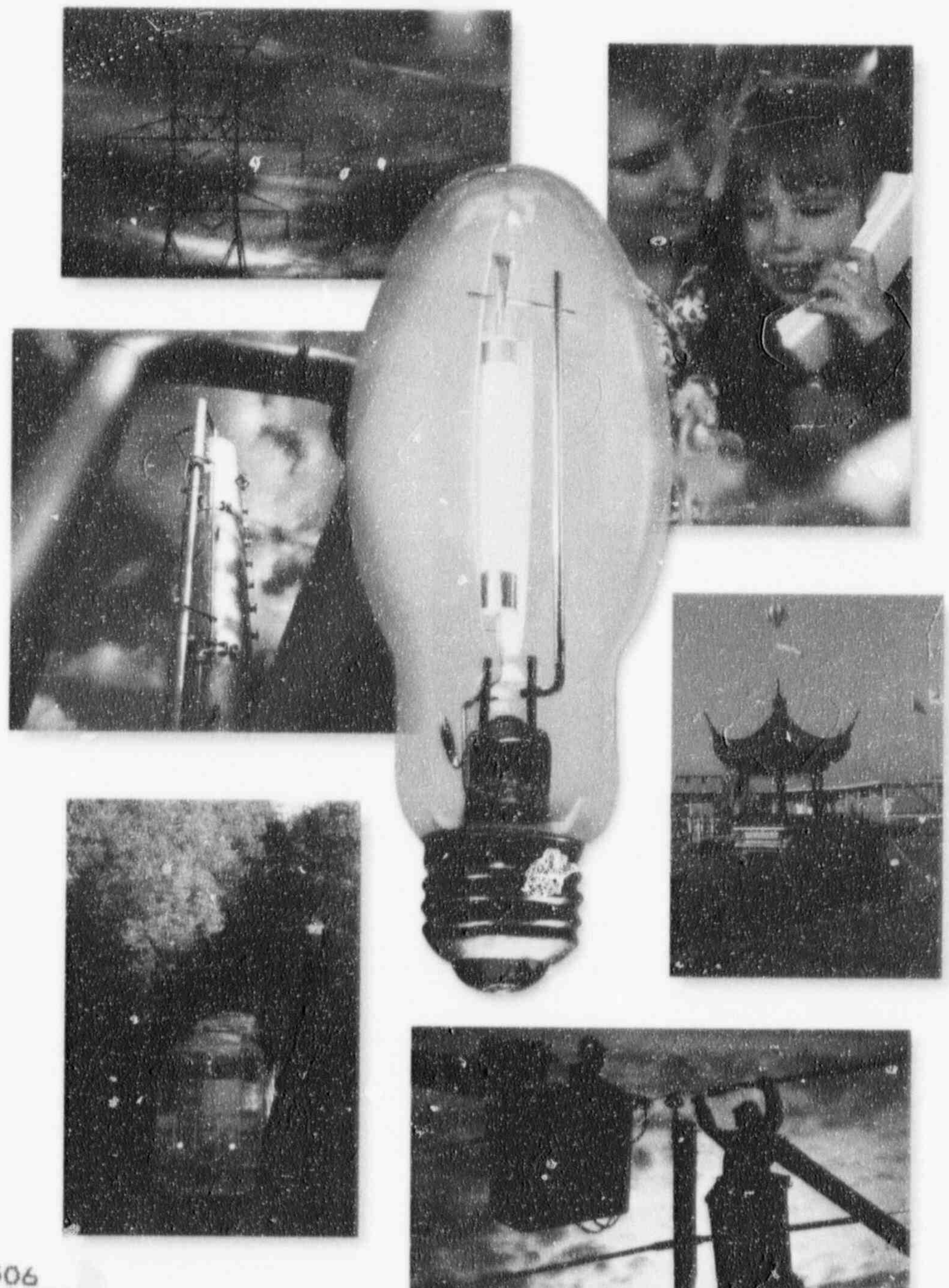
IES INDUSTRIES

1996 Annual Report



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Contents

Company Profile

IES Industries Inc. is a diversified holding company bringing long-term value to shareholders through [illegible] and [illegible]. The Company has two wholly-owned subsidiaries, IES Utilities Inc. and IES Diversified Inc. IES Utilities provides electric, natural gas and steam energy to more than 500 communities throughout Iowa. IES Diversified has interests in energy, transportation and telecommunications businesses.

About the Cover

Through its 1) electric, natural gas and steam [illegible], 2) telecommunications, 3) transportation, and 4) [illegible] and [illegible], IES Industries Inc. is [illegible] value in the years to come.

Market Price Per Common Share

[illegible]	High	Low	Close
First Quarter	[illegible]	[illegible]	[illegible]
Second Quarter	[illegible]	[illegible]	[illegible]
Third Quarter	[illegible]	[illegible]	[illegible]
Fourth Quarter	[illegible]	[illegible]	[illegible]

[illegible]	High	Low	Close
First Quarter	[illegible]	[illegible]	[illegible]
Second Quarter	[illegible]	[illegible]	[illegible]
Third Quarter	[illegible]	[illegible]	[illegible]
Fourth Quarter	[illegible]	[illegible]	[illegible]

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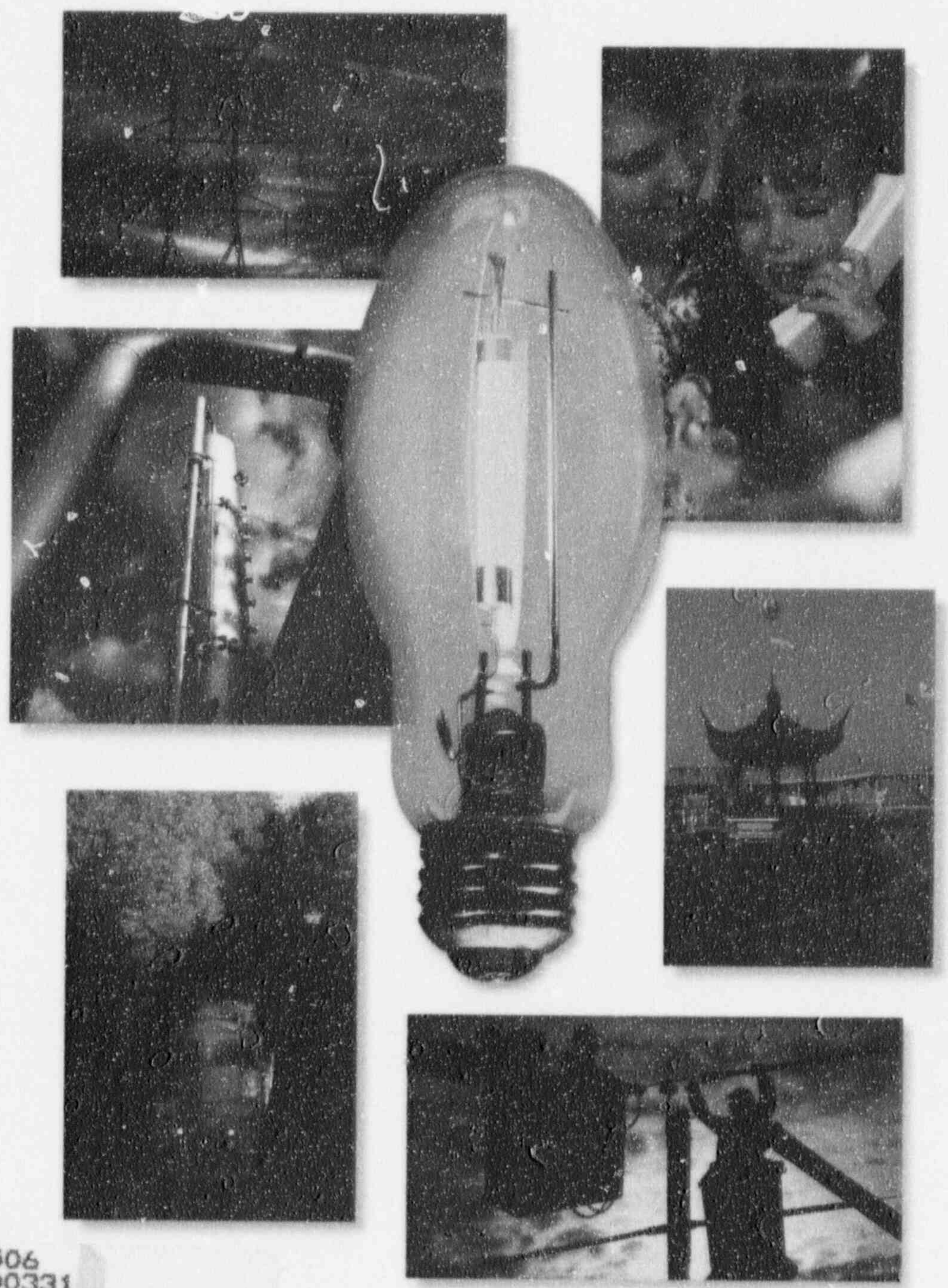

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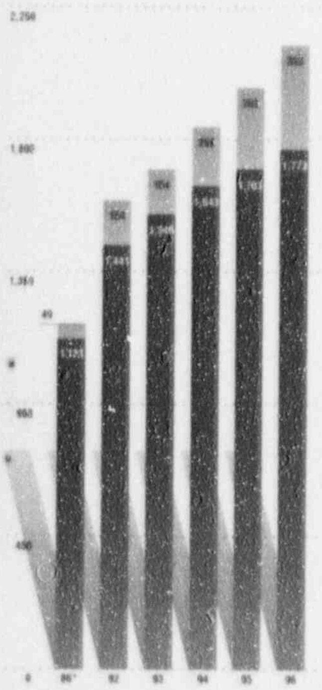
Financial Highlights

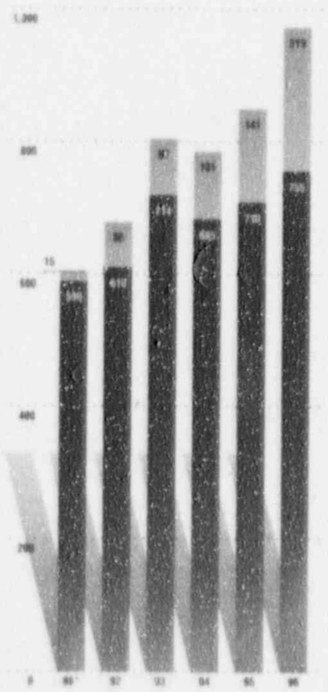
DOLLAR AMOUNTS IN THOUSANDS (EXCEPT PER SHARE DATA)	1996	1995	INCREASE (DECREASE)	PERCENT INCREASE (DECREASE)
Operating revenues	**$973,912**	$851,010	$122,902	14
Operating income	**$164,308**	$151,712	$ 12,596	8
Net income	**$ 60,907**	$ 64,176	$ (3,269)	(5)
Earnings per average common share	**$ 2.04**	$ 2.20	$ (0.16)	(7)
Dividends declared per common share	**$ 2.10**	$ 2.10	—	—
Construction and acquisition expenditures	**$238,378**	$218,099	$ 20,279	9
Cash flows from operating activities	**$183,359**	$199,831	$ (16,472)	(8)
Sales of electricity to customers (000's kwh)	**9,953,204**	9,783,514	169,690	2
Utility gas sales (000's dekatherms)	**42,140**	39,805	2,335	6
Number of common shareholders	**27,468**	29,731	(2,263)	(8)
Number of full-time employees	**2,406**	2,635	(229)	(9)

Assets
(in millions of dollars)



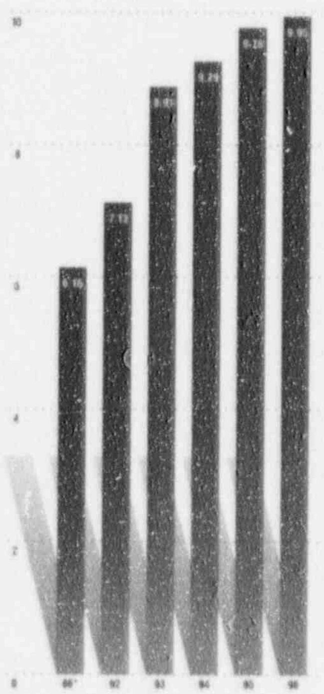
■ Utility ■ Non-Utility

Operating Revenues
(in millions of dollars)



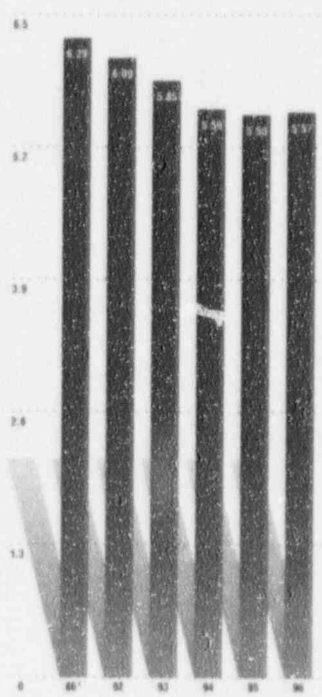
■ Utility ■ Non-Utility

Electric Sales
(in thousands of gwh)



Sales (Before Off-System)

Average Electric Prices
(cents per kwh)



Average Price per kwh (Before Off-System)

** 1986 numbers are pro forma figures of Iowa Southern Inc. and IE Industries Inc., which merged in 1991 to form IES Industries Inc.*

To Our Shareholders

Dear Shareholders:

IES Industries recorded a successful year in both decisions and performance.

On September 5, 1996, IES shareholders approved the merger with WPL Holdings, Inc. and Interstate Power Co., a three-way consolidation aimed at creating the new Interstate Energy Corporation, a regional energy powerhouse. This merger will give IES shareholders a large stake in a much larger company with excellent management strength and growth potential. Your vote of approval for this merger, rejecting the unsolicited merger proposal from MidAmerican Energy Co., reaffirmed our objective in achieving long-term prosperity and sustainable gain in shareholder value. We anticipate the completion of our pending merger by the end of the third quarter of 1997.

The 1996 net income was $61 million, or $2.04 per share. Excluding merger expenses and the cost of defending against the hostile takeover, the net income would have been $2.30 per share.

Our fourth quarter earnings rose 29 percent from the same period in 1995, reflecting a decrease in expenses and an adjustment to annualize depreciation. For the year, our core business unit, IES Utilities, was able to control expenses and to continue our growth in sales. Furthermore, as part of our merger filings, we have placed a self-imposed electric price freeze for the next three years (excluding price changes due to government-mandated programs or unforeseen dramatic changes in operation), which we believe will increase our competitive advantage at the marketplace. The operating income of Whiting Petroleum, our major non-utility subsidiary, more than doubled from the previous year. The total shareholder return for the year of 1996 ranked IES Industries as third in our peer group of 18 companies.

Since the Energy Policy Act enacted by Congress in 1992, our core utility business has been undergoing dramatic changes anticipating deregulation and competition. As new laws and regulations mandate a competitive future we, together with our merger partners, are working with legislators and regulators to ensure that we will have equal opportunities at the marketplace and we will not be disadvantaged in future competition. We believe that a level playing field must be created for all in the energy industry.

Internally we have long recognized the importance of low energy cost and high service reliability for our customers. Last year we stated that customer satisfaction was a major focus in our internal restructuring effort. The process improvement program initiated in 1994 and implemented in 1996 will result in significant improvements in customer service and cost reductions in the years ahead.

For 1996, in addition to pursuing the lofty goals in cost reduction and service improvement, it was also necessary to allocate our time and energy in preparing for the integrated operation after the merger completion. The success story of 1996 is described in detail in the following pages of this report. We would like to further highlight the following exceptional performers among a host of successes brought about by our dedicated and skilled employees.

Our nuclear power station, Duane Arnold Energy Center (DAEC), in 1996 achieved 493 days of continuous operation. The following refueling outage was only 36 days, the shortest down time for refueling since the plant became operational in 1974. The exceptional performance at the DAEC has placed the plant among the best in the world.

Our largest fossil generating station, Ottumwa Unit I, in 1996 again achieved the distinction of being ranked as one of the most efficient in the country.

While we respond proactively in the changing environment of the electric utility business, we continue to remain focused on the growth opportunities in the diversified area. Over the past decade, IES has put together an impressive portfolio of diversified businesses, including energy, transportation

In November 1996, the Board of Directors elected Larry D. Root President & Chief Operating Officer of IES Industries and IES Utilities. Mr. Root returns from retirement to serve in this capacity. Lee Liu continues to be Chairman & Chief Executive Officer.

and telecommunications interests. Our investments in Whiting Petroleum and IES Transportation have consistently produced good returns, and the investment in telecommunications at McLeod, Inc. realized a significant increase in value in 1996. We intend to build on our history of success in the diversified area, and we will continue to seek additional growth opportunities in order to enhance our shareholder value.

