par value — authorized 24,000,000 shares; outstanding 13,548,441 and 13,172,893 shares, respectively	$179,578	$171,472
Retained earnings ($20,414,000 restricted as to payment of cash dividends)	64,192	62,161
	243,770	233,633
Cumulative preferred stock:		
Iowa Electric Light and Power Company — par value $50 per share — authorized 466,406 shares; outstanding 366,406 shares —		
6.10% — 100,000 shares	5,000	5,000
4.80% — 146,406 shares	7,320	7,320
4.30% — 120,000 shares	6,000	6,000
	18,320	18,320
Redeemable cumulative preference stock:		
Iowa Electric Light and Power Company — par value $100 per share — authorized 700,000 shares; outstanding 110,000 and 361,565 shares, respectively —		
9.50% — - and 51,565 shares	—	5,157
8.92% — - and 50,000 shares	—	5,000
8.65% — - and 25,000 shares	—	2,500
8.55% — 110,000 and 130,000 shares	11,000	13,000
7.96% — - and 75,000 shares	—	7,500
7.44% — - and 30,000 shares	—	3,000
	11,000	36,157
Less — Amount to be redeemed within one year	1,000	3,094
	10,000	33,063
Long-term debt:		
Series 1986 debentures, 8⅛%, due 1993	45,000	—
Iowa Electric Light and Power Company —		
First mortgage bonds —		
Series I, 5⅛%, due 1991	16,000	16,000
Series J, 6¼%, due 1996	15,000	15,000
Series K, 8⅝%, due 1999	20,000	20,000
Series L, 7⅞%, due 2000	15,000	15,000
Series M, 7⅝%, due 2002	30,000	30,000
Series N, 11%, due 1989	—	9,000
Series O, 9.80%, due 1991	4,921	5,954
Series P & Q, 6.70%, due 2006	9,200	9,200
Series R, 8¼%, due 2007	25,000	25,000
Series S, 12%, due 2009	—	25,000
Series T, 14¾, due 1991	30,000	30,000
Series U, 9⅞%, due 2000	5,300	5,300
Series V, 11%, due 1988	35,000	35,000
	205,421	240,454
Guarantee of pollution control bonds, 5.72%, $5,200,000 due serially 1987-1994; $10,200,000 due 2003	15,400	16,200
	220,821	256,654
Other subsidiaries' debt maturing through 1989	2,100	374
	267,921	257,028
Unamortized debt premium and (discount) net	(1,106)	(1,325)
	266,815	255,703
Less — Amount due within one year	1,883	4,007
	264,932	251,696
	$537,022	$536,712

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

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	1986	1985	1984
		(in thousands)	
Cash and equivalents at beginning of period	$ 8,243	$ 5,334	$ 5,686
Funds provided internally:			
Net income	28,536	19,056	30,023
Non-cash items included in net income —			
Depreciation and amortization	34,226	32,638	29,732
Deferred taxes and investment tax credits	3,462	8,815	9,561
Amortization of deferred charges	5,658	5,441	6,728
Refueling outage provision	4,494	(6,261)	8,152
Other	(86)	72	—
Allowance for equity funds used during construction	(1,271)	(1,133)	(902)
Total funds provided internally	75,019	58,628	83,294
Less — Dividends on common stock	26,156	24,794	23,106
Net funds provided internally	48,863	33,834	60,188
Funds provided from external sources:			
Issuance of common stock	8,106	9,036	8,551
Issuance of long-term debt	46,633	35,278	—
Net change in commercial paper and short-term notes payable	(2,580)	(4,588)	10,085
Sinking fund requirements and reduction in long-term debt and preference stock	(61,133)	(16,079)	(7,076)
Other	(349)	316	95
Net funds from external sources	(9,323)	23,963	11,655
Funds used for construction	(42,618)	(47,866)	(39,404)
Other changes:			
Cash on deposit with trustee	493	9,849	(9,757)
Accounts receivable	3,239	4,326	19,774
Materials, supplies and fuel	1,020	7,609	(8,322)
Adjustment clause balances	(107)	1,460	(14)
Accounts payable	(4,300)	4,090	(13,595)
Accrued taxes	740	2,416	2,307
Investments	(396)	(18,902)	(2,567)
Deferred charges	(5,054)	(20,149)	(26,607)
Other	781	2,279	5,990
Net funds from other changes	(3,584)	(7,022)	(32,791)
Increase (decrease) in funds	(6,662)	2,909	(352)
Cash and equivalents at end of period	$ 1,581	$ 8,243	$ 5,334

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) CORPORATE RESTRUCTURING:

On May 20, 1986, Iowa Electric Light and Power Company (Iowa Electric) shareholders approved a corporate restructuring plan which provided for the establishment of IE Industries Inc. (Industries), a holding company. As of July 1, 1986, Iowa Electric became a wholly-owned subsidiary of Industries. As a result of the restructuring, the former owners of common stock of Iowa Electric became the holders of an equivalent number of shares of Industries' common stock.

On September 30, 1986, Industries purchased from Iowa Electric the Cedar Rapids and Iowa City Railway Company (CRANDIC), Iowa Land and Building Company, Industrial Energy Applications, Inc. and a 30% equity investment in Teleconnect Company (Teleconnect). All entities were purchased for their respective book values at September 30, except for CRANDIC which was purchased for its appraised fair value, which was in excess of its book value, as required by Iowa Electric's First Mortgage Bond Indenture.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

(a) *Basis of Consolidation* —

The consolidated financial statements include the accounts of Industries and its wholly-owned subsidiaries (the Company). All significant intercompany balances and transactions have been eliminated from the consolidated financial statements. Prior years financial statements and footnotes have been restated and presented on a consolidated basis.