We have increased our presence in the international utility marketplace in 1996 by entering into a joint partnership with the Jiaxing City Power Bureau in China. The partnership's first project is the ownership and operation of a coal-fired electric cogeneration facility which produces electricity for the city and process steam for the industrial customers. The city of Jiaxing is one of the fastest-growing industrial areas of China. We are enthused with this long-term strategic business alliance. From this first step, we look forward to exploring more opportunities in the Jiaxing area. At the same time we will continue with our effort to seek out other international opportunities elsewhere.

Our vision for the future is a merged company with expanded resources, increased options, and broader opportunities in the United States and overseas. With a larger customer base and stronger financial capability, we will be able to access the domestic market beyond our current geographic borders, and have a presence in the carefully-selected international market. We believe that our growth strategy will position us to achieve exceptional and sustainable value for our shareholders.

We want to express our deep appreciation to you, our shareholders, for your support of the formation of Interstate Energy Corp. We are gratified by your approval of the merger, which we are confident will provide the best sustainable long-term return for your investment.

In addition we would like to express our gratitude to our employees for their extraordinary effort to undertake the challenging task of merger integration, process improvement and reliable day-to-day operation. Furthermore, we owe special thanks to those who worked tirelessly for the merger vote and the takeover defense. The overflow of enthusiasm and support was greatly appreciated.

In closing, we note changes in our senior management team. James E. Hoffman has been appointed Executive Vice President of IES Industries, responsible for the company's diversified business activities. In addition, Thomas M. Walker joined our company as Executive Vice President & Chief Financial Officer. New members of our senior management team also include Dundeana K. Langer, as Assistant Vice President, Field Operations, and John E. Ebright, as Controller & Chief Accounting Officer. These experienced managers will also have senior management positions with Interstate Energy Corp. once the merger is completed.

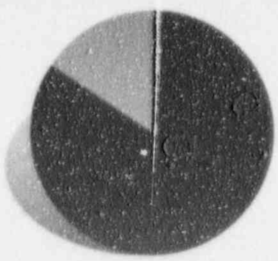
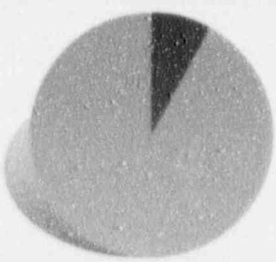
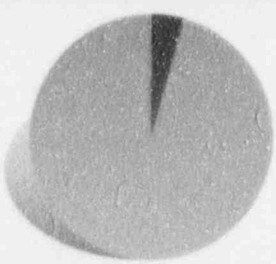
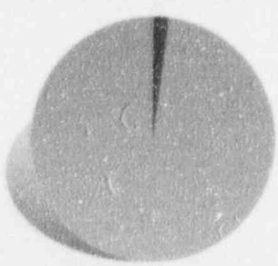
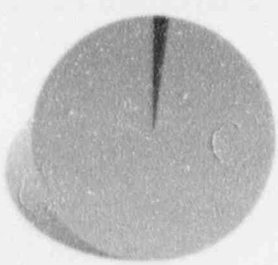
Lee Liu

Lee Liu
Chairman of the Board &
Chief Executive Officer

Larry D. Root

Larry D. Root
President &
Chief Operating Officer

IES at a Glance

Percent of Assets	Business	Focus
	**IES Utilities** IES Utilities provides electric, natural gas and steam energy to customers in more than 550 communities across Iowa. The company serves approximately 336,000 electric customers and 176,000 natural gas customers in a growing Iowa service territory.	"Focus on the customer" has become the theme for IES Utilities. The company's employee-driven process improvement program began generating results in 1996 in enhancing customer service and strengthening the company's competitive cost position. The launch of the Customer Service Guarantee program reinforced the company's commitment to meeting customer needs.
	**IES Energy** Whiting Petroleum Corp. is a natural gas and oil acquisition and development company based in Denver. The company focuses on developing proven and producing oil and gas properties. Industrial Energy Applications, Inc. (IEA) offers commodities-based and facilities-based energy resources and services for customers. IEA serves as the exclusive marketing agent for Whiting's oil and gas.	IES Energy companies are positioned to take advantage of the changing energy marketplace. Whiting has had a multi-year commitment to aggressive acquisition of proven and producing oil and natural gas properties. IEA and Whiting are focused on meeting customers' changing needs as deregulation continues in the oil and gas industry and begins to take hold in the electricity marketplace.
	**IES Investments** IES Industries has other interests in opportunities outside the regulated sector, including telecommunications, financial investments and community development projects in support of IES Industries' other operations.	IES Investments' most significant investment is its interest in McLeod, Inc. McLeod provides bundled telecommunications services and is building the Iowa fiber optic network in conjunction with the state. IES's McLeod investment provides not only a potential significant return but an opportunity to explore options to combine energy and telecommunications services.
	**IES Transportation** The cornerstone of IES Transportation is The Cedar Rapids and Iowa City Railway Company (CRANDIC), a short-line railroad with approximately 55 miles of track. IEI Barge Services, Inc. operates a barge and transfer terminal on the Mississippi River. IES Transfer Services is a distribution center with warehouse and transfer capabilities in Cedar Rapids.	Through its transportation companies, IES is able to offer customers a package of options, including rail, barge and truck transportation and transfer. IES is working to leverage those services with its utility and other diversified businesses. The company is also pursuing opportunities to market its transportation expertise to new customers.
	**IES International** IES created its IES International subsidiary in 1996 to manage its growing international investments in energy-related opportunities. The subsidiary seeks to generate returns in growing and developing international marketplaces. To date, the company has investments in New Zealand and China.	IES International seeks to leverage its experience and expertise in energy production and delivery in overseas locations. The company is pursuing opportunities primarily where it has existing business and customer contacts. By partnering with local companies, IES International is successfully managing its risk while navigating local business and regulatory processes.

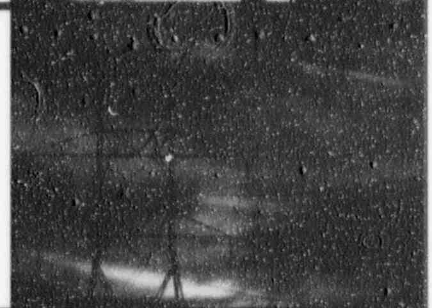
Markets

!ES Industries' economic development efforts continue to increase energy sales. Electric sales volumes to industrial customers increased 4.1 percent over the volumes of 1995, the seventh consecutive year that industrial sales have grown. IES's new electric incentive pricing program should further foster growth in Iowa. The company added more than 4,300 customers in 1996.

IES Utilities Service Area

The two IES Energy companies are ideally positioned to serve the western, central and southeast United States. From its Cedar Rapids base and regional offices in St. Louis, Atlanta, Denver and Phoenix, IEA continues to move closer to its customers. IES Energy companies do business in 27 states.

States in which IES Energy does business.



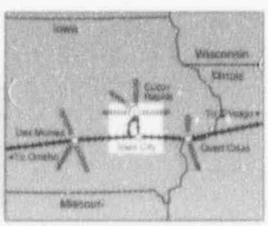
Following its Initial Public Offering in June 1996, McLeod acquired a telemarketing firm and a regional telephone directory publisher, both based in Cedar Rapids. At the same time, McLeod has outlined an aggressive growth strategy to take its bundled business and residential local phone service into 12 states in the coming years.

McLeod telecommunication services

Initial Market Focus

Expanded Market Focus

The IES Transportation companies are strategically located to serve customers and growing markets. CRANDIC offers customers access to major rail centers through its affiliation with lines including the Iowa Interstate Railroad and Burlington Northern Santa Fe Railroad. IEI Barge Services is positioned to serve the growing industrial base along the Mississippi River.



CRANDIC's lines offer interconnections to major Midwest rail centers.

IES International focuses on the Pacific Rim and Central and South America, where energy needs significantly outpace current supply. The company's partnership in Jiaxing is an entry into one of the fastest-growing and most heavily-industrialized areas of China. The company's New Zealand investment benefits from the privatization of that nation's electric distribution system.

IES International is a partner with the Jiaxing City Power Bureau, Jiaxing, China.

Questions & Answers

During 1996, these were frequently-asked questions IES received from shareholders:

Q Why is it necessary for IES Industries to merge with WPL Holdings, Inc. and Interstate Power Co.?

A Our industry is undergoing fundamental transition from a regulated marketplace to a more competitive environment that will allow customers greater choice in selecting their energy suppliers. We believe companies that will succeed in the competitive marketplace will be those that have sufficient resources to offer a variety of products and services and to expand beyond existing geographic borders, both nationally and internationally. IES will be better positioned for the future as part of a more powerful, regional company than as a stand-alone utility.

Q When will the merger be completed?

A The merger is subject to the approval of several federal agencies, including the Federal Energy Regulatory Commission, as well as regulatory authorities in four states. We have made progress in the approval process; Minnesota's Public Utility Commission conditionally approved the merger in January 1997 and the FERC has set a timetable for acting on the merger. Given that timetable, we anticipate completing the merger by the end of the third quarter of 1997. A number of integration teams from the merger partners have begun work so we will be able to realize savings and synergies as soon as possible after the merger is approved.

Q What will happen to my share value and dividend as a result of the merger?

A Based on the amended merger agreement, each share of IES common stock will be converted into 1.14 shares of Interstate Energy common stock. Based on the closing price of WPLH common stock on December 31, 1996, each share of IES common stock is valued at $32.06 per share. Based on WPLH's current dividend rate, it is anticipated that IES shareholders will receive an initial cash dividend of at least $2.28 for each share of IES common stock they own at the time of the merger.

Q Why have IES's earnings per share fallen for the past two years?

A There were extraordinary factors that affected our net income during that time. For example, our 1996 net income of $2.04 per share reflected a charge of 26 cents per share for the costs of preparing for the company's pending three-way merger and expenses incurred as a result of the unsolicited merger proposal by MidAmerican Energy Co. In 1995, net income of $2.20 per share reflected a 33-cents-per-share reduction caused by the Iowa Utilities Board's order reducing retail electric prices by $14.4 million.

Q What is IES's strategy for growth?

A IES is taking steps to expand both its core utility business and its diversified businesses. At IES Utilities, we are continuing our long-standing commitment to economic development and competitive pricing, to generate sales volume growth beyond the industry average. On the diversified side, we are leveraging our years of successful experience in energy and transportation into new realms, including international partnerships. By building on our expertise and relationships, both nationally and internationally, our goal is to derive a substantial portion of our future income from our diversified businesses.

Q What are we doing to minimize our risk in international operations?

A We are focusing our efforts on developing international markets where there are needs for the services of companies like IES. We also are focused on opportunities where we can offer services in which we have expertise, including developing energy production and delivery infrastructure. By forming local partnerships, we can reduce capital commitments, spread our risk and benefit from our partners' knowledge of local customs and regulatory processes. We are also investigating opportunities to follow our existing domestic customers into new markets, meeting their energy needs as they expand into new locations.

Q How well is IES positioned to compete in a deregulated utility marketplace?

A For the past three years, IES has made significant changes in its utility operations as part of a process improvement initiative to improve its cost structure, efficiency, reliability and customer service. Such improvements will enable IES Utilities to be a stronger player in the competitive marketplace.

Q What is IES doing to make its customer service stand out from that of possible competitors?

A We have devoted a significant amount of time and effort to dramatically change how we provide service to customers. We are investing in training so that our employees are expertly skilled and prepared to meet the diverse needs of our customers. We initiated a Customer Service Guarantee program, which provides service guarantees in those areas that are most important to customers. We anticipate this program will grow in the years ahead. The account management program is an example of how we are dedicating resources to ensure that we know our customers and their businesses. The changes that we made this year in our interruptible electric pricing program, in direct response to customers' requests, is another demonstration of our focus on customer needs.

Our Merger

The strategic merger of IES Industries, WPL Holdings, Inc. and Interstate Power Company was approved by shareholders of all three companies on Sept. 5, 1996. Interstate Energy Corporation (IEC), with over $2 billion in sales and $4.6 billion in assets, will be among the top 40 electric utility companies in the United States. More importantly, the merger will allow IES to achieve an overriding objective – to be part of a stronger and more powerful company than we could ever be standing alone. The merger also will result in a stronger complement of diversified businesses. We believe these assets will be the engine for significant future growth.

Each of our merger partners brings distinct strengths which, when combined, give the merged company a portfolio of competencies and resources that will differentiate us from our competitors.

The merger planning process is already well along, with development of the IEC operating structure. IEC will have four major business units in three locations, with the utility operations remaining decentralized so that IEC can remain close to its customers. The business units and their locations are as follows:

- Energy delivery and the non-regulated business units both will be headquartered in Cedar Rapids, Iowa.
- Administration business unit will be headquartered in Dubuque, Iowa.
- Power generation will be headquartered in Madison, Wis., as will the parent holding company.

During the year, we also named the top executives for the utilities and the four future IEC business

More than 1,000 shareholders attended the IES Industries annual meeting on September 5. Following presentations by merger partner representatives, including Interstate Power Co. Vice President Rich Ewers, shareholders overwhelmingly voted to create Interstate Energy Corp., a regional energy company.

units. They are as follows:

- Eliot G. Protsch will serve as President of IES Utilities, as well as Executive Vice President of the energy delivery business unit. He is currently Senior Vice President at Wisconsin Power and Light Co.
- Michael R. Chase will be President of Interstate Power Co. and Executive Vice President of the administration business unit. He is currently President and Chief Executive Officer of Interstate Power.
- William D. Harvey will serve as President of Wisconsin Power and Light Co. and Executive Vice President of Generation. He is presently Senior Vice President, Wisconsin Power and Light.
- James E. Hoffman will be President of the non-regulated company and also Executive Vice President of the business development unit, combining the diversified activities of IES and WPL Holdings. He is currently Executive Vice President of IES.
- Thomas M. Walker will be Executive Vice President & Chief Financial Officer of IEC. He is currently Executive Vice President & Chief Financial Officer of IES.

As announced at the time of the merger, Lee Liu, Chairman of the Board & Chief Executive Officer of IES, will become Chairman of IEC. Wayne Stoppelmoor, Chairman of Interstate Power, will serve as Vice Chairman, and Erroll B. Davis Jr., Chairman of the Board, President and Chief Executive Officer of WPL Holdings, will be President and Chief Executive Officer of IEC.

As our merger planning progresses, we have established several integration teams, composed of employees who are seeking information and ideas throughout the three companies. Through their efforts, we will be able to realize savings and synergies once the merger is approved. Regulatory approvals are also proceeding. The Federal Energy Regulatory Commission, in applying its new merger policies to its review of the IEC merger, has established a timetable that should permit the merger to be completed by the end of the third quarter of 1997.

The Chairmen of the three merger partners (from left, Wayne Stoppelmoor of Interstate Power Co., Erroll B. Davis Jr. of WPL Holdings, Inc. and Lee Liu of IES Industries Inc.) have been significantly involved in merger and business expansion activities. In November, the three company Chairmen traveled to Jiaxing, China, to launch IES International's newest venture.

During 1996, we began implementing our employee-driven process improvement initiative at IES Utilities Inc. to ensure our competitive edge over the long term. As we continue implementation in 1997, IES Utilities, its customers and IES shareholders will begin to realize benefits from the redesign of

our business processes throughout our company.

This improvement effort has transformed how IES Utilities operates and responds to our customers. Employees are *living* the vision of our company - "to be the supplier of choice for its products and services through outstanding performance and responsible corporate citizenship." At IES Utilities today, every employee is focusing on providing service and value in everything we do.

In 1996, we maintained our competitive energy prices. IES Utilities' average electric industrial price, at 3.82 cents per kilowatt-hour, is among the lowest in the nation and far below the national average of 4.92 cents, according to figures reported by the Edison Electric Institute in July 1996.

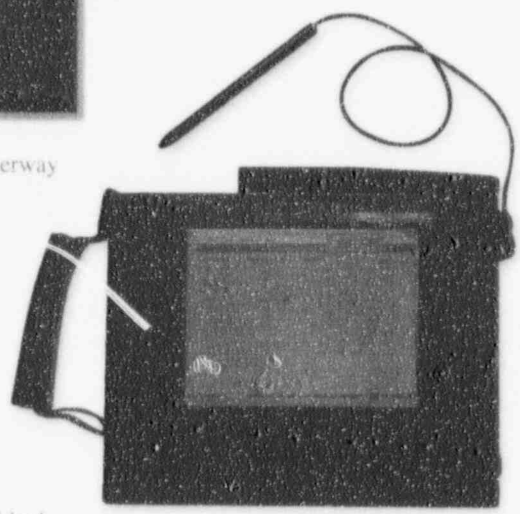
We also saw continued energy sales growth in 1996. Results included:

- A 3.5 percent weather-normalized increase in kilowatt-hour sales volumes, excluding off-system sales. (The growth was 1.7 percent on an actual basis.)
- A 4.1 percent increase in electric sales volumes to our industrial customers.
- An increase of 5.9 percent in natural gas sales and transportation volumes. (The increase was 1.9 percent on a weather-normalized basis.)

IES Utilities' new Red Cedar Cogeneration Station in Cedar Rapids is a 23-megawatt electric production facility that also supplies process steam to Penford Products Co. ▼ Training at the DAEC simulator is one factor that influenced the nuclear plant's licensed reactor operator 100 percent pass rate in 1996 and the plant's overall outstanding performance.

Creation of business units for processes including how we deliver energy and generate electricity was a first step in defining IES Utilities' new business structure for the coming competitive environment. Like the other units, our energy delivery group has revamped its work processes, including dedicating crews to the maintenance and reliability of our energy services.

Through its Vision Impact pilot, IES Utilities is testing a comprehensive software and technology program to enhance the company's responsiveness and customer satisfaction. Mobile terminals connect employees with dispatchers and customers in several test communities. The company will launch Vision Impact systemwide in the next year.



- A significant increase in steam sales, primarily due to the addition of a new industrial customer.

Our planning for the future includes expanded investment in technology to serve customers' needs. IES Utilities is developing a leading-edge system integrating outage management, work management, service calls and a geographic information system. The use of mobile data terminals will allow customer service calls to be routed directly to an employee's customer service vehicle or even to the home of an employee who lives near the customer. A pilot program is currently underway in several communities.

To enhance the company's delivery of energy and customer service, IES Utilities is consolidating 18 operating facilities and instituting an individualized "rapid responder" system for quicker service. The company also established new customer payment locations with dedicated customer service phone lines to replace eight commercial office locations.

IES Utilities fully recognizes that customers today put the highest

Customer satisfaction is the ultimate test. In 1996, 92 percent of customers surveyed expressed satisfaction with IES Utilities' 24-hour customer service centers.

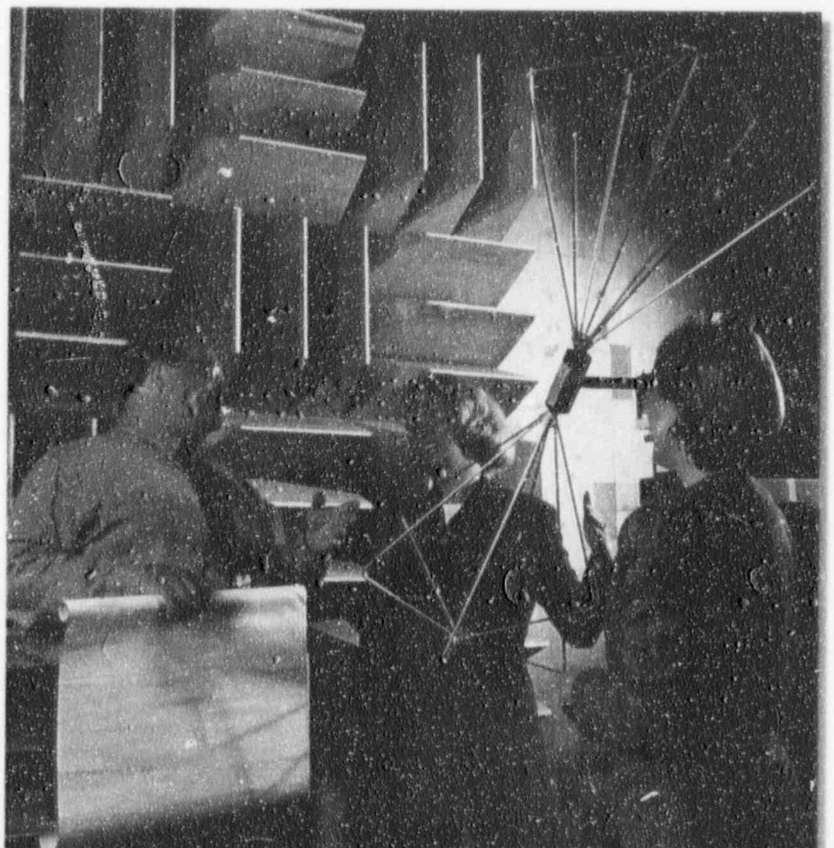
respecting customers' property and repairing security lighting on customers' schedules.

For our industrial customers, IES Utilities inaugurated an account management approach, assigning a dedicated account manager to each of our top 1,000 customers. The manager serves as a single point for coordinating the resources of IES Utilities, tailoring solutions to specific needs and ensuring that energy solutions are provided quickly, efficiently and most economically. Our goal is not just to *respond* to customers' needs, but to know their businesses so well that we *anticipate*

Manufacturing and technology customers like Norand Company have unique needs in their energy services. IES Utilities' 20 account managers like Jan Otto provide single points of contact for coordinating the company's resources to meet the needs of these customers. This customer-focused approach is vital for success in a competitive environment.

priority on reliable service and value. The way to retain customers in a competitive environment is to offer superior service and reliability at exceptional value. The changes we are making to achieve those goals reflect our commitment to our customers, communities and shareholders.

In November, we launched IES Utilities' Customer Service Guarantee program, another tangible demonstration that we are not just talking about customer service, but living it. The program provides financial guarantees in the areas that are most important to customers—keeping service appointments as scheduled, notifying them of planned service interruptions,



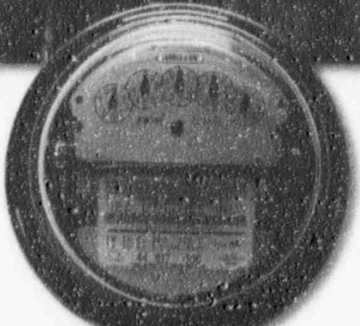
IES Utilities' new electric incentive pricing program is an extension of the company's long-standing commitment to Iowa's economic growth. The program of incentive prices for customers who significantly increase electric load encouraged Dexter Company's $6 million expansion of its Fairfield foundry.

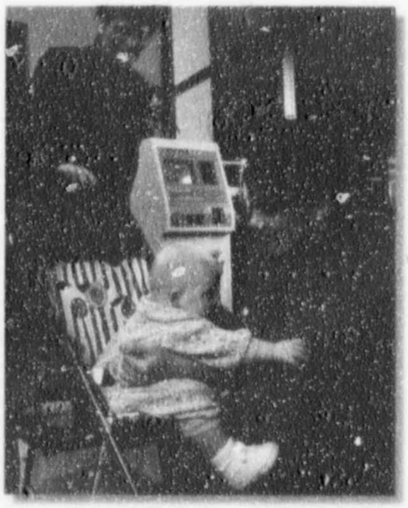
Breaking the monopoly mindset, IES Utilities inaugurated a program to provide financial guarantees to customers on four of the services that they said matter most to them. The company's commitment to connecting service when a customer requests it – or making it right with a customer – is one of the ways IES Utilities is focusing on the customer.

their needs. Early reaction from customers has been positive.

As part of its economic development commitment, IES Utilities initiated an electric incentive pricing program for customers who add new or incremental electric loads exceeding 100 kilowatts. Another economic development initiative is an enhanced marketing support for our service communities to help them attract new businesses. We also launched an innovative short-term loan program for communities to encourage new building construction to attract industries.

Another IES Utilities success story was the Duane Arnold Energy Center. The nuclear power plant had an outstanding 1996. The plant's refueling outage was completed in just 36 days, the shortest in the plant's 22-year history. Prior to the outage, the plant operated continuously for a record 493 days, placing it fourth in the world for reactors of its type. Employees also worked safely, surpassing more than 4.5 million employee-hours worked without a lost-time accident.





Busy customers demand innovative utility service. Through an automated payment terminal pilot program, customers can transact business with IES at their convenience.

Focusing on proven and producing oil and natural gas properties, Whiting Petroleum Corp. has increased its daily oil production by nearly 350 percent in the past three years.

IES believes that providing energy products and services in a competitive marketplace is one of the corporation's greatest opportunities for rapid growth. It is a strategy that we have actively pursued through two related and complementary businesses, Whiting Petroleum Corp. and Industrial Energy Applications, Inc. (IEA).

1996 was simply an exceptional year for Whiting Petroleum. The company's earnings exceeded our expectations for the year and were the highest since IES acquired Whiting Petroleum in 1992. Higher oil and natural gas prices and increased gas sales contributed to the higher profits for the company.

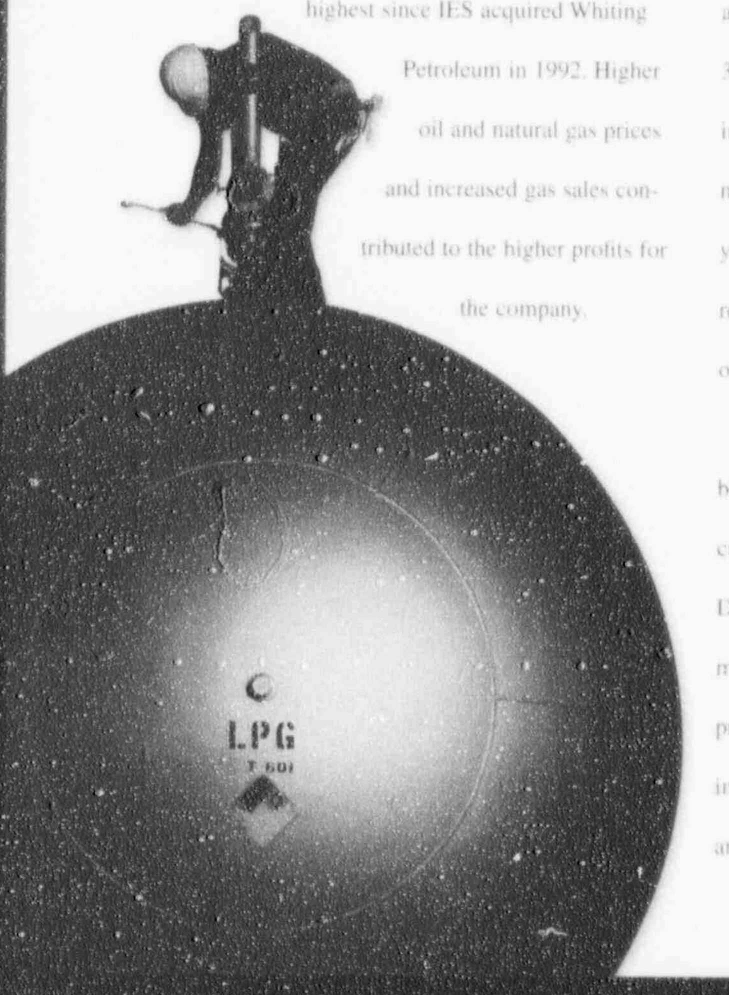
At the same time, Whiting continued its strategy of acquiring and developing relatively small domestic fields that have oil and natural gas reserves. The business strategy is based on buying proven properties and then aggregating them to add value through management and operational expertise. By acquiring *producing* properties, Whiting avoids the risk and long-term upfront costs of exploring undeveloped regions. In the past three years, Whiting's earnings have grown by an annualized rate of approximately 35 percent. The company also has increased its oil and gas reserves by nearly 250 percent in the past three years. The company's oil and gas reserves totaled 27 million barrels of oil equivalent at the end of 1996.

While high oil and gas prices benefited Whiting Petroleum, they created a challenging year for IEA. Despite benefiting as the exclusive marketing agent for oil and natural gas produced by Whiting, IEA felt the impact of high gas prices in 1996 and its commitments to supply gas

to customers at contracted prices. The company is taking steps to mitigate the effect of the volatility in the gas market in the future.

IEA also made a significant investment in its natural gas supply sources by purchasing a gas-gathering and transportation system in eastern Texas. The pipeline consists of 66 miles of transmission, gathering and feeder lines connected to 185 wells in the system. Since taking over operation of the pipeline in November, IEA is focusing on increasing revenues by connecting new and existing wells to the system.

IEA also provides industrial and commercial customers with products and services both "up to" and

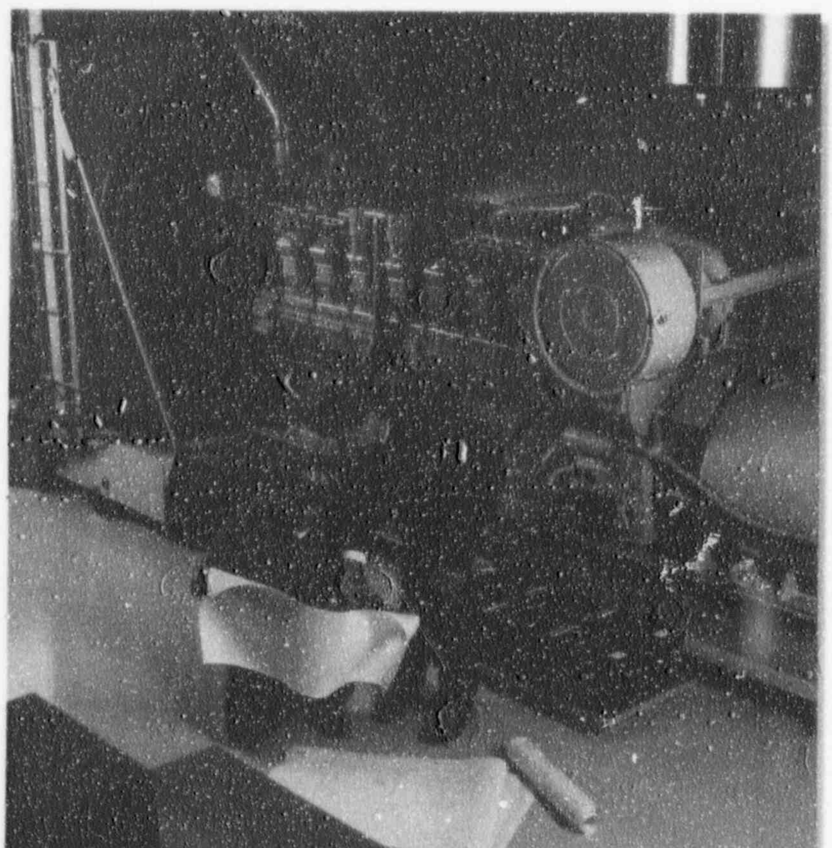


In 1996, IEA completed the purchase of a natural gas gathering and transportation system in eastern Texas. The 66 miles of transmission, gathering and feeder lines connect the 185 wells on the system to transportation pipelines. In 1997, the system is expected to carry throughput of between 70 million and 100 million dekatherms of natural gas per day. The two largest shippers on the system recently signed 10-year contracts.

"inside" the plant. Those services include standby and peaking generation, cogeneration, propane air systems and/or steam production. We believe there are particular opportunities in providing standby generation to current and prospective manufacturing customers whose operations require continual and uninterrupted power supplies. The company also is continuing to aggressively pursue such "inside-the-fence" facility-based opportunities as cogeneration plants.

The IES Energy companies are working to position themselves for the future as the energy industry experiences further competitive changes. IES Energy is pursuing alliances with partners in order to strengthen our position in the energy marketplace. We believe there will continue to be numerous opportunities in this sector of the energy industry, and we are committed to being a player.

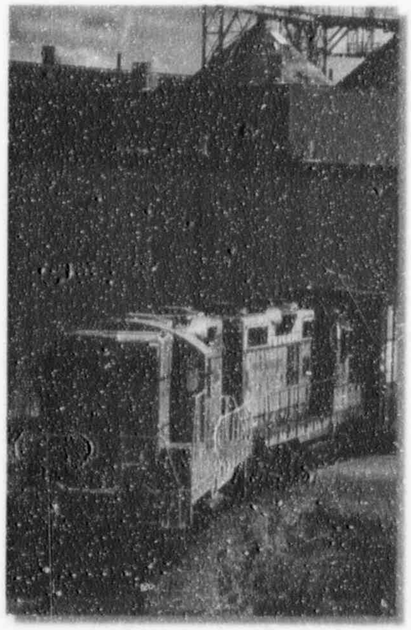
As part of its portfolio of services, IEA provides standby electric generation equipment, operations and maintenance services to 20 customers at 26 sites in four states. AEGON USA, Inc. relies on IEA for back-up generation service at its corporate data center in Cedar Rapids.