(b) *Regulation* —

Industries is exempt from regulation under the Public Utility Holding Company Act of 1935. The principal operating entity of the Company is Iowa Electric, a utility subject to regulation by the Iowa Utilities Board (IUB), the Minnesota Public Utilities Commission and the Federal Energy Regulatory Commission (FERC).

(c) *Accounting for the Investment in Teleconnect Company* —

Teleconnect is a regional company engaged principally in supplying long distance and telemarketing services. Industries uses the equity method to account for its investment in Teleconnect and the Consolidated Statements of Income include Industries' portion of Teleconnect's net income. Industries' investment in Teleconnect at December 31, 1986 included $12,900,000 of unamortized purchase price in excess of book value at the date of acquisition which 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 3.7% of the cost of depreciable electric property for 1986 and 3.6% for 1985 and 1984. The average rate for gas property was 3.0% for 1986-1984.

The DAEC is currently being depreciated using a remaining life method. In its 1986 electric rate case, Iowa Electric proposed to change the estimated life of the DAEC from 28 years to 36 years and to separately provide a reserve for decommissioning. Such accounting was approved by the IUB, and Iowa Electric will identify $21,709,000 of the accumulated depreciation as an internal decommissioning reserve. As revenues are collected to cover future decommissioning costs, they will be funded externally under a trust arrangement as ordered by the IUB.

(e) *Revenues* —

Iowa Electric records revenue when billed to its customers based on a monthly meter reading cycle. Electric and gas service provided from the date of the latest meter reading to month-end is unbilled.

(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 1986-1984 were 10.8%, 11.1% and 11.4%, respectively.

(g) *Adjustment Clauses* —

Iowa Electric's tariffs include an electric 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 month and the immediately preceding month. 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 other 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 also 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 higher operation and maintenance expenditures 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 a reserve. During a refueling outage, such reserve is reversed to offset the higher 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 operating income.

In accordance with past rate making practices, the tax effects of Iowa Electric's timing differences relating to the following items were not deferred: the interest component of AFC, certain capitalized overheads, certain differences in depreciable lives and utility plant removal costs. In its order of March 4, 1987, the IUB allowed normalization of Federal income taxes only where required by the Internal Revenue Code.

Iowa state income taxes have not been deferred by Iowa Electric since June 1, 1981, pursuant to an order of the IUB. That order also required that Federal accumulated deferred income taxes provided in excess of the current 46% tax rate be amortized to income over a five year period. Pursuant to an August 1, 1984 court decision, certain accumulated Federal and state deferred income taxes previously provided by Iowa Electric are being amortized to income over a seven year period ending in 1990.

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.

(3) RATE MATTERS:

On April 25, 1986, Iowa Electric applied to the IUB for an electric rate increase to be charged to Iowa retail customers. The amount requested was $43.9 million on an annual basis or an average increase of 16%. The requested increase included 1) $7.6 million related to costs incurred to cancel coal contracts, 2) $1.8 million related to costs associated with abandoned projects, including the Guthrie County generating station, 3) $9.2 million related to the recovery of plant through increased depreciation charges, including $1.6 million related to decommissioning, 4) $8.8 million related to return on investment in plant and 5) the balance related to increased operation and maintenance expenses and other items.

An interim increase in the amount of $19.2 million was allowed by the IUB effective July 24, 1986. In the IUB's March 4, 1987 order, Iowa Electric was allowed a final rate increase of $20.5 million. No refund liability associated with the interim rate increase is expected. Iowa Electric requested a rehearing since it believes the IUB staff erroneously handled the income tax effects associated with the coal contract termination costs; this caused a $7 million understatement of the allowed rate increase. The Consumer Advocate has 20 days to request a rehearing of the order.

As more fully discussed in Note 12, in another IUB proceeding, a hearing examiner issued a proposed decision stating that all AFC recorded for the Guthrie County generating plant be disallowed. The IUB affirmed this decision in its March 4 rate order.

Iowa Electric filed a gas rate case with the IUB on December 23, 1985 requesting a $3.9 million increase in rates. On February 7, 1986, the IUB approved interim rates to be placed into effect immediately in the amount of $3.4 million. On October 23, 1986, the IUB issued a Decision and Order which, in effect, allowed Iowa Electric to increase non-fuel related tariffs by approximately $1.5 million on an annual basis. The primary reason for the decrease from the original $3.9 million request was a reduction in the allowed return on common equity from 14.80% to 11.82%. Iowa Electric has provided for the refund of $1.2 million which was made in March, 1987.

Iowa Electric's $44.2 million 1983 electric rate increase (of which $40.0 million on an annual basis was approved by the IUB on August 1, 1984) remains on appeal in the Linn County District Court. The issue remaining on appeal by Iowa Electric relates to a single deferred income tax item. On September 9, 1986, the IUB filed a Statement of Position with the Linn County District Court indicating that, as a result of an IRS private letter ruling involving another Iowa utility, the Court should rule in favor of Iowa Electric's position on this matter.

The issues remaining on appeal by the Consumer Advocate would require a significant reduction of the $40 million rate increase if decided against Iowa Electric. A final court decision adverse to Iowa Electric relating to one of the issues would result in an immediate refund obligation. An adverse decision on the remaining issues on appeal would result in refund obligations through a prospective reduction in rates. Iowa Electric is of the opinion that the likelihood of a decision overturning the IUB's Order on any of the issues remaining on appeal by the Consumer Advocate is remote. Accordingly, no refund liabilities have been recorded.