With capabilities in short-line rail, barge transportation and transfer and ancillary services, the three companies of IES Transportation provide integrated solutions for industrial customers in the region. IES Transportation clearly demonstrates our strategy of diversifying into businesses that build on existing customer relationships while providing opportunity for greater returns than in the traditional utility business.

Although market factors reduced earnings at The Cedar Rapids and Iowa City Railway Company (CRANDIC) from their record 1995 levels, the short-line railroad nevertheless led IES Transportation's pre-tax 19 percent return on investment in 1996. As corn prices reached an all-time high, some of CRANDIC's large grain processing customers reduced their corn purchases and shipments. An aggressive cost-control program at CRANDIC, and more stabilized corn prices late in 1996, benefited IES Transportation's results.

CRANDIC continues to prosper because it cost-effectively offers industrial customers access to major U.S. rail centers. CRANDIC has developed alliances with railroads such as the Iowa Interstate Railroad and the Burlington Northern Santa Fe Railroad. CRANDIC's performance in the coming year also should benefit from new customer alliances. The location of Cedar River Paper Co. on the CRANDIC line, for example, demonstrates our success in offering integrated economic development packages to current and potential customers.

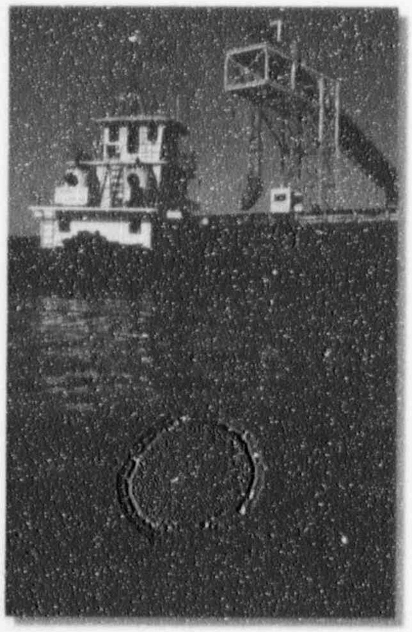


For more than 90 years, CRANDIC has been a vital transportation link for eastern Iowa companies. CRANDIC's reliable service has helped to draw manufacturing facilities like Cedar River Paper Co. to the area and to the IES Utilities service territory. In 1996, CRANDIC moved its shop and repair facilities to a new location to allow it to make railcar repairs more efficiently.

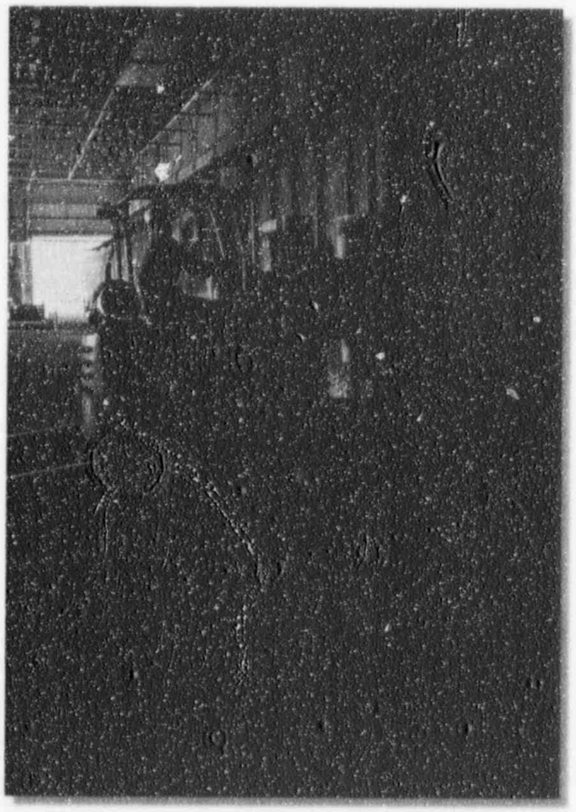
During the year, CRANDIC also continued its investment in equipment to meet customers' needs. The company added four rebuilt locomotives that will allow it to handle heavier loads of coal and grain for customers. In addition, CRANDIC leased additional boxcar capacity to help serve customers.

In addition to rail hauling, IES Transportation has developed two facilities that offer product loading/

New buildings at its Mississippi River harbor and enhanced relationships with its key customers helped position IEI Barge Services for the future.



IES Transfer Services expanded its service offerings in 1996 to include bulk material transloading, new trucking services and railcar pre-trip inspections.

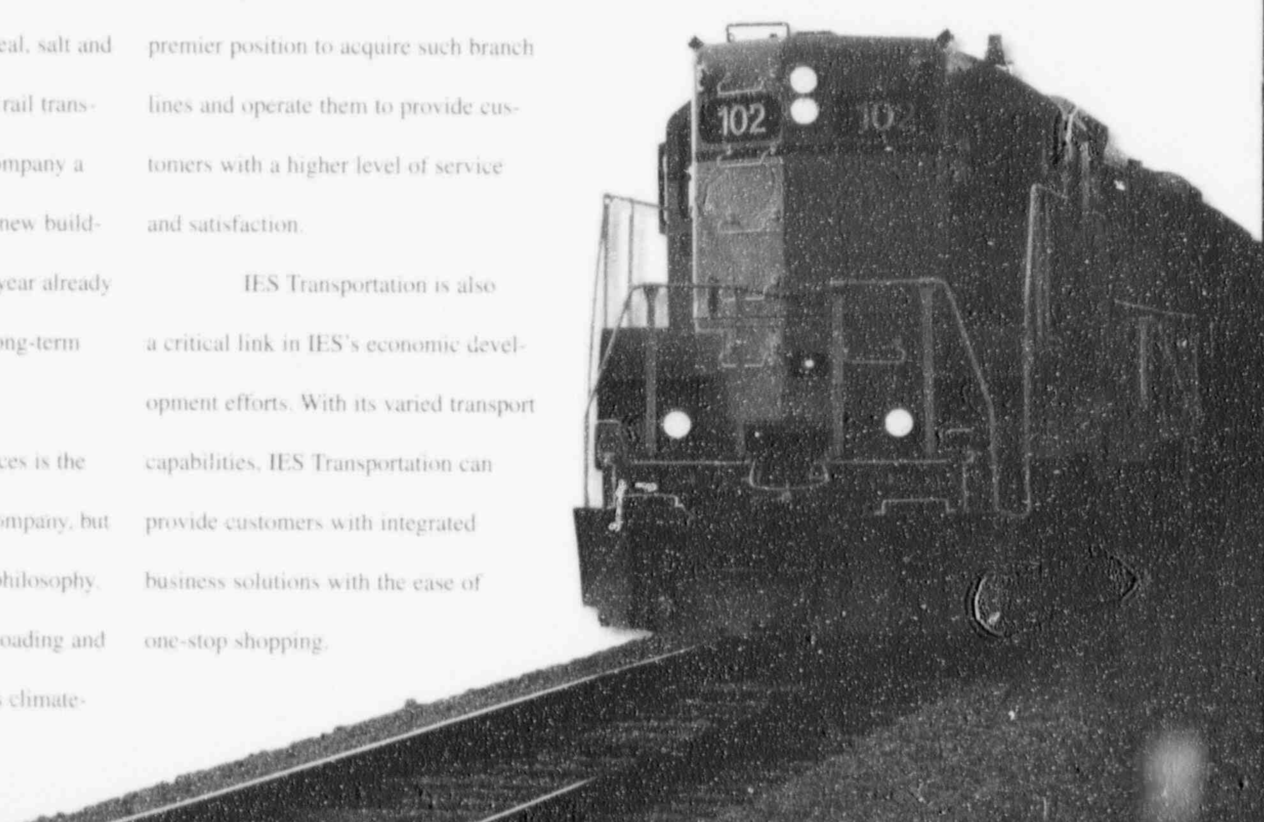


unloading, transfer and storage services. IEI Barge Services, located on a private Mississippi River harbor in East Dubuque, Ill., has found a niche serving customers who transport such diverse bulk products as coal, fishmeal, salt and cottonseed. River, truck and rail transportation access gives the company a foundation for growth. Two new buildings built on the harbor this year already are fully utilized thanks to long-term customer agreements.

IES Transfer Services is the newest IES Transportation company, but it follows that same service philosophy. The company provides transloading and short-term warehousing in its climate-controlled storage facility, which is equipped with overhead cranes capable of lifting up to 45 tons. IES Transfer also offers trucking services, railcar inspections and rail-to-truck transfer for customers who lack direct rail access.

IES Transportation is continually looking for opportunities that will allow us to further develop our transportation business. As the large railroads merge to form more national operations based on high-volume and high-speed transportation, it is likely they will want to divest some of their branch lines. CRANDIC, with 90 years of experience in running a short-line railroad, is in a premier position to acquire such branch lines and operate them to provide customers with a higher level of service and satisfaction.

IES Transportation is also a critical link in IES's economic development efforts. With its varied transport capabilities, IES Transportation can provide customers with integrated business solutions with the ease of one-stop shopping.



During the past decade, IES has invested in its future, not only in its core utility business but by investing in companies with significant growth potential. In particular, we have sought opportunities that complement IES's growth strategies. One of our most exciting endeavors recently has been the investment in McLeod, Inc., a Cedar Rapids-based company that provides local and long distance telecommunications services. McLeod is currently building a state-wide fiber optic network in conjunction with the state of Iowa that will enable it to provide additional voice and data communications services. The company also recently expanded into wireless telecommunications. In a recent Federal Communications Commission auction, McLeod successfully acquired 26 U.S. Personal Communications Services licenses in 24 Midwest markets, serving a potential population of approximately 6.5 million people. The company also publishes and distributes nearly eight million telephone directories in 15 states and maintains a telemarketing service in Cedar Rapids.

McLeod, Inc. broke ground in 1996 on a new technology campus in Cedar Rapids. The new campus headquarters will allow McLeod to consolidate most of its growing business operations in one location.

The McLeod strategy for growth is excellent in its own right. But more importantly, the McLeod investment could fit nicely with our core business. We believe the convergence of the telecommunications and utilities industries already has begun and we could envision teaming with McLeod and other similar companies to provide a multiplicity of new products and services to current and potential customers. McLeod also has honed its marketing skills and expertise in a highly-competitive marketplace. This experience will be an invaluable asset as IES continually seeks to enhance its ability to communicate and market its services in a deregulated marketplace.

McLeod has aggressively expanded its fiber optic network, building more than 2,130 miles of lines in Iowa in 1996. Through a partnership agreement, IES Utilities has granted McLeod access to its electric poles across the utility service area.

We increasingly view the international arena as a prime opportunity to create shareholder value. With privatizations throughout the Pacific Rim and energy demand exceeding supply in many parts of South America and Western Europe, international markets offer growth and higher returns on investments with a manageable level of risk. To encourage success, one of our strategies has been to form partnerships with other companies, to allow us to spread risk, reduce capital commitments and benefit from local partners' understanding of business customs and regulatory approval procedures in other countries.

In 1995, we entered the New Zealand energy market through a $25 million investment in two distribution companies, Powerco Ltd. and Central Power Ltd. We made an additional $6 million investment in the companies in 1996.

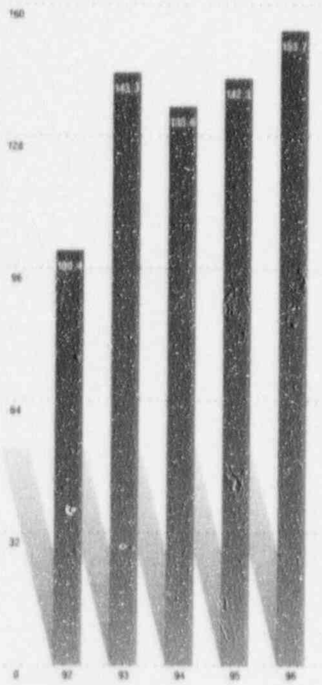
Also in 1996, IES International extended its international presence through a 50-percent joint venture with the Jiaxing City Power Bureau in Jiaxing, China. This $13 million investment leverages our operational expertise in a rapidly-developing area that offers double-digit annual growth prospects. We view this as the first step in a growing presence in China.

IES has a strong base of customers with significant global presence and expertise, and a network of business relationships and worldwide contacts. IES Utilities has long been successful in attracting global companies such as Cargill, Ajinomoto and PMX Industries to its Iowa service territory. We intend to build on these relationships. One of our strategies is to follow our customers, extending existing relationships to new geographic locations.

IES International leverages its utility experience to generate returns with international partners. The company's investment in two New Zealand companies was followed this year with formation of JIES Heat and Power partnership in China.

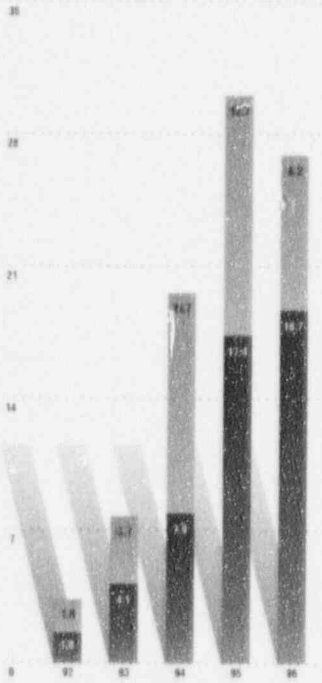
IES Utilities Operating Income

(in millions of dollars)



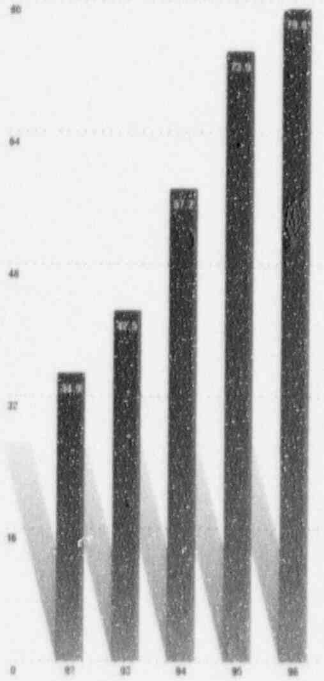
Whiting Oil and Gas Reserves

(barrels of oil equivalent in millions)



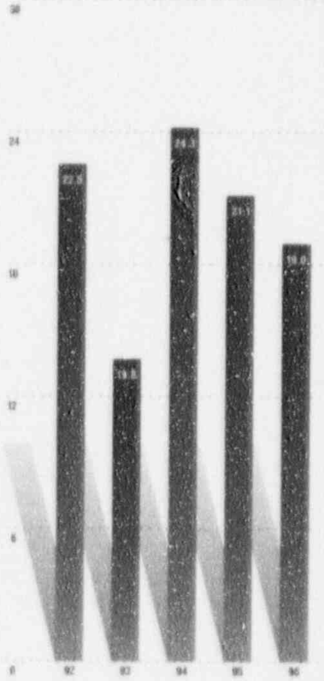
IEA Capacity at Year-End

(in megawatts)



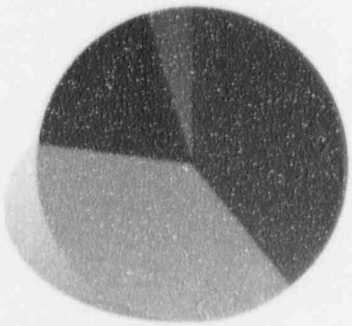
IES Transportation Pre-tax Return on Investment

(p· rcent)



1996 IES Utilities Electric Revenue Mix

(percent)

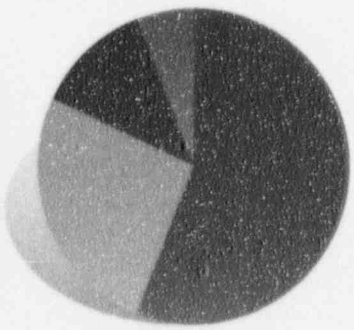


Large General Service	39%
General Service	18%
Residential & Rural	38%
Sales for Resale & Other	5%

(Excludes off-system sales and other revenues)

1996 IES Utilities Electric Sales Mix

(percent)

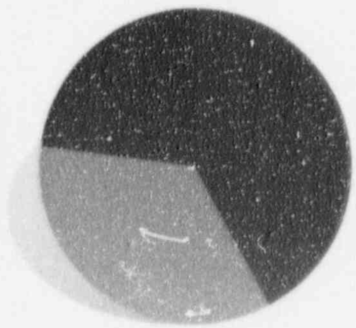


Large General Service	56%
General Service	12%
Residential & Rural	26%
Sales for Resale & Other	6%

(Excludes off-system sales)

1996 IES Utilities Energy Source

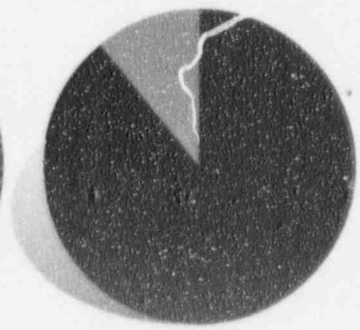
(percent)



Fossil	42%
Purchased	35%
Nuclear	23%

1996 IES Utilities Electric Capacit· Mix at Peak Demand

(percent)



Fossil	72%
Nuclear	17%
Purchased	11%

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

The Consolidated Financial Statements include the accounts of IES Industries Inc. (Industries) and its consolidated subsidiaries (collectively the Company). Industries' wholly-owned subsidiaries are IES Utilities Inc. (Utilities) and IES Diversified Inc. (Diversified).