(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 1986	1985	1984
		(in thousands)	
Federal income taxes:			
Current	**$ 11,786**	$ 242	$ 2,859
Deferred —			
Nuclear waste disposal costs, net	**(877)**	(1,850)	(2,536)
Coal contract termination costs	**(963)**	3,283	9,300
Plant abandonments	**3,998**	—	—
Refueling outage provision	**(2,067)**	2,880	(3,750)
Premium and expense for redemption of first mortgage bonds	**1,408**	—	—
Depreciation and other	**10,014**	9,063	7,247
Prior years	**(7,153)**	(7,164)	(6,531)
Investment tax credits —			
Deferred	**1,645**	4,884	7,285
Amortization	**(1,892)**	(1,725)	(1,482)
Employees' Stock Ownership Plan and other	**45**	55	618
Total Federal income taxes	**15,944**	9,668	13,010
State income taxes:			
Current	**3,289**	1,474	3,149
Deferred —			
Depreciation and other	**182**	214	170
Prior years	**(833)**	(772)	(140)
Total state income taxes	**2,638**	916	3,179
Total income taxes	**$ 18,582**	$ 10,584	$ 16,189

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

	Year Ended December 31 1986	1985	1984
Statutory Federal income tax rate	**46.0%**	46.0%	46.0%
Add (deduct):			
Allowance for funds used during construction	**(2.3)**	(3.2)	(1.5)
Amortization of investment tax credits	**(4.0)**	(5.8)	(3.2)
Amortization of certain accumulated deferred income taxes over five and seven years	**(7.5)**	(12.8)	(6.6)
Effect of court decision on prior years	**—**	—	(9.0)
Preferred and preference dividend requirements of subsidiary	**3.3**	6.4	4.4
State income taxes, net of Federal benefits	**4.0**	2.6	3.3
Other items, net	**(.1)**	2.5	1.6
Overall effective income tax rate	**39.4%**	35.7%	35.0%

At December 31, 1986, primarily as a result of rate making practices, Federal and state deferred income taxes have not been provided on cumulative net tax timing differences of $71,000,000 and $186,000,000, respectively. Based on statutory rates in effect at December 31, 1986, the associated unrecorded deferred income taxes approximate $42,000,000. 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.

(5) 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. The credit agreement between the lessor and the bank has a termination date of December 31, 1989, 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 $50,000,000. Iowa Electric is responsible for the payment of taxes, maintenance, operating cost, risk of loss and insurance relating to the leased fuel.

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 1986-1984 were $13,708,000, $9,560,000 and $11,408,000, respectively.

Iowa Electric is operating the Prairie Creek Generating Station, Units 1, 2 and 3, under a ten year capital lease agreement. Under the agreement, Iowa Electric has the right to purchase the units at any time during the lease term for $7 million plus 10% interest accrued from the effective date of the lease, January 1, 1985, with a reduction for all prior lease payments made. Additional payments declining from $500,000 to $100,000 in years 1 through 5, respectively, will be added to the purchase price if Iowa Electric elects to acquire ownership during the first five years of the lease. The lease payments (included in other operation expenses) for 1986 and 1985 were $1,100,000 annually.

Operating lease rental expenses were $7,444,000, $7,242,000 and $6,113,000 for 1986-1984, 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)	
1987	$ 14,315	$ 3,255
1988	15,345	3,133
1989	12,188	2,971
1990	6,118	2,957
1991	4,440	2,948
Through 2003	4,196	34,054
	56,602	$ 49,318
Less: Amount representing interest	9,260	
Present value of net minimum lease obligations	$ 47,342	

(6) RETIREMENT PLAN:

The Company has a non-contributory retirement plan for the benefit of its employees. All pension costs accrued are funded currently. Total pension cost requirements paid to the Trustee were $2,786,000, $2,535,000 and $3,076,000 for 1986-1984, respectively. Payments made from the pension fund to retired employees and beneficiaries during 1986 totaled $5,520,000.

Other information supplied by the actuary concerning the Plan is as follows:

	December 31	
	1986	1985
	(in thousands)	
Actuarial present value of accumulated plan benefits:		
Vested	**$ 53,531**	$ 48,415
Non-vested	**5,933**	5,234
	$ 59,464	$ 53,649
Net assets available for benefits	**$ 82,263**	$ 72,694
Assumed rate of return	**8.0%**	8.0%

The above benefits were determined using the frozen entry age actuarial cost method, which computes the normal cost as a level percentage of pay.

The Company offered an early retirement plan to all eligible employees providing they retired during the period January 1 through February 28, 1986. Incentive benefits of $897,000 were charged to expense. In addition, a long-term liability of $1,800,000 was recorded to reflect the present value of certain supplemental benefits to be paid to early retirees in future periods. A corresponding equivalent amount has been recorded as a deferred charge and is being amortized as this amount is funded through payments to the retirement plan. This amount is expected to be recovered through the rate making process in future periods.

In addition to providing pension benefits, the Company provides certain health care benefits for retired employees. The cost of such benefits is expensed as claims are paid. Such costs totaled $754,000, $769,000 and $559,000 for 1986-1984, respectively.

(7) CHANGES IN OUTSTANDING SHARES OF COMMON STOCK:

On May 20, 1986, Iowa Electric's common shareholders adopted an amendment to the Articles of Incorporation which cancelled all shares of Iowa Electric common stock, except for 1,000 shares held by Industries. Industries thereby became the parent of Iowa Electric on July 1, 1986, the effective date of the corporate restructuring. Simultaneous with the cancellation of Iowa Electric's common stock, the holders of such cancelled common stock became the holders of an equal number of shares of Industries' common stock.

The following table presents information relating to the issuance of Iowa Electric's common stock prior to its corporate restructuring on July 1, 1986 and Industries' common stock subsequent to such restructuring:

	Common Stock	
	Number of Shares	Amount (in thousands)
Balance, December 31, 1983	12,093,485	$ 153,885
Stock plan issuances**	579,417	8,551
Balance, December 31, 1984	12,672,902	162,436
Stock plan issuances**	499,991	9,036
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

**Net of stock issuance costs*
***Dividend Reinvestment and Stock Purchase Plan, Employee Stock Purchase Plan, Employees' Stock Ownership Plan*

Shares reserved for issuance pursuant to the various stock plans totaled 1,494,046 at December 31, 1986.

(8) PREFERRED AND PREFERENCE STOCK:

Industries has 1,000,000 shares of Cumulative Preferred Stock, no par value, authorized for issuance, of which none is issued and outstanding at December 31, 1986.

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.

On October 1, 1986, Iowa Electric redeemed the Series 9.50%, 8.92%, 8.65%, 7.96%, and 7.44% Cumulative Preference Stock at the general redemption prices of $104.75, $103.59, $103.93, $104.98 and $104.32, respectively. The redemption prices included premiums of $933,821, which were charged to retained earnings.

In addition, Iowa Electric Cumulative Preference Stock aggregating $4,094,000 in 1986 and $3,094,000 in both 1985 and 1984 was redeemed at par under mandatory and optional sinking fund provisions. Annual sinking fund redemptions of $1,000,000 will be required in 1987-1991.

The Series 8.55% Cumulative Preference Stock is redeemable at the option of Iowa Electric upon 30 days' notice at $106.41 through October 1, 1988 and at decreasing amounts thereafter. However, no redemption may be made prior to October 1, 1988 by the application of certain monies having a cost to Iowa Electric of less than 8.55% per annum.

(9) LONG-TERM DEBT:

On August 27, 1986, Industries issued $45,000,000 of 8⅛% Series 1986 Debentures, due 1993. The related discount and issuance expenses are being amortized over the life of the issue. The proceeds from the sale were used to purchase from Iowa Electric its wholly-owned subsidiaries and 30% equity investment in Teleconnect. For a more detailed discussion of the purchase, refer to Note 1.

On October 1, 1986, Iowa Electric redeemed the Series N and S First Mortgage Bonds. The redemption prices of 101.56% and 109.52% required premiums of $2,454,880 to be paid, which were deferred and are being amortized over the remaining lives of the redeemed issues.

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 1987-1991 are as follows. The table pertains to Iowa Electric unless otherwise noted.

		Debt Maturities			
Year	Sinking Fund Requirements*	Debt Issue	Maturity Date	Amount	Total
1987	$2,243,000	Pollution Control	11/1/87	$ 800,000	
		Other Subsidiaries' Debt	Various	50,000	$ 3,093,000
1988	2,243,000	Series V	4/1/88	35,000,000	
		Pollution Control	11/1/88	800,000	
		Other Subsidiaries' Debt	Various	274,000	38,317,000
1989	2,243,000	Pollution Control	11/1/89	600,000	
		Other Subsidiaries' Debt	Various	1,776,000	4,619,000
1990	2,083,000	Pollution Control	11/1/90	600,000	2,683,000
1991	1,050,000	Series I	1/1/91	16,000,000	
		Series O	7/1/91	790,000	
		Series T	11/1/91	30,000,000	
		Pollution Control	11/1/91	600,000	48,440,000

**Includes annual sinking fund requirements of $1,210,000 for the years 1987-1989 and $1,050,000 for 1990-1991 which, by terms of the Indenture under which Series I, J, K, L, M and R bonds have been issued, may be satisfied by the pledging of additional property. Iowa Electric intends to meet the 1987 requirements for these issues by this means.*

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

(10) SHORT-TERM BORROWINGS:

Short-term bank notes payable outstanding at December 31, 1986 amounted to $16,200,000 and were repaid on January 5, 1987 with proceeds from the issuance of commercial paper.

At December 31, 1986, Industries had an unused line of credit in the amount of $10,000,000. Iowa Electric had lines of credit totaling $52,000,000, of which $18,700,000 was borrowed against or used to support commercial paper.

(11) COMMITMENTS AND CONTINGENCIES:

Construction Program

Iowa Electric's construction program for 1987 anticipates expenditures aggregating approximately $43,000,000 for which substantial commitments have been made.

Long-term Power Purchase Contract

Iowa Electric has a purchase power contract, as amended, with the City of Muscatine, Iowa for capacity purchases of 100 Mw through May 1987, 90 Mw for the next four years and 70 Mw for the final two years. 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 amounted to $33,048,000 in 1986.

Nuclear Fuel

Iowa Electric has contracted to purchase uranium hexaflouride for future processing into nuclear fuel. Pursuant to a non-cancellable agreement signed July 12, 1985, Iowa Electric agreed to take delivery of 630,000 kilograms of uranium hexaflouride on January 4, 1988 at a cost of $46,935,000. These amounts are expected to fulfill Iowa Electric's nuclear fuel requirements through the 1994 refueling outage. The contract contains provisions for requesting early or deferred delivery and payment dates with specified adjustments made to the purchase price. The delivery date may not be deferred beyond December 31, 1993.

The U.S. District Court in Colorado ruled that the Department of Energy (DOE) has violated its statutory duty to impose restrictions on the enrichment of foreign uranium for domestic use. On June 20, 1986, the District Court issued an injunction prohibiting such enrichment effective January 1, 1987. Iowa Electric participated with several other U.S. nuclear utilities in an appeal by DOE and in a request for injunction staying the effect of the District Court's injunction. The Court of Appeals granted the stay allowing the DOE to fulfill its obligations for enrichment services pending further order of the Court. Further action by the Court on the merits of the appeal is expected by the end of the second quarter of 1987. Iowa Electric is monitoring the case closely and may have to take action to secure foreign enrichment services.