Competition

Utilities and its predominant business, electric energy generation, transmission and distribution, are in a period of fundamental change in the manner in which customers obtain, and energy suppliers provide, energy services. As legislative, regulatory, economic and technological changes occur, electric utilities are faced with increasing pressure to become more competitive. Such competitive pressures could result in loss of customers and an incurrence of stranded costs (i.e., the cost of assets rendered unrecoverable as the result of competitive pricing). To the extent stranded costs cannot be recovered from customers, they would be borne by security holders.

The National Energy Policy Act of 1992 addresses several matters designed to promote competition in the electric wholesale power generation market. In April 1996, the Federal Energy Regulatory Commission (FERC) issued final rules (FERC Orders 888 and 889), largely confirming earlier proposals, requiring electric utilities to open their transmission lines to other wholesale buyers and sellers of electricity. The rules became effective on July 9, 1996. Utilities filed conforming pro-forma open access transmission tariffs with the FERC which became effective October 1, 1995. In response to FERC Order 888, Utilities filed its final pro-forma tariffs with FERC on July 9, 1996. The non-rate provisions of the tariffs were approved on November 13, 1996. FERC has not yet ruled on the rate provisions of the tariffs. The geographic position of Utilities' transmission system could provide revenue opportunities in the open access environment. Industrial Energy Applications, Inc. (IEA), a wholly-owned subsidiary under Diversified, received approval in the 1995 FERC proceeding to market electric power at market based rates. The Company cannot predict the long-term consequences of these rules on its results of operations or financial condition.

FERC does not have jurisdiction over the retail jurisdiction, and thus the final FERC rules do not provide for the recovery of stranded costs resulting from retail competition. The various states retain jurisdiction over the question of whether to permit retail competition, the terms of such retail competition and the recovery of any portion of stranded costs that are ultimately determined by FERC and the states to have resulted from retail competition.

The Iowa Utilities Board (IUB) initiated a Notice of Inquiry (Docket No. NOI-95-1) in early 1995 on the subject of "Emerging Competition in the Electric Utility Industry" to address all forms of competition in the electric utility industry and to gather information and perspectives on electric competition from all persons or entities with an interest or stake in the issues. In January 1996, the IUB created its own timeline for evaluating industry restructuring in Iowa. Included in the IUB's process was the creation of a 22-member advisory panel, of which Utilities is a member. The IUB conducted public information meetings around the state of Iowa. A draft report was created by the IUB staff and is expected to be finalized in the first quarter of 1997. The draft report indicated that the IUB is of the opinion that there is no compelling reason to move quickly into restructuring the electric utility industry in Iowa. However, they will continue the analysis and debate on restructuring and retail competition in Iowa.

As part of Utilities' strategy for the emerging and competitive power markets, Utilities, Interstate Power Company (IPC) and Wisconsin Power and Light Company (the utility subsidiary of WPL Holdings, Inc. [WPLH]), and a number of other utilities have proposed the creation of an independent system operator (ISO) for the companies' power transmission grid. (The Company, WPLH and IPC have entered into a merger agreement, as discussed later.) The companies would retain ownership and control of the facilities, but the ISO would set rates for access and assure fair treatment for all companies seeking access. The proposal requires approval from state regulators and the FERC. Various other proposals for ISO's have been made by other companies and Utilities is monitoring all such proposals. Membership in an ISO could become a condition of merger approval by the various regulatory bodies.

Utilities is subject to the provisions of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS 71). If a portion of Utilities' operations become no longer subject to the provisions of SFAS 71, as a result of competitive restructurings or otherwise, a write-down of related regulatory assets would be required, unless some form of transition cost recovery is established by the appropriate regulatory body. In addition, the Company would be required to determine any impairment to other assets and write-down such assets to their fair value. Utilities believes that it still meets the requirements of SFAS 71.

The Company cannot predict the long-term consequences of these competitive issues on its results of operations or financial condition. The Company's strategy for dealing with these emerging issues includes seeking growth opportunities, continuing to offer quality customer service, ongoing cost reductions and productivity enhancements, the major objective of which is to allow Utilities to better prepare for a competitive, deregulated electric utility industry. In this connection, Utilities is in the final stages of a significant process improvement program to improve its service levels, reduce its cost structure and become more market-focused and customer oriented. (The Company's continuous improvement efforts, in general, will be an ongoing effort, however).

Examples of the process improvement changes being implemented are, but are not limited to: managing the business in business unit form, rather than functionally; formation of alliances with vendors of certain types of material and/or services rather than opening most purchases to a bidding process; changing standards and construction practices in transmission and distribution areas; changing certain work practices in power plants; making investments in information technology upgrades; and improving the method by which service is delivered to customers in all customer classes. The specific changes range from simple improvements in current operations to radical changes in the way work is performed and service is delivered. Some of the changes are currently in the pilot stage thus the results from this evaluation period or the potential effects of the pending merger could prove that some of the changes are not efficient or effective and must be revised or eliminated. Subject to delays caused by implementing any such revisions, implementation of the changes began in 1996 and will continue into 1997; however, certain results will not be realized until 1997. In addition, the Company must give consideration to the potential effects of the pending merger as part of the implementation process so that duplication of efforts are avoided.

Proposed Merger of the Company

The Company, WPLH and IPC have entered into an Agreement and Plan of Merger, as amended (Merger Agreement), dated November 10, 1995. As a result of the transactions contemplated by the Merger Agreement, the combined company, Interstate Energy Corporation (Interstate Energy), anticipates cost savings of approximately $749 million over a ten-year period, net of transaction costs and costs to achieve the savings of approximately $14 million and $64 million, respectively. The estimate of potential cost savings constitutes a forward-looking statement and actual results may differ materially from this estimate. The estimate is necessarily based upon various assumptions that involve judgments with respect to, among other things, future national and regional economic and competitive conditions, technological developments, inflation rates, regulatory treatments, weather conditions, financial market conditions, future business decisions and other uncertainties. No assurance can be given that the estimated cost savings will actually be realized.

The merger, which is conditioned upon, among other things, receipt of certain regulatory and governmental approvals, is expected to close by the end of the third quarter of 1997. As part of the approval process, management has proposed retail and wholesale price freezes to be implemented in certain jurisdictions. Refer to Notes 2 and 3 of the Notes to Consolidated Financial Statements for additional information regarding the proposed merger and the proposed price freezes.

Results of Operations

The following discussion analyzes significant changes in the components of net income and financial condition from the prior periods for the Company.

The Company's net income decreased ($3.3) million and ($2.6) million during 1996 and 1995, respectively. Earnings per average common share declined to $2.04 in 1996 from $2.20 in 1995. The 1996 decrease in earnings was primarily due to costs incurred relating to the successful defense of the hostile takeover attempt mounted by MidAmerican Energy Company (MAEC) and preparing for the Company's pending three-way merger. The Company estimates that the hostile takeover defense and merger costs reduced 1996 earnings by $0.15 per share and $0.11 per share, respectively. The 1996 earnings benefited from increased electric, gas and steam sales at Utilities, the impact of a natural gas pricing increase implemented in the fourth quarter of 1995 and increased earnings at the Company's oil and gas subsidiary, Whiting Petroleum Corporation (Whiting). Increased operating expenses, higher interest expense and a higher effective income tax rate also contributed to the decrease in earnings in 1996. The 1995 results reflect the impact of the IUB price reduction order in Utilities' latest electric rate case. The effect of the lower electric prices, including the required refund, reduced the 1995 net income by approximately $9.7 million ($0.33 per share). Warmer than normal weather conditions during the summer months, which added $0.18 to earnings, and an aggressive cost containment program partially offset the negative effects of the IUB order. The 1994 results were affected by milder than normal weather, particularly during the summer months.

The Company's operating income increased $12.6 million and $3.8 million during 1996 and 1995, respectively. The contrasting relationship between the change in operating income and net income for 1996 was due to the hostile takeover defense costs of $7.8 million, which are included in "Miscellaneous, net" in the Consolidated Statements of Income, higher interest expense and a higher effective income tax rate. The 1995 difference was also due to increased interest expense and a higher effective income tax rate. Reasons for the changes in the results of operations are explained in the following discussion.

Electric Operations

Electric margins and Kwh sales for Utilities were as follows:

	REVENUES AND COSTS (IN THOUSANDS)			KWHS SOLD (IN THOUSANDS)		
	1996	1995	1994	**1996**	1995	1994
Residential and rural	**$212,799**	$216,270	$199,587	**2,633,704**	2,680,340	2,484,089
General service	**98,196**	97,496	97,454	**1,231,115**	1,242,373	1,170,923
Large general service	**213,223**	199,840	191,601	**5,500,606**	5,283,694	4,990,890
Sales for resale and other	**30,565**	29,063	30,608	**587,779**	577,107	645,673
Total, excluding off-system sales	**554,783**	542,669	519,250	**9,953,204**	9,783,514	9,291,575
Off-system sales	**19,490**	17,802	18,077	**1,231,298**	1,086,121	1,137,219
Total	**574,273**	560,471	537,327	**11,184,502**	10,869,635	10,428,794
Fuel for production (excluding steam)	**74,608**	90,558	81,567			
Purchased power	**88,350**	66,874	68,794			
Margin	**$411,315**	$403,039	$386,966			

Electric margins increased $8.3 million and $16.1 million during 1996 and 1995, respectively. The increase during 1996 was primarily due to higher sales relating to continuing sales growth in Utilities' service territory, lower purchased power capacity costs and increased revenues due to the recovery of previously deferred energy efficiency expenditures. These increases were partially offset by a true-up adjustment to Utilities' unbilled sales recorded in 1995 and lower sales to residential and rural customers during 1996, primarily due to cooler weather conditions during the summer of 1996 as compared to the summer of 1995. The 1995 electric margin increase was primarily due to higher sales due to a significantly warmer summer in 1995 as compared to 1994, sales growth, the unbilled sales adjustment, lower purchased power capacity costs and the recovery of energy efficiency costs. These increases were partially offset by a reduction in revenues of approximately $17 million as a result of the IUB price reduction order, of which approximately $3.5 million related to revenues collected in the fourth quarter of 1994. Refer to Notes 3(a) and 3(b) of the Notes to Consolidated Financial Statements for a discussion of merger-related retail and wholesale electric price proposals that Utilities has announced and the energy efficiency cost recoveries, respectively.

Under historically normal weather conditions, total sales (excluding off-system sales) during 1996 and 1995 would have increased 3.5% and 3.6%, as compared to actual increases of 1.7% and 5.3%, respectively.

Utilities' electric tariffs include energy adjustment clauses (EAC) that are designed to currently recover the costs of fuel and the energy portion of purchased power billings to customers. See Note 1(k) of the Notes to Consolidated Financial Statements for discussion of the EAC.

Gas Operations

Gas margins and dekatherm sales for Utilities and IEA were as follows:

	REVENUES AND COSTS (IN THOUSANDS)			DTHS SOLD (IN THOUSANDS)		
	1996	1995	1994	**1996**	1995	1994
Utilities–						
Residential	**$ 97,708**	$ 84,562	$ 82,79[illegible]	**17,680**	16,302	15,766
Commercial	**46,966**	40,390	40,912	**10,323**	9,534	9,298
Industrial	**12,256**	8,790	12,515	**3,796**	3,098	4,010
Transportation and other	**3,934**	3,550	2,811	**10,341**	10,871	8,901
Total Utilities	**160,864**	137,292	139,033	**42,140**	39,805	37,975
IEA	**113,115**	53,047	26,536	**43,055**	31,916	14,443
Total	**273,979**	190,339	165,569	**85,195**	71,721	52,418
Gas purchased for resale	**217,351**	141,716	120,795			
Margin	**$ 56,628**	$ 48,623	$ 44,774			

Total gas margins increased $8.0 million and $3.8 million during 1996 and 1995, respectively. The 1996 increase was primarily due to an annual increase of $6.3 million in Utilities' gas rates that was implemented in the fourth quarter of 1995, recovery of Utilities' previously deferred energy efficiency expenditures and the increased sales, largely the result of more favorable weather conditions in 1996. While IEA's gas sales were up significantly in 1996, their margins actually decreased due to fluctuations in gas prices and the competitiveness of the gas marketing business. Therefore, this decrease partially offset the increase in Utilities' margin. The 1995 margin increase was primarily due to the price increase at Utilities mentioned above, recovery of Utilities' previously deferred energy efficiency expenditures and higher IEA gas margins resulting from increased volumes sold due to heightened marketing efforts as well as expanding into additional regional markets.

Under historically normal weather conditions, Utilities' gas sales and transported volumes would have increased 1.9% and 3.5% in 1996 and 1995, as compared to actual increases of 5.9% and 4.8%, respectively.

Utilities' gas tariffs include purchased gas adjustment clauses (PGA) that are designed to currently recover the cost of gas sold. See Note 1(k) of the Notes to Consolidated Financial Statements for discussion of the PGA.

Other Revenues

Other revenues increased $25.5 million and $17.2 million during 1996 and 1995, respectively, primarily because of increased revenues at Whiting due to increases in oil and gas prices and increased gas volumes sold during 1996, and increases in oil and gas volumes sold in 1995. An increase in Utilities' steam revenues also contributed to the increase in both years. The steam volumes sold increased significantly during 1996 and 1995 primarily due to the addition of a new industrial customer. The 1995 increase was partially offset as a result of the sale of several of Diversified's subsidiaries during 1995 and 1994. The operations of the subsidiaries that were sold were not significant to the results of operations or financial position of the Company.

Operating Expenses

Other operating expenses increased $13.4 million and $24.5 million in 1996 and 1995, respectively. Contributing to the increase in both periods were increased operating activities at Whiting and IEA, increased labor and benefits costs at Utilities, increases in the amortization of previously deferred energy efficiency expenditures at Utilities (which are currently being recovered through rates) and costs relating to the pending merger. The 1996 increase was partially offset by decreased operating expenses at the Duane Arnold Energy Center (DAEC), Utilities' nuclear generating facility. The 1995 increase was also due to costs relating to the Company's process improvement program, partially offset by lower nuclear operating and insurance costs at Utilities, decreased costs resulting from the sale of the Diversified subsidiaries and a cost-cutting effort implemented after the receipt of the IUB electric price reduction order earlier in 1995.

Maintenance expenses increased or (decreased) $2.9 million and ($6.7) million during 1996 and 1995, respectively. The 1996 increase was due to increased maintenance activities at Utilities' fossil-fueled generating stations, partially offset by lower maintenance expenses at the DAEC. The 1995 decrease was due to lower maintenance expenses at the DAEC and at Utilities' fossil-fueled generating stations as well as the cost containment actions discussed above.

Depreciation and amortization increased $9.4 million and $11.6 million in 1996 and 1995, respectively, because of increases in utility plant in service, the acquisition of oil and gas operating properties and amortization costs relating to the future dismantlement and abandonment of Whiting's offshore oil and gas properties. (See Note 13(f) of the Notes to Consolidated Financial Statements for a further discussion of the dismantlement and abandonment costs). The 1995 increase was partially offset by lower depreciation rates implemented at Utilities as a result of the IUB electric price reduction order. Depreciation and amortization expenses for all periods include a provision for decommissioning the DAEC, which is collected through rates. The current annual recovery level is $6.0 million.