Nuclear Insurance Programs

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. With respect to public liability coverage, Iowa Electric could be assessed a maximum of $3,500,000 per accident with a maximum of $7,000,000 per year if losses relating to the accidents exceeded $160,000,000. With respect to excess property damage and replacement power coverages, Iowa Electric could be assessed a maximum of $5,200,000 and $806,000, respectively, if the insurer's losses relating to an accident exceeded its reserves. No such assessments have been made under these policy provisions.

(12) DEFERRED CHARGES:

Coal Contract Termination

In October 1984, Iowa Electric exercised a provision in an agreement with a coal supplier to cancel a contract which was to have expired on September 30, 1997. Such action was taken because of lower spot market coal prices and reduced coal requirements. The terms of the agreement specified a contract termination payment of $20,218,000, which was partially offset by prepayments of $6,203,000 made in prior years.

In August 1985, Iowa Electric terminated a second contract with another coal supplier which was to have expired March 31, 1986. Such action was taken because of lower spot market coal prices and a reduced need for low sulfur coal. A contract termination payment of $7,293,000 was negotiated, which was partially offset by prepayments of $701,000 made in prior years.

In its March 4 rate order, the IUB allowed the recovery of $24,307,000, the retail portion of these costs, over four years. (See Note 3 for a discussion of Iowa Electric's petition for rehearing.) The portion of coal costs relating to wholesale customers is currently being recovered in rates.

Cancelled Plant

In February 1986, Iowa Electric and its two partners announced the cancellation of plans to build a 650 Mw generating station which was to have been located in Guthrie County, Iowa. Depressed economic conditions in Iowa and adequate power reserves were the key reasons for the cancellation.

Iowa Electric's investment in this project at December 31, 1986 was $15,078,000, of which $5,214,000 was AFC. Iowa Electric pursued recovery of $16,466,000 through the rate making process as discussed in Note 3. This amount reflects the Guthrie County abandonment and costs of other cancelled generating projects. On July 17, 1986, a hearing examiner ruled that Iowa Electric should not have recorded any AFC on the Guthrie County project and required that such AFC be reversed. In its March 4 rate order, the IUB affirmed the hearing examiner's decision. Iowa Electric requested a rehearing of this issue. When the issue is ultimately decided, any disallowed AFC will be charged against income. The IUB allowed recovery of the remaining costs of the cancelled plants over ten years.

The Financial Accounting Standards Board issued Statement No. 90 (SFAS No. 90) in December, 1986, which requires discounting of future revenues associated with the recovery of the costs of abandoned projects if such costs are not allowed in rate base. The IUB order of March 4 did not allow rate base treatment of the cost of the abandoned projects. If that decision is ultimately upheld, the provisions of SFAS No. 90 will require an adjustment to reduce such costs to their discounted value.

(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, 1986 is as follows:

	DAEC	Ottumwa Unit 1
	(in thousands)	
Utility plant in service	$355,787	$ 62,049
Accumulated depreciation	$111,179	$ 10,944
Construction work in progress	$ 11,933	$ 27
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 1986	1985	1984
		(in thousands)	
Operating results:			
Revenues—			
Electric	**$285,448**	$291,624	$297,538
Gas	**125,441**	155,149	164,330
Railroad	**11,037**	7,786	7,754
Operating income—			
Electric	**$ 55,851**	$ 48,677	$ 58,857
Gas	**9,112**	3,366	9,353
Railroad	**5,818**	3,250	3,134
Other information:			
Depreciation—			
Electric	**$ 31,758**	$ 29,657	$ 27,245
Gas	**2,021**	2,604	2,140
Railroad	**146**	135	136
Construction expenditures—			
Electric	**$ 34,788**	$ 43,244	$ 33,102
Gas	**1,843**	2,106	3,046
Railroad	**835**	1,442	673
Assets—			
Identifiable assets*—			
Electric	**$689,327**	$686,059	$676,285
Gas	**54,152**	53,059	54,868
Railroad	**22,090**	19,324	15,521
	765,569	758,442	746,674
Other corporate assets	**85,641**	92,476	84,528
Total consolidated assets	**$851,210**	$850,918	$831,202