During the first quarter of 1996, the Financial Accounting Standards Board (FASB) issued an Exposure Draft on Accounting for Liabilities Related to Closure and Removal of Long-Lived Assets which deals with, among other issues, the accounting for decommissioning costs. If current electric utility industry accounting practices for such decommissioning are changed: (1) annual provisions for decommissioning could increase relative to 1996 and, (2) the estimated cost for decommissioning could be recorded as a liability, rather than as accumulated depreciation, with recognition of an increase in the recorded amount of the related DAEC plant. If such changes are required, Utilities believes that there would not be an adverse effect on its financial position or results of operations based on current rate making practices. See Note 1(g) of the Notes to Consolidated Financial Statements for a discussion of the recovery of decommissioning costs allowed in Utilities' most recent rate case.

Taxes other than income taxes increased or (decreased) ($0.8) million and $2.7 million during 1996 and 1995, respectively, largely due to changes in property taxes at Utilities caused by fluctuations in assessed property values. The 1996 decrease was partially offset by an increase in production taxes at Whiting.

Interest Expense and Other

Interest expense increased $4.[illegible] million and $4.7 million in 1996 and 1995, respectively, primarily because of increases in the average amount of short-term debt outstanding at Utilities and the average amount of borrowings under Diversified's credit facility. Lower average interest rates, partially attributable to refinancing long-term debt at lower rates and the mix of long-term and short-term debt, partially offset the increases for both periods. The increase in interest expense during 1996 was also due to a higher amount of long-term debt outstanding at Utilities, partially offset by the refund interest recorded in 1995 at Utilities and the effect of the interest rate swap agreement discussed in Note 12(a) of the Notes to Consolidated Financial Statements.

Miscellaneous, net reflects comparative decreases in income of ($5.5) million and ($0.3) million during 1996 and 1995, respectively. The 1996 decrease was primarily due to approximately $7.8 million in costs incurred relating to the successful defense of the hostile takeover attempt mounted by MAEC and certain property write-downs at Diversified. The decrease was partially offset by dividends received from the two New Zealand entities in which the company has equity investments and various gains realized on the disposition of assets. The 1995 decrease was primarily because of higher fees associated with an increase in the average amount of utility accounts receivable sold, partially offset by various gains realized on the sale of several investments by Diversified.

Federal and State Income Taxes

Federal and state income taxes increased $4.9 million and $0.9 million in 1996 and 1995, respectively. The increase for both periods was due to a higher effective tax rate resulting from: 1) the effect of property related temporary differences for which deferred taxes had not previously been provided in rates, pursuant to rate making principles, that are now becoming payable and are being recovered from rate payers and 2) adjustments to tax reserves. The 1996 increase in effective tax rate was also due to recording the impacts of a tentative Internal Revenue Service audit settlement for tax years 1991-1993 as well as the incurrence of certain merger-related expenses, which are not tax deductible.

Liquidity and Capital Resources

The Company's capital requirements are primarily attributable to Utilities' construction programs, its debt maturities and the level of Diversified's business opportunities. The Company's pretax ratio of times interest earned was 2.99, 3.12 and 3.38 in 1996-1994, respectively. Cash flows from operating activities were $183 million, $200 million and $217 million in 1996-1994, respectively. The 1996 decrease was primarily due to the timing of income tax payments and other changes in working capital. The 1995 decrease was primarily due to expenditures related to the 1995 DAEC refueling outage and other changes in working capital.

The Company anticipates that future capital requirements will be met by cash generated from operations and external financing. The level of cash generated from operations is partially dependent upon economic conditions, legislative activities, environmental matters and timely regulatory recovery of Utilities' costs. See Notes 3 and 13 of the Notes to Consolidated Financial Statements.

Access to the long-term and short-term capital and credit markets, and costs of external financing, are dependent on the Company's creditworthiness. The Company's debt ratings are as follows:

	MOODY'S	STANDARD & POOR'S
Utilities – Long-term debt	A2	A
– Commercial paper	P1	A1
Diversified – Commercial paper	P2	A2

Utilities' credit ratings are under review for potential upgrade related to the pending merger.

The Company's liquidity and capital resources will be affected by environmental, regulatory and competitive issues, including the ultimate disposition of remediation issues surrounding the Company's environmental liabilities and the Clean Air Act as amended, as discussed in Note 13 of the Notes to Consolidated Financial Statements, and emerging competition in the electric utility industry as discussed in the Competition section. Consistent with rate making principles of the IUB, management believes that the costs incurred for the above matters will not have a material adverse effect on the financial position or results of operations of the Company.

At December 31, 1996, Utilities had approximately $61 million of energy efficiency program costs recorded as regulatory assets. See Note 3(b) of the Notes to Consolidated Financial Statements for a discussion of the timing of the filings for the recovery of these costs under IUB rules and Iowa statutory changes recently enacted relating to these programs.

At December 31, 1996, the Company had a $20.0 million investment in Class A common stock of McLeod, Inc. (McLeod), a $9.2 million investment in Class B common stock and vested options that, if exercised, would represent an additional investment of approximately $2.3 million. McLeod provides local, long-distance and other telecommunications services. See Notes 6(b) and 11 of the Notes to Consolidated Financial Statements for further information on the Company's investment in McLeod.

The Company has financial guarantees amounting to $22.9 million outstanding at December 31, 1996, which are not reflected in the consolidated financial statements. Such guarantees are generally issued to support third-party borrowing arrangements and similar transactions. The Company believes that the likelihood of material cash payments by the Company under these agreements is remote.

The Company increased its investments in foreign entities by approximately $20 million in 1996 (see Note 6(a) of the Notes to Consolidated Financial Statements for a further discussion). The Company also continues to explore other international investment opportunities. Such investments carry a higher level of risk than the Company's traditional utility investments or Diversified's domestic investments. Such risks could include foreign government actions, foreign economic and currency risks and others. The Company may also incur business development expenses for potential projects pursued by the Company that may never materialize. The Company is striving to select international investments where these risks are both understood and minimized.

The Resale Power Group of Iowa (RPGI), consisting of virtually all of Utilities' wholesale customers, has notified Utilities that it will not purchase its power supply from Utilities after December 31, 1998. It is possible that certain RPGI customers will drop out of RPGI in order to remain as Utilities' customers. RPGI will continue to purchase transmission services from Utilities after December 31, 1998. While the Company cannot determine the outcome of this issue at this time, the result will not have a material adverse effect on its financial position or results of operations given 1) Utilities' wholesale sales only accounted for approximately 5% of Utilities' total 1996 electric sales, excluding off-system sales; 2) Utilities currently has to supplement its generating capability with purchased power to meet its sales load; and 3) Utilities' annual electric sales growth rate continues to be strong.

Under provisions of the Merger Agreement, there are restrictions on the amount of common stock and long-term debt the Company can issue pending the merger. The Company does not expect the restrictions to have a material effect on its ability to meet its future capital requirements.

Construction and Acquisition Program

The Company's construction and acquisition program anticipates expenditures of approximately $225 million for 1997, of which approximately $147 million represents expenditures at Utilities and approximately $78 million represents expenditures at Diversified. Of the $147 million of Utilities' expenditures, 39% represents expenditures for electric transmission and distribution facilities, 21% represents electric generation expenditures, 21% represents information technology expenditures and 5% represents gas expenditures. The remaining 14% represents miscellaneous electric, steam and general expenditures. Diversified's anticipated expenditures include approximately $75 million for domestic and international energy-related construction and acquisition expenditures.

The Company's levels of construction and acquisition expenditures are projected to be $208 million in 1998, $212 million in 1999, $182 million in 2000 and $198 million in 2001. It is estimated that virtually all of Utilities' construction and acquisition expenditures will be provided by cash from operating activities (after payment of dividends) for the five-year period 1997-2001. Financing plans for Diversified's construction and acquisition program will vary, depending primarily on the level of energy-related acquisitions.

Capital expenditure and investment and financing plans are subject to continual review and change. The capital expenditure and investment programs may be revised significantly as a result of many considerations including changes in economic conditions, variations in actual sales and load growth compared to forecasts, requirements of environmental, nuclear and other regulatory authorities, acquisition and business combination opportunities, the availability of alternate energy and purchased power sources, the ability to obtain adequate and timely rate relief, escalations in construction costs and conservation and energy efficiency programs.

Under provisions of the Merger Agreement, there are restrictions on the amount of construction and acquisition expenditures the Company can make pending the merger. The Company does not expect the restrictions to have a material effect on its ability to implement its anticipated construction and acquisition program.

Long-Term Financing

Other than Utilities' periodic sinking fund requirements, which Utilities intends to meet by pledging additional property, the following long-term debt will mature prior to December 31, 2001:

(IN MILLIONS)	
Utilities	$207.2
Diversified's credit facility	172.1
Other subsidiaries' debt	11.2
	$390.5

The Company intends to refinance the majority of the debt maturities with long-term securities.

In September 1996, Utilities repaid at maturity $15 million of Series J, 6.25% First Mortgage Bonds and, in a separate transaction, issued $60 million of Collateral Trust Bonds, 7.25%, due 2006.

Utilities has entered into an Indenture of Mortgage and Deed of Trust dated September 1, 1993 (New Mortgage). The New Mortgage provides for, among other things, the issuance of Collateral Trust Bonds upon the basis of First Mortgage Bonds being issued by Utilities. The lien of the New Mortgage is subordinate to the lien of Utilities' first mortgages until such time as all bonds issued under the first mortgages have been retired and such mortgages satisfied. Accordingly, to the extent that Utilities issues Collateral Trust Bonds on the basis of First Mortgage Bonds, it must comply with the requirements for the issuance of First Mortgage Bonds under Utilities' first mortgages. Under the terms of the New Mortgage, Utilities has covenanted not to issue any additional First Mortgage Bonds under its first mortgages except to provide the basis for issuance of Collateral Trust Bonds.

The indentures pursuant to which Utilities issues First Mortgage Bonds constitute direct first mortgage liens upon substantially all tangible public utility property and contain covenants which restrict the amount of additional bonds which may be issued. At December 31, 1996, such restrictions would have allowed Utilities to issue at least $241 million of additional First Mortgage Bonds.

In order to provide an instrument for the issuance of unsecured subordinated debt securities, Utilities entered into an Indenture dated December 1, 1995 (Subordinated Indenture). The Subordinated Indenture provides for, among other things, the issuance of unsecured subordinated debt securities. Any debt securities issued under the Subordinated Indenture are subordinate to all senior indebtedness of Utilities, including First Mortgage Bonds and Collateral Trust Bonds.

Utilities has received authority from the FERC and the SEC to issue up to $250 million of long-term debt, and has $190 million of remaining authority under the current FERC docket through April 1998, and $140 million of remaining authority under the current SEC shelf registration.

Diversified has a variable rate credit facility that extends through November 20, 1999, with two one-year extensions potentially available to Diversified. Refer to Note 10(a) of the Notes to Consolidated Financial Statements for a further discussion of this credit facility.

The Articles of Incorporation of Utilities authorize and limit the aggregate amount of additional shares of Cumulative Preference Stock and Cumulative Preferred Stock that may be issued. At December 31, 1996, Utilities could have issued an additional 700,000 shares of Cumulative Preference Stock and 100,000 additional shares of Cumulative Preferred Stock. In addition, Industries had 5,000,000 shares of Cumulative Preferred Stock, no par value, authorized for issuance, none of which were outstanding at December 31, 1996.

The Company's capitalization ratios at year end were as follows:

	1996	1995
Long-term debt	**52%**	49%
Preferred stock	**1**	2
Common equity	**47**	49
	100%	100%

Under provisions of the Merger Agreement, there are restrictions on the amount of common stock and long-term debt the Company can issue pending the merger. The Company does not expect the restrictions to have a material effect on its ability to meet its future capital requirements.

Short-Term Financing

For interim financing, Utilities is authorized by the FERC to issue, through 1998, up to $200 million of short-term notes. In addition to providing for ongoing working capital needs, this availability of short-term financing provides Utilities flexibility in the issuance of long-term securities. At December 31, 1996, Utilities had outstanding short-term borrowings of $135 million.

Utilities has an agreement, which expires in 1999, with a financial institution to sell, with limited recourse, an undivided fractional interest of up to $65 million in its pool of utility accounts receivable. At December 31, 1996, Utilities had sold $65 million under the agreement. Refer to Note 5 of the Notes to Consolidated Financial Statements for a further discussion of this agreement, including the issuance of a new accounting standard which impacts the accounting for the sales.

At December 31, 1996, the Company had bank lines of credit aggregating $136.1 million. Utilities was using $110 million to support commercial paper (weighted average interest rate of 5.70%) and $11.1 million to support certain pollution control obligations. Commitment fees are paid to maintain these lines and there are no conditions which restrict the unused lines of credit. In addition to the above, Utilities has an uncommitted credit facility with a financial institution whereby it can borrow up to $40 million. Rates are set at the time of borrowing and no fees are paid to maintain this facility. At December 31, 1996, there was $25 million outstanding under this facility (weighted average interest rate of 6.28%).

Environmental Matters

Utilities has been named as a Potentially Responsible Party (PRP) by various federal and state environmental agencies for 28 Former Manufactured Gas Plant (FMGP) sites. Utilities has recorded environmental liabilities related to the FMGP sites of approximately \$36 million (including \$4.7 million as current liabilities) at December 31, 1996. Regulatory assets of approximately \$36 million, which reflect the future recovery that is being provided through Utilities' rates, have been recorded in the Consolidated Balance Sheets. Considering the current rate treatment allowed by the IUB, management believes that the clean-up costs incurred by Utilities for these FMGP sites will not have a material adverse effect on its financial position or results of operations. Refer to Note 13(f) of the Notes to Consolidated Financial Statements for a further discussion, including a discussion of a lawsuit filed by Utilities seeking recovery of FMGP-related costs from its insurance carriers.

The Clean Air Act Amendments of 1990 (Act) requires emission reductions of sulfur dioxide (SO2) and nitrogen oxides (NOx) to achieve reductions of atmospheric chemicals believed to cause acid rain. The acid rain program under the Act also governs SO2 allowances. The Act and other federal laws also require the United States Environmental Protection Agency (EPA) to study and regulate, if necessary, additional issues that potentially affect the electric utility industry, including emissions relating to NOx, ozone transport, mercury and particulate control; toxic release inventories and modifications to the PCB rules.

In 1995, the EPA published the Sulfur Dioxide Network Design Review for Cedar Rapids, Iowa, which, based on the EPA's assumptions and worst-case modeling method suggests that the Cedar Rapids area could be classified as "nonattainment" for the National Ambient Air Quality Standards established for SO2. The worst-case modeling study suggested that two of Utilities' generating facilities contribute to the modeled exceedences.

Pursuant to a routine review of operations, Utilities determined that certain changes undertaken during the previous three years at one of its power plants may have required a federal Prevention of Significant Deterioration (PSD) permit. Refer to Note 13(g) of the Notes to Consolidated Financial Statements for a further discussion of the above mentioned air quality issues.

The National Energy Policy Act of 1992 requires owners of nuclear power plants to pay a special assessment into a "Uranium Enrichment Decontamination and Decommissioning Fund." Refer to Note 13(f) of the Notes to Consolidated Financial Statements for a further discussion.

The Nuclear Waste Policy Act of 1982 assigned responsibility to the U.S. Department of Energy (DOE) to establish a facility for the ultimate disposition of high level waste and spent nuclear fuel and authorized the DOE to enter into contracts with parties for the disposal of such material beginning in January 1998. Utilities entered into such a contract and has made the agreed payments to the Nuclear Waste Fund (NWF) held by the U.S. Treasury. The DOE, however, has experienced significant delays in its efforts and material acceptance is now expected to occur no earlier than 2010 with the possibility of further delay being likely. Utilities has been storing spent nuclear fuel on-site since plant operations began in 1974 and has current on-site capability to store spent fuel until 2001. Utilities is aggressively reviewing options for expanding on-site storage. Utilities has been formally notified by the DOE that they anticipate being unable to begin acceptance of spent nuclear fuel by January 31, 1998. Utilities is evaluating courses of action to protect the interests of its customers and its rights under the DOE contract. Utilities is also evaluating legislation proposed to the Congress addressing this issue. In July 1996, the IUB initiated a Notice of Inquiry (NOI) on spent nuclear fuel. One purpose of the NOI was to evaluate whether the current collection of money from Utilities' customers for payment to the NWF should be placed in an escrow account in lieu of being paid to the NWF. Utilities believes that the issue of using an escrow account should be decided at the federal level rather than the state level. Utilities cannot predict the outcome of this NOI.