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

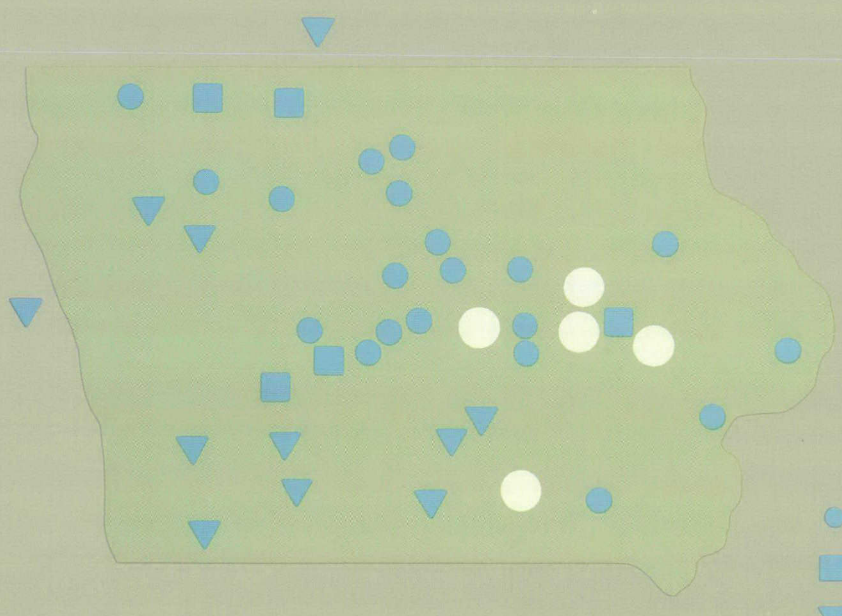
SELECTED CONSOLIDATED FINANCIAL DATA

	1986	1985	1984	1983	1982	1981
Income statement data (000's):						
Operating revenue	**$429,245**	$461,798	$476,706	$452,925	$410,913	$354,381
Operating income	**72,271**	56,286	71,966	66,334	68,627	58,875
Net income	**28,536**	19,056	30,023	23,289	22,247	19,128
Common stock data:						
Average number of shares outstanding (000's)	**13,408**	12,973	12,445	10,901	10,339	9,856
Earnings per average common share	**$ 2.13**	$ 1.47	$ 2.41	$ 2.14	$ 2.15	$ 1.94
Return on average common equity	**12.0%**	8.2%	13.5%	11.6%	12.3%	11.5%
Dividends declared per common share	**$ 1.95**	$ 1.91	$ 1.855	$ 1.795	$ 1.735	$ 1.675
Annual dividend rate at end of year	**1.98**	1.94	1.90	1.84	1.78	1.72
Market price per common share at year-end	**23.38**	20.75	18.00	14.88	15.75	12.13
Book value per common share at year-end	**17.99**	17.73	18.16	17.75	17.69	17.45
Ratio of market price to book value at year-end	**130%**	117%	98%	84%	89%	69%
Capitalization (000's):						
Common equity	**$243,770**	$233,633	$230,179	$214,725	$185,785	$176,396
Preferred and preference stock	**28,320**	51,383	54,476	57,570	60,664	62,758
Long-term debt	**264,932**	251,696	220,252	233,108	236,965	240,021
	$537,022	$536,712	$504,907	$505,403	$483,414	$479,175
Capitalization ratios:						
Common equity	**46%**	43%	45%	43%	38%	37%
Preferred and preference stock	**5**	10	11	11	13	13
Long-term debt	**49**	47	44	46	49	50
	100%	100%	100%	100%	100%	100%
Other selected financial data:						
Total assets (000's)	**$851,210**	$850,918	$831,202	$800,049	$750,227	$735,985
Construction expenditures, including AFC (000's)	**$ 42,618**	$ 47,866	$ 39,404	$ 48,110	$ 42,595	$ 60,272
Percent of construction expenditures financed internally from operations	**100%**	72%	100%	99%	96%	64%
Times interest earned before income taxes	**3.00**	2.32	3.04	2.74	2.75	2.42
Number of Iowa Electric preferred and preference shareholders	**2,222**	2,802	3,006	3,121	3,251	3,336
Number of common shareholders	**29,869**	32,348	32,805	31,768	31,743	31,546

SELECTED FINANCIAL DATA — ie:

	1986	1985	1984	1983	1982	1981
Balance sheet data:						
Utility plant in service (000's)—						
Electric	**$870,818**	$838,139	$787,500	$764,696	$729,351	$691,741
Gas	**70,785**	71,126	69,586	67,173	64,484	61,180
Other	**22,761**	22,512	20,021	14,902	13,170	12,325
	$964,364	$931,777	$877,107	$846,771	$807,005	$765,246
Accumulated depreciation (000's)	**$354,641**	$332,783	$303,233	$275,500	$250,562	$226,979
Ratio of accumulated depreciation to utility plant in service	**37%**	36%	35%	33%	31%	30%
AFC as a percent of net income	**8%**	9%	4%	14%	17%	30%
Times interest earned before income taxes	**3.10**	2.32	3.05	2.74	2.67	2.33
Construction expenditures, including AFC (000's)	**$ 40,111**	$ 45,427	$ 38,793	$ 47,874	$ 41,880	$ 57,092
Percent of construction expenditures financed internally from operations	**100%**	69%	100%	94%	92%	63%

ie: SYSTEM MAP



Gas and Electric Commercial Offices

Electric Commercial Offices

Gas Commercial Offices

Principal Electric Generating Plants

ELECTRIC OPERATING COMPARISON—ie:

	1986	1985	1984	1983	1982	1981	Five Year Compound Rate of Growth
Operating revenue (000's):							
Residential	**$100,067**	$ 99,309	$ 98,882	$ 92,229	$ 79,721	$ 71,214	
Rural	**16,801**	16,858	17,233	16,106	15,304	13,433	
Commercial	**86,111**	86,059	89,500	83,019	73,932	66,778	
Industrial	**65,537**	70,562	73,629	66,332	63,520	54,865	
Street lighting and public authorities	**4,161**	4,346	4,367	4,150	3,770	3,556	
Total from ultimate consumers	**272,677**	277,134	283,611	261,836	236,247	209,846	
Sales for resale	**11,641**	13,282	12,883	13,447	9,931	9,236	
Other	**1,130**	1,208	1,044	911	710	601	
	$285,448	$291,624	$297,538	$276,194	$246,888	$219,683	
Energy sales (000's Kwh):							
Residential	**1,215,722**	1,174,150	1,209,678	1,272,030	1,186,263	1,161,253	0.9%
Rural	**213,431**	208,491	210,958	212,775	221,803	211,394	0.2
Commercial	**1,118,493**	1,072,674	1,071,934	1,066,847	1,031,782	1,017,005	1.9
Industrial	**1,440,276**	1,391,573	1,365,959	1,290,168	1,292,404	1,216,450	3.4
Street lighting and public authorities	**48,643**	51,117	52,952	55,030	52,664	54,279	(2.0)
Total to ultimate consumers	**4,036,565**	3,898,005	3,911,481	3,896,850	3,784,916	3,660,381	2.0
Sales for resale	**307,759**	296,629	294,047	322,436	314,973	308,429	—
	4,344,324	4,194,634	4,205,528	4,219,286	4,099,889	3,968,810	1.8
Sources of electric energy (000's Kwh):							
Generated —							
Fossil, primarily coal	**1,844,564**	1,524,106	1,079,576	1,608,895	1,602,903	1,438,669	
Nuclear	**2,095,334**	1,348,821	1,889,865	1,615,878	1,588,391	1,542,730	
Hydro	**5,595**	3,892	5,517	6,309	6,706	5,198	
	3,945,493	2,876,819	2,974,958	3,231,082	3,198,000	2,986,597	
Purchased and net interchange	**751,634**	1,705,080	1,588,615	1,377,310	1,248,647	1,334,437	
	4,697,127	4,581,899	4,563,573	4,608,392	4,446,647	4,321,034	
Operating statistics:							
Heat rate (Btu per Kwh generated)	**11,212**	11,495	11,657	11,591	11,610	11,519	
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	**540,750**	541,250	492,250	491,250	499,750	498,500	
Peaking turbines and others	**155,900**	156,500	155,900	157,800	157,800	180,500	
	1,046,650	1,047,750	998,150	999,050	1,007,550	1,029,000	
Purchase capability	**100,000**	100,000	149,000	201,250	102,504	177,202	
	1,146,650	1,147,750	1,147,150	1,200,300	1,110,054	1,206,202	
Net peak load (Kw) — 60 minutes integrated	**953,926**	922,190	966,935	985,456	930,985	914,100	0.9%
Number of customers at year-end	**206,007**	205,959	204,712	204,460	204,290	203,997	0.2%
Residential and rural service:							
Average number of customers	**175,502**	175,221	175,039	174,002	173,890	173,882	
Average annual Kwh sales per customer	**8,143**	7,891	8,116	8,533	8,097	7,894	
Revenue per Kwh sold	**8.18¢**	8.40¢	8.17¢	7.30¢	6.75¢	6.17¢	
Average annual revenue per customer	**$665.91**	$662.98	$663.37	$622.60	$546.46	$486.81	

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

GAS OPERATING COMPARISON— ie:

	1986	1985	1984	1983	1982	1981	Five Year Compound Rate of Growth
Operating revenues (000's):							
Residential	**$ 59,153**	$ 68,719	$ 73,089	$ 71,202	$ 65,219	$ 47,536	
Commercial — firm	**23,986**	27,466	28,995	28,123	25,985	18,630	
— interruptible	**8,433**	11,032	12,055	12,041	11,520	8,633	
Industrial — firm	**11,961**	16,324	17,868	19,815	19,250	21,430	
— interruptible	**21,037**	30,968	31,456	29,999	26,743	22,808	
Total from ultimate consumers	**124,570**	154,509	163,463	161,180	148,717	119,037	
Other	**588**	461	433	1,046	228	183	
	$125,158	$154,970	$163,896	$162,226	$148,945	$119,220	
Energy sales (000's dekatherms):							
Residential	**12,092**	13,147	13,444	13,015	14,320	12,936	(1.3)%
Commercial — firm	**5,160**	5,514	5,575	5,374	5,984	5,350	(.7)
— interruptible	**2,374**	2,713	2,838	2,840	3,065	2,861	(3.2)
Industrial — firm	**3,474**	4,293	4,842	5,186	5,630	7,179	(8.7)
— interruptible	**6,731**	8,261	7,986	7,697	7,378	7,664	(2.3)
	29,831	33,928	34,685	34,112	36,377	35,990	(3.2)
Operating statistics:							
Gas purchased for resale (000's dekatherms)	**28,954**	34,507	34,125	34,894	35,925	35,924	
Cost of gas purchased for resale (000's)	**$ 99,867**	$133,394	$136,603	$140,844	$125,753	$102,921	
Cost per dekatherm of gas purchased for resale	**$3.45**	$3.87	$4.00	$4.04	$3.50	$2.86	
Sendout capability at time of peak demand (dekatherms)	**263,986**	261,291	261,291	261,221	273,942	269,683	
Peak daily sendout (dekatherms)	**220,836**	264,772	246,384	272,727	269,455	252,442	(2.4)%
Number of customers at year-end	**126,951**	132,986	133,165	132,587	131,638	131,285	(0.7)%
Residential service:							
Average number of customers	**110,480**	114,372	114,316	113,603	112,926	112,221	
Average annual dekatherm sales per customer	**109**	115	118	115	127	115	
Revenue per dekatherm sold	**$4.89**	$5.23	$5.44	$5.47	$4.55	$3.67	
Average annual revenue per customer	**$535.42**	$600.84	$639.36	$626.77	$577.54	$423.59	

Units for 1981 are reported in 000's Mcf.

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Kiowa Corporation
(Valve and Zinc Die Casting)
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President and Chief Executive Officer of the Company

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Senior Vice President—
Operations and Production
Iowa Electric Light and Power Company

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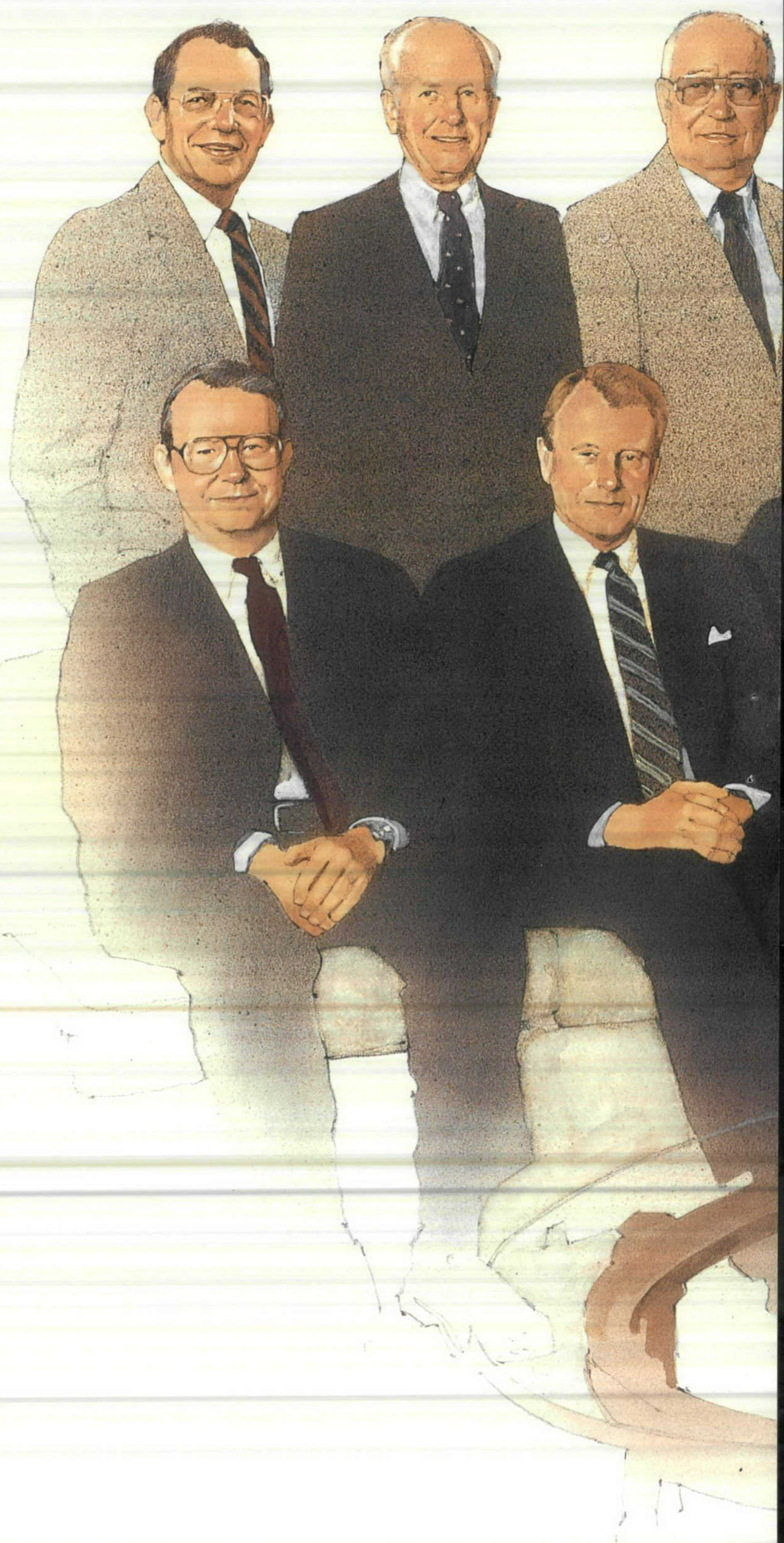
Cedar Rapids, Iowa

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

IE INDUSTRIES INC.

(E) Member Executive Committee
(A) Member Audit Committee
(N) Member Nominating Committee
(C) Member Compensation Committee



Seated: (left to right) Larry D. Root, Henry Royer, David Q. Reed, Richard E. Scherling, J.B. Rehnstrom
Standing: (left to right) J. Wayne Bevis, Dr. Leo L. Nussbaum, Walter E. Brown, Lee Liu, Robert D. Ray, Dr. Salomon Levy

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Cedar Rapids, Iowa

William O. Gray
Attorney at Law
Cedar Rapids, Iowa

John W. Norris
Retired, Former President and Chairman of the Board
Lennox Industries, Inc.
Marshalltown, Iowa

Stevan B. Smith
Retired, Former Vice President and Secretary
Iowa Electric Light and Power Company
Cedar Rapids, Iowa

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

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Chairman of the Board, President and Chief Executive Officer

J.B. Rehnstrom
Senior Vice President—Finance and Secretary

Robert J. Kucharski
Vice President, Treasurer and Assistant Secretary

IOWA ELECTRIC LIGHT AND POWER COMPANY

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Chairman of the Board, President and Chief Executive Officer

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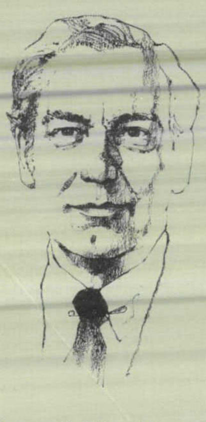
(56-27)
Senior Vice President—Finance and Secretary

Larry D. Root
(50-16)
Senior Vice President—Operations and Production

Dr. Samuel J. Tuthill
(61-9)
Senior Vice President—Technical Services



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Vice President and Treasurer

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(44-3)
Vice President — Corporate Affairs and Planning

Thomas J. Pitner
(45-8)
Vice President and General Counsel

William C. Jurgensen
(46-28)
Assistant Secretary

Figures in parentheses represent age and years of service.

ANNUAL REPORT

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IE
INDUSTRIES

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