The Low-Level Radioactive Waste Policy Amendments Act of 1985 mandated that each state must take responsibility for the storage of low-level radioactive waste produced within its borders. The State of Iowa has joined the Midwest Interstate Low-Level Radioactive Waste Compact Commission (Compact), which is planning a storage facility to be located in Ohio to store waste generated by the Compact's six member states. At December 31, 1996, Utilities has prepaid costs of approximately \$1.1 million to the Compact for the building of such a facility. A Compact disposal facility is anticipated to be in operation in approximately ten years after approval of new enabling legislation by the member states. Such legislation was approved in 1996 by all six states that are members of the Compact. Final approval by the U.S. Congress is now required. On-site storage capability currently exists for low-level radioactive waste expected to be generated until the Compact facility is able to accept waste materials. In addition, the Barnwell, South Carolina disposal facility has reopened for an indefinite time period and Utilities is in the

process of shipping to Barnwell the majority of the low-level radioactive waste it has accumulated on-site, and currently intends to ship the waste it produces in the future as long as the Barnwell site remains open, thereby minimizing the amount of low-level waste stored on-site. However, management of the Barnwell site has modified its fee schedule to emphasize total radioactivity content and weight, instead of the historical volume related fees. Utilities is evaluating the outcome of these changes on its potential future disposal costs at the Barnwell site; such changes could result in a revision to Utilities' future disposal plans.

The possibility that exposure to electric and magnetic fields (EMF) emanating from power lines, household appliances and other electric sources may result in adverse health effects has been the subject of increased public, governmental, industry and media attention. A recent study completed by the National Research Council concluded that the current body of evidence does not support the notion that exposure to these fields may result in adverse health effects. Utilities will continue to monitor the events in this area, including future scientific research.

Whiting is responsible for certain dismantlement and abandonment costs related to various off-shore oil and gas properties. Refer to Note 13(f) of the Notes to Consolidated Financial Statements for a further discussion.

Other Matters

Labor Issues

Utilities has six collective bargaining agreements, covering approximately 54% of its workforce. None of the agreements expire in 1997.

Financial Derivatives

The Company has a policy that financial derivatives are to be used only to mitigate business risks and not for speculative purposes. Derivatives have been used by the Company on a very limited basis. At December 31, 1996, the only material financial derivatives outstanding for the Company were the interest rate swap agreement and gas futures contracts described in Note 12 of the Notes to Consolidated Financial Statements.

Inflation

Utilities does not expect the effects of inflation at current levels to have a significant effect on its financial position or results of operations.

Selected Consolidated Quarterly Financial Data (unaudited)

The following unaudited consolidated quarterly data, in the opinion of the Company, includes adjustments, which are normal and recurring in nature, necessary for the fair presentation of the results of operations and financial position. Utilities' results of operations are a significant portion of the consolidated results. The quarterly amounts were affected by, among other items, Utilities' rate activities, seasonal weather conditions, changes in sales and operating expenses and costs incurred relating to the successful defense of the hostile takeover attempt mounted by MidAmerican Energy Company. Refer to Management's Discussion and Analysis of the Results of Operations and Financial Condition for a discussion of these items. The fourth quarter of 1996 net income benefited from lower than anticipated costs for a refueling outage at Utilities' nuclear power plant.

	QUARTER ENDED			
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	MARCH 31	JUNE 30	SEPTEMBER 30	DECEMBER 31
1996				
Operating revenues	**$243,197**	**$210,648**	**$233,907**	**$286,160**
Operating income	**36,995**	**26,770**	**55,701**	**44,842**
Net income	**14,095**	**8,056**	**20,889**	**17,867**
Earnings per average common share	**0.48**	**0.27**	**0.70**	**0.59**
1995				
Operating revenues	$206,392	$189,447	$238,467	$216,704
Operating income	22,115	33,456	63,710	32,431
Net income	6,740	12,508	31,120	13,808
Earnings per average common share	0.23	0.43	1.06	0.48

Report of Independent Public Accountants

To the Board of Directors of IES Industries Inc.:

We have audited the accompanying consolidated balance sheets and statements of capitalization of IES Industries Inc. (an Iowa corporation) and subsidiary companies as of December 31, 1996 and 1995, and the related consolidated statements of income, retained earnings and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of IES Industries Inc. and subsidiary companies as of December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles.

Arthur Andersen LLP

ARTHUR ANDERSEN LLP

Chicago, Illinois
January 31, 1997

Report of Management

The Company's management has prepared and is responsible for the presentation, integrity and objectivity of the consolidated financial statements and related information included in this report. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and, in some cases, include estimates that are based upon management's judgment and the best available information, giving due consideration to materiality. Financial information contained elsewhere in this report is consistent with that in the consolidated financial statements.

The Company maintains a system of internal accounting controls which it believes is adequate to provide reasonable assurance that assets are safeguarded, transactions are executed in accordance with management authorization and the financial records are reliable for preparing the consolidated financial statements. The system of internal accounting controls is supported by written policies and procedures, by a staff of internal auditors and by the selection and training of qualified personnel. The internal audit staff conducts comprehensive audits of the Company's system of internal accounting controls. Management strives to maintain an adequate system of internal controls, recognizing that the cost of such a system should not exceed the benefits derived. In accordance with generally accepted auditing standards, the independent public accountants (Arthur Andersen LLP) obtained a sufficient understanding of the Company's internal controls to plan their audit and determine the nature, timing and extent of other tests to be performed. Management is not aware of any material internal control weaknesses.

The Board of Directors, through its Audit Committee comprised entirely of outside directors, meets periodically with management, the internal auditor and Arthur Andersen LLP to discuss financial reporting matters, internal control and auditing. To ensure their independence, both the internal auditor and Arthur Andersen LLP have full and free access to the Audit Committee.

Lee Liu
Chairman of the Board & Chief Executive Officer

Thomas M. Walker
Executive Vice President & Chief Financial Officer

John E. Ebright
Controller & Chief Accounting Officer

Consolidated Statements of Income

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	Year Ended December 31 1996	1995	1994
Operating revenues:			
Electric	**$574,273**	$560,471	$537,327
Gas	**2[illegible]3,979**	190,339	165,569
Other	**125,6[illegible]**	100,200	82,968
	973,912	851,010	785,864
Operating expenses:			
Fuel for production	**84,579**	96,256	85,952
Purchased power	**88,350**	66,874	68,794
Gas purchased for resale	**217,351**	141,716	120,795
Other operating expenses	**214,759**	201,390	176,363
Maintenance	**49,001**	46,093	52,841
Depreciation and amortization	**107,393**	97,958	86,378
Taxes other than income taxes	**48,171**	49,011	46,308
	809,604	699,298	637,931
Operating income	**164,308**	151,712	147,933
Interest expense and other:			
Interest expense	**54,822**	50,727	46,010
Allowance for funds used during construction	**(2,103)**	(3,424)	(3,910)
Preferred dividend requirements of IES Utilities Inc.	**914**	914	914
Miscellaneous, net	**2,333**	(3,170)	(3,472)
	55,966	45,047	39,542
Income before income taxes	**108,342**	106,665	108,391
Federal and state income taxes	**47,435**	42,489	41,573
Net income	**$ 60,907**	$ 64,176	$ 66,818
Average number of common shares outstanding	**29,861**	29,202	28,560
Earnings per average common share	**$ 2.04**	$ 2.20	$ 2.34

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

Consolidated Statements of Retained Earnings

(IN THOUSANDS)	Year Ended December 31 1996	1995	1994
Balance at beginning of year	**$221,077**	$218,293	$211,750
Net income	**60,907**	64,176	66,818
Cash dividends declared on common stock, at a per share rate of $2.10 for all years	**(62,738)**	(61,392)	(60,065)
Other	**—**	—	(210)
Balance at end of year	**$219,246**	$221,077	$218,293

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

Consolidated Balance Sheets

Assets (IN THOUSANDS)	December 31 1996	1995
Property, plant and equipment:		
Utility–		
Plant in service–		
Electric	**$2,007,839**	$1,900,157
Gas	**175,472**	165,825
Other	**126,850**	106,396
	2,310,161	2,172,378
Less–Accumulated depreciation	**1,030,390**	950,324
	1,279,771	1,222,054
Leased nuclear fuel, net of amortization	**34,725**	36,935
Construction work in progress	**43,719**	52,772
	1,358,215	1,311,761
Other, net of accumulated depreciation and amortization of $70,031 and $53,026, respectively	**223,805**	193,215
	1,582,020	1,504,976
Current assets:		
Cash and temporary cash investments	**8,675**	6,942
Accounts receivable–		
Customer, less allowance for doubtful accounts of $1,087 and $1,145, respectively	**50,821**	37,214
Other	**12,040**	10,493
Income tax refunds receivable	**8,890**	982
Production fuel, at average cost	**13,323**	12,155
Materials and supplies, at average cost	**22,842**	28,354
Adjustment clause balances	**10,752**	—
Regulatory assets	**26,539**	22,791
Oil and gas properties held for resale	**—**	9,843
Prepayments and other	**24,169**	23,099
	178,051	151,873
Investments:		
Nuclear decommissioning trust funds	**59,325**	47,028
Investment in foreign entities	**44,946**	24,770
Investment in McLeod, Inc.	**29,200**	9,200
Cash surrender value of life insurance policies	**11,217**	9,838
Other	**4,903**	3,897
	149,591	94,733
Other assets:		
Regulatory assets	**201,129**	207,202
Deferred charges and other	**14,771**	26,807
	215,900	234,009
	$2,125,562	$1,985,591

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

Capitalization and Liabilities

(IN THOUSANDS)

	December 31 1996	1995
Capitalization (See Consolidated Statements of Capitalization):		
Common stock	**$ 407,635**	$ 391,269
Retained earnings	**219,246**	221,077
Total common equity	**626,881**	612,346
Cumulative preferred stock of IES Utilities Inc.	**18,320**	18,320
Long-term debt (excluding current portion)	**701,100**	601,708
	1,346,301	1,232,374
Current liabilities:		
Short-term borrowings	**135,000**	101,000
Capital lease obligations	**15,125**	15,717
Maturities and sinking funds	**8,473**	15,447
Accounts payable	**99,861**	80,089
Dividends payable	**16,431**	16,244
Accrued interest	**8,985**	8,051
Accrued taxes	**43,926**	53,983
Accumulated refueling outage provision	**1,316**	7,690
Adjustment clause balances	**—**	3,148
Environmental liabilities	**5,679**	5,634
Other	**22,087**	21,800
	356,883	328,803
Long-term liabilities:		
Pension and other benefit obligations	**39,643**	52,677
Capital lease obligations	**19,600**	21,218
Environmental liabilities	**47,502**	43,087
Other	**18,488**	13,039
	125,233	130,021
Deferred credits:		
Accumulated deferred income taxes	**262,675**	257,278
Accumulated deferred investment tax credits	**34,470**	37,115
	297,145	294,393
Commitments and contingencies (Note 13)		
	$2,125,562	$1,985,591

Consolidated Statements of Capitalization

(DOLLARS IN THOUSANDS)	December 31 1996	1995
Common equity:		
Common stock–no par value–authorized 48,000,000 shares;		
outstanding 30,077,212 and 29,508,415 shares, respectively	**$ 407,635**	$ 391,269
Retained earnings	**219,246**	221,077
	626,881	612,346
Cumulative preferred stock of IES Utilities Inc.	**18,320**	18,320
Long-term debt:		
IES Utilities Inc.–		
Collateral Trust Bonds–		
7.65% series, due 2000	**50,000**	50,000
7.25% series, due 2006	**60,000**	—
6% series, due 2008	**50,000**	50,000
7% series, due 2023	**50,000**	50,000
5.5% series, due 2023	**19,400**	19,400
	229,400	169,400
First Mortgage Bonds–		
Series J, 6 1/4%, retired in 1996	—	15,000
Series L, 7 7/8%, due 2000	**15,000**	15,000
Series M, 7 5/8%, due 2002	**30,000**	30,000
Series Y, 8 5/8%, due 2001	**60,000**	60,000
Series Z, 7.60%, due 1999	**50,000**	50,000
6 1/8% series, due 1997	**8,000**	8,000
9 1/8% series, due 2001	**21,000**	21,000
7 3/8% series, due 2003	**10,000**	10,000
7 1/4% series, due 2007	**30,000**	30,000
	224,000	239,000
Pollution control obligations–		
5.75%, due serially 1997 to 2003	**3,416**	3,556
5.95%, due serially 2000 to 2007, secured by First Mortgage Bonds	**10,000**	10,000
Variable rate (4.25% - 4.35% at December 31, 1996), due 2000 to 2010	**11,100**	11,100
	24,516	24,656
Subordinated Deferrable Interest Debentures, 7 7/8%, due 2025	**50,000**	50,000
Total IES Utilities Inc.	**527,916**	483,056
IES Diversified Inc.–		
Credit facility	**172,105**	124,245
Other subsidiaries' debt maturing through 2013	**11,994**	12,307
	712,015	619,608
Unamortized debt premium and (discount), net	**(2,442)**	(2,453)
	709,573	617,155
Less–Amount due within one year	**8,473**	15,447
	701,100	601,708
	$1,346,301	$1,232,374

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

Consolidated Statements of Cash Flows

(IN THOUSANDS)	1996	1995	1994
		Year Ended December 31	
Cash flows from operating activities:			
Net income	**$ 60,907**	$ 64,176	$ 66,818
Adjustments to reconcile net income to net cash flows from operating activities–			
Depreciation and amortization	**107,393**	97,958	86,378
Amortization of principal under capital lease obligations	**16,491**	15,714	16,246
Deferred taxes and investment tax credits	**9,189**	7,757	4,050
Refueling outage provision	**(6,374)**	(7,506)	12,536
Amortization of other assets	**9,828**	7,391	2,228
Other	**856**	712	387
Other changes in assets and liabilities–			
Accounts receivable	**(22,154)**	(15,221)	6,777
Sale of utility accounts receivable	**7,000**	4,000	800
Production fuel, materials and supplies	**650**	4,050	(1,184)
Accounts payable	**20,934**	2,902	21,871
Accrued taxes	**(17,965)**	9,434	4,575
Provision for rate refunds	**(106)**	106	(8,670)
Adjustment clause balances	**(13,900)**	4,581	(6,582)
Gas in storage	**(1,154)**	3,245	1,135
Other	**11,764**	532	9,340
Net cash flows from operating activities	**183,359**	199,831	216,705
Cash flows from financing activities:			
Dividends declared on common stock	**(62,738)**	(61,392)	(60,065)
Proceeds from issuance of common stock	**14,164**	15,616	16,426
Purchase of treasury stock	**(269)**	—	(6,233)
Net change in IES Diversified Inc. credit facility	**47,860**	43,745	48,500
Proceeds from issuance of other long-term debt	**60,000**	100,007	11,640
Reductions in other long-term debt	**(15,454)**	(100,424)	(9,790)
Net change in short-term borrowings	**34,000**	64,000	13,000
Principal payments under capital lease obligations	**(19,108)**	(14,463)	(16,304)
Other	**(458)**	(1,438)	(46)
Net cash flows from financing activities	**57,997**	45,651	(2,872)
Cash flows from investing activities:			
Construction and acquisition expenditures–			
Utility	**(142,259)**	(125,558)	(138,829)
Other	**(96,119)**	(92,541)	(67,719)
Oil and gas properties held for resale	**9,843**	(9,843)	—
Deferred energy efficiency expenditures	**(16,857)**	(18,029)	(16,157)
Nuclear decommissioning trust funds	**(6,008)**	(6,100)	(5,532)
Proceeds from disposition of assets	**8,295**	14,271	8,803
Other	**3,482**	(5,733)	3,129
Net cash flows from investing activities	**(239,623)**	(243,533)	(216,305)
Net increase (decrease) in cash and temporary cash investments	**1,733**	1,949	(2,472)
Cash and temporary cash investments at beginning of year	**6,942**	4,993	7,465
Cash and temporary cash investments at end of year	**$ 8,675**	$ 6,942	$ 4,993
Supplemental cash flow information:			
Cash paid during the year for–			
Interest	**$ 53,046**	$ 50,877	$ 44,421
Income taxes	**$ 54,881**	$ 26,478	$ 36,097
Noncash investing and financing activities–			
Capital lease obligations incurred	**$ 14,281**	$ 2,918	$ 14,297

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

1 Summary of Significant Accounting Policies

(a) Basis of Consolidation – The Consolidated Financial Statements include the accounts of IES Industries Inc. (Industries) and its consolidated subsidiaries (collectively the Company). Industries is an investor-owned holding company whose primary operating company, IES Utilities Inc. (Utilities), is engaged principally in the generation, transmission, distribution and sale of electric energy and the purchase, distribution, transportation and sale of natural gas. The Company's principal markets are located in the state of Iowa. The Company also has various non-utility subsidiaries which are primarily engaged in the energy-related, transportation and real estate development businesses.

All subsidiaries for which Industries owns directly or indirectly more than 50% of the voting stock are included as consolidated subsidiaries. Industries' wholly-owned subsidiaries are Utilities and IES Diversified Inc. (Diversified). All significant intercompany balances and transactions, other than energy-related transactions affecting Utilities, have been eliminated from the Consolidated Financial Statements. Such energy-related transactions are made at prices that approximate market value and the associated costs are recoverable from Utilities' customers through the rate making process.

Investments for which the Company has at least a 20% voting interest are generally accounted for under the equity method of accounting. These investments are stated at acquisition cost, increased or decreased for the Company's equity in undistributed net income or loss, which is included in "Miscellaneous, net" in the Consolidated Statements of Income. Investments that do not meet the criteria for the consolidating or equity methods of accounting are accounted for under the cost method.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect: 1) the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and 2) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Certain prior period amounts have been reclassified on a basis consistent with the 1996 presentation.

(b) Regulation – Because of its ownership of Utilities, Industries is a holding company under the Public Utility Holding Company Act of 1935, but claims an exemption from all provisions thereof except Section 9(a)(2), which applies to the purchase of stock of other utility companies. Utilities is subject to regulation by the Iowa Utilities Board (IUB) and the Federal Energy Regulatory Commission (FERC).

Refer to Note 2 for a discussion of the proposed merger of the Company.

(c) Regulatory Assets – Utilities is subject to the provisions of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS 71). The regulatory assets represent probable future revenue to Utilities associated with certain incurred costs as these costs are recovered through the rate making process. At December 31, regulatory assets as reflected in the Consolidated Balance Sheets were comprised of the following items:

(IN MILLIONS)	1996	1995
Deferred income taxes (Note 1(d))	**$ 84.7**	$ 91.1
Energy efficiency program costs (Note 3(b))	**61.1**	49.7
Environmental liabilities (Note 13(f))	**46.3**	46.9
Employee pension and benefit costs (Note 8)	**22.9**	27.5
Other	**12.7**	14.8
	227.7	230.0
Classified as "Current assets – regulatory assets"	**26.6**	22.8
Classified as "Other assets – regulatory assets"	**$201.1**	$207.2

Refer to the individual notes referenced above for a further discussion of certain items reflected in regulatory assets.

If a portion of Utilities' operations become no longer subject to the provisions of SFAS 71, a write-off of related regulatory assets would be required, unless some form of transition cost recovery is established by the appropriate regulatory body. In addition, the Company would be required to determine any impairment to other assets and write-down such assets to their fair value. Effective January 1, 1996, the Company adopted SFAS 121 which established accounting standards for the impairment of long-lived assets. This standard also requires that regulatory assets that are no longer probable of recovery through future revenues be charged to earnings. There was no impact on the Company's financial position or results of operations upon adoption of SFAS 121.

(d) Income Taxes – The Company follows the liability method of accounting for deferred income taxes, which requires the establishment of deferred tax liabilities and assets, as appropriate, for all temporary differences between the tax basis of assets and liabilities and the amounts reported in the financial statements. Deferred taxes are recorded using currently enacted tax rates.

Except as noted below, income tax expense includes provisions for deferred taxes to reflect the tax effects of temporary differences between the time when certain costs are recorded in the accounts and when they are deducted for tax return purposes. As temporary differences reverse, the related accumulated deferred income taxes are reversed to income. Investment tax credits for Utilities have been deferred and are subsequently credited to income over the average lives of the related property.

Consistent with rate making practices for Utilities, deferred tax expense is not recorded for certain temporary differences (primarily related to utility property, plant and equipment). As the deferred taxes become payable, over periods exceeding 30 years for some generating plant differences, they are recovered through rates. Accordingly, Utilities has recorded deferred tax liabilities and regulatory assets, as identified in Note 1(c).

(e) Temporary Cash Investments – Temporary cash investments are stated at cost, which approximates market value, and are considered

cash equivalents for the Consolidated Statements of Cash Flows. These investments consist of short-term liquid investments that have maturities of less than 90 days from the date of acquisition.

(f) Depreciation of Utility Property, Plant and Equipment – Utilities uses the remaining life method of depreciation for its nuclear generating facility, the Duane Arnold Energy Center (DAEC), and the straight-line method for all other utility property. The remaining life of the DAEC is based on the Nuclear Regulatory Commission (NRC) license life of 2014. The average rates of depreciation for electric and gas properties of Utilities, consistent with current rate making practices, were as follows:

	1996	1995	1994
Electric	**3.5%**	3.4%	3.6%
Gas	**3.5%**	3.5%	3.8%

The electric and gas depreciation rates declined in 1995 from 1994 because of revised depreciation rates approved in rate proceedings of Utilities.

(g) Decommissioning of the DAEC – Pursuant to the most recent electric rate case order, the IUB allows Utilities to recover $6.0 million annually for the cost to decommission the DAEC. Decommissioning expense is included in "Depreciation and amortization" in the Consolidated Statements of Income and the cumulative amount is included in "Accumulated depreciation" in the Consolidated Balance Sheets to the extent recovered through rates. The current recovery figures are based on the following assumptions: 1) cost to decommission the DAEC of $252.8 million, which is Utilities 70% portion in 1993 dollars, based on the NRC minimum formula (which exceeds the amount in the current site-specific study completed in 1994); 2) inflation of 4.91% annually through 1997; 3) the prompt dismantling and removal method of decommissioning, which is assumed to begin in the year 2014; 4) monthly funding of all future collections into external trust funds and funded on a tax-qualified basis to the extent possible; and 5) an average after-tax return of 6.82% for all external investments. All of these assumptions are subject to change in future regulatory proceedings. At December 31, 1996, Utilities had $59.3 million invested in external decommissioning trust funds as indicated in the Consolidated Balance Sheets, and also had an internal decommissioning reserve of $21.7 million recorded as accumulated depreciation. Earnings on the external trust funds, which were $2.2 million in 1996, are recorded as interest income and a corresponding interest expense payable to the funds is recorded. The earnings accumulate in the external trust fund balances and in accumulated depreciation on utility plant.

See "Management's Discussion and Analysis of the Results of Operations and Financial Condition" for a discussion of the Exposure Draft on Accounting for Liabilities Related to Closure and Removal of Long-Lived Assets, issued by the Financial Accounting Standards Board (FASB) in the first quarter of 1996, which deals with, among other issues, the accounting for decommissioning costs.

(h) Property, Plant and Equipment – Utility plant (other than acquisition adjustments of $29.4 million, net of accumulated amortization, recorded at cost) is recorded at original cost, which includes overhead and administrative costs and an allowance for funds used during construction (AFC). The AFC, which represents the cost during the construction period of funds used for construction purposes, is capitalized by Utilities 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 prescribed FERC formula. The aggregate gross rates used by Utilities for 1996-1994 were 5.5%, 6.5% and 9.3%, respectively. These capitalized costs are recovered by Utilities in rates as the cost of the utility plant is depreciated.

Other property, plant and equipment is recorded at cost. Upon retirement or sale of other property and equipment, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is included in "Miscellaneous, net" in the Consolidated Statements of Income.

Normal repairs, maintenance and minor items of utility plant and other property, plant and equipment are expensed. Ordinary retirements of utility plant, including removal costs less salvage value, are charged to accumulated depreciation upon removal from utility plant accounts, and no gain or loss is recognized.

(i) Oil and Gas Properties – Whiting Petroleum Corporation (Whiting), a wholly-owned subsidiary under Diversified, uses the full cost method of accounting for its oil and gas properties. Accordingly, all costs of acquisition, exploration and development of properties are capitalized. Amortization of proved oil and gas properties is calculated using the units of production method. At December 31, 1996, capitalized costs less related accumulated amortization did not exceed the sum of 1) the present value of future net revenue from estimated production of proved oil and gas reserves (calculated using current prices); plus 2) the cost of properties not being amortized, if any; plus 3) the lower of cost or estimated fair value of unproved properties included in the costs being amortized, if any; less 4) income tax effects related to differences in the book and tax basis of oil and gas properties. The Company had $9.8 million on its Consolidated Balance Sheet at December 31, 1995, relating to specific oil and gas properties purchased by Whiting in the fourth quarter of 1995 that it intended to sell during 1996. The Company subsequently decided not to sell these properties and, accordingly, the balance at December 31, 1996 is included in "Other property, plant and equipment" on the Consolidated Balance Sheet.

(j) Operating Revenues – The Company accrues revenues for services rendered but unbilled at month-end in order to more properly match revenues with expenses.

(k) Adjustment Clauses – Utilities' tariffs provide for subsequent adjustments to its electric and natural gas rates for changes in the cost of fuel and purchased energy and in the cost of natural gas purchased for resale. Changes in the under/over collection of these costs are reflected in "Fuel for production" and "Gas purchased for resale" in the Consolidated Statements of Income. The cumulative effects

are reflected in the Consolidated Balance Sheets as a current asset or current liability, pending automatic reflection in future billings to customers.

(l) Accumulated Refueling Outage Provision – The IUB allows Utilities to collect, as part of its base revenues, funds to offset other operating and maintenance expenditures incurred during refueling outages at the DAEC. As these revenues are collected, an equivalent amount is charged to other operating and maintenance expenses with a corresponding credit to a reserve. During a refueling outage, the reserve is reversed to offset the refueling outage expenditures.

2 Proposed Merger of the Company

On November 10, 1995, Industries, WPL Holdings, Inc. (WPLH) and Interstate Power Company (IPC) entered into an Agreement and Plan of Merger, as amended (Merger Agreement), providing for: a) IPC becoming a wholly-owned subsidiary of WPLH, and b) the merger of Industries with and into WPLH, which merger will result in the combination of Industries and WPLH as a single holding company (collectively, the Proposed Merger). The new holding company will be named Interstate Energy Corporation (Interstate Energy) and Industries will cease to exist. The Proposed Merger, which will be accounted for as a pooling of interests and is intended to be tax-free for federal income tax purposes, has been approved by the respective Boards of Directors and shareholders. It is still subject to approval by several federal and state regulatory agencies. The companies expect to receive such regulatory approvals by the end of the third quarter of 1997.

The summary below contains selected unaudited pro forma financial data for the year ended December 31, 1996. The financial data should be read in conjunction with the historical consolidated financial statements and related notes of the Company, WPLH, and IPC and in conjunction with the unaudited pro forma combined financial statements and related notes of Interstate Energy included in the Form 10-K Annual Report of the Company. The pro forma combined earnings per share reflect the issuance of shares associated with the exchange ratios discussed below.

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	IES INDUSTRIES	WPLH	IPC	PRO FORMA COMBINED (UNAUDITED)
Operating revenues	$ 973,912	$ 932,844	$326,084	$2,232,840
Net income from continuing operations	60,907	73,205	25,860	159,972
Earnings per share from continuing operations	2.04	2.38	2.69	2.12
Assets at Dec. 31, 1996	2,125,562	1,900,531	639,200	4,665,293
Long-term obligations at Dec. 31, 1996	744,298	430,190	188,731	1,363,219

Under the terms of the Merger Agreement, the outstanding shares of WPLH's common stock will remain unchanged and outstanding as shares of Interstate Energy. Each outstanding share of the Company's common stock will be converted to 1.14 shares of Interstate Energy's common stock. Each share of IPC's common stock will be converted to 1.11 shares of Interstate Energy's common stock. It is anticipated that Interstate Energy will retain WPLH's common share dividend payment level as of the effective time of the merger. On January 22, 1997, the Board of Directors of WPLH declared a quarterly dividend of $0.50 per share. This represents an equivalent annual rate of $2.00 per share.

WPLH is a holding company headquartered in Madison, Wisconsin, and is the parent company of Wisconsin Power and Light Company (WP&L) and Heartland Development Corporation (HDC). WP&L supplies electric and gas service to approximately 385,000 and 150,000 customers, respectively, in south and central Wisconsin. HDC and its principal subsidiaries are engaged in businesses in three major areas: environmental engineering and consulting, affordable housing and energy services. IPC, an operating public utility headquartered in Dubuque, Iowa, supplies electric and gas service to approximately 165,000 and 49,000 customers, respectively, in northeast Iowa, northwest Illinois and southern Minnesota.

Interstate Energy will be the parent company of Utilities, WP&L and IPC and will be registered under the Public Utility Holding Company Act of 1935, as amended (1935 Act). The Merger Agreement provides that these operating utility companies will continue to operate as separate entities for a minimum of three years beyond the effective date of the merger. In addition, the non-utility operations of the Company and WPLH will be combined shortly after the effective date of the merger under one entity to manage the diversified operations of Interstate Energy. The corporate headquarters of Interstate Energy will be in Madison.

The SEC historically has interpreted the 1935 Act to preclude registered holding companies, with limited exceptions, from owning both electric and gas utility systems. Although the SEC has recommended that registered holding companies be allowed to hold both gas and electric utility operations if the affected states agree, it remains possible that the SEC may require as a condition to its approval of the Proposed Merger that the Company, WPLH and IPC divest their gas utility properties, and possibly certain non-utility ventures of the Company and WPLH, within a reasonable time after the effective date of the Proposed Merger.

3 Rate Matters

(a) Electric Price Announcements – Utilities and its Iowa-based proposed merger partner, IPC, announced in 1996 their intentions to hold retail electric prices to their current levels until at least January 1, 2000. The companies made the proposal as part of their testimony in the merger-related application filed with the IUB; the application was later withdrawn and was resubmitted in January 1997 and the companies included the same proposal in the resubmittal of the filing. The proposal excludes price changes due to government-mandated

programs, such as energy efficiency cost recovery, or unforeseen dramatic changes in operations.

Utilities, WP&L and IPC also proposed to freeze their wholesale electric prices for four years from the effective date of the merger as part of their merger filing with the FERC. The Company does not expect the merger-related electric price proposals to have a material adverse effect on its financial position or results of operations.

(b) Energy Efficiency Cost Recovery – Current IUB rules mandate Utilities to spend 2% of electric and 1.5% of gas gross retail operating revenues for energy efficiency programs. Under provisions of the IUB rules, Utilities is currently recovering the energy efficiency costs incurred through 1993 for such programs, including its direct expenditures, carrying costs, a return on its expenditures and a reward. These costs are being recovered over a four-year period and the recovery began on June 1, 1995.

In December 1996, under provisions of the IUB rules, the Company filed for recovery of the costs relating to its 1994 and 1995 programs. Utilities' proposed recovery was for approximately $53 million ($42 million electric and $11 million gas) and was composed of $34 million for direct expenditures and carrying costs, $10 million for a return on the expenditures over the recovery period and $9 million for a reward based on a sharing of the benefits of such programs. The Company expects to receive the final order in the proceeding in June 1997 with recovery of the allowed costs to commence in the third quarter of 1997.

Iowa statutory changes enacted in 1996, and applicable to future programs once the legislation is implemented by the IUB, have eliminated: 1) the 2% and 1.5% spending requirements described above in favor of IUB-determined energy savings targets, 2) the delay in recovery of energy efficiency costs by allowing recovery which is concurrent with spending and 3) the recovery of a sharing reward. The IUB commenced a rulemaking in January 1997 to implement the statutory change and a final order in this proceeding is expected in the second quarter of 1997. The proposed rules provide that the Company would begin to recover its 1996 expenditures, and the 1997 expenditures incurred at such time, during the summer of 1997 over a likely four-year recovery period. The Company would also begin concurrent recovery of its prospective expenditures at such time. The implementation of these changes will gradually eliminate the regulatory asset which exists under the current rate making mechanism as these costs are recovered.

The Company has the following amounts of energy efficiency costs included in regulatory assets on its Consolidated Balance Sheets at December 31:

(IN THOUSANDS)	1996	1995
Costs incurred through 1993	**$12,834**	$18,287
Costs incurred in 1994 - 1995	**33,161**	31,393
Costs incurred in 1996	**15,087**	—
	$61,082	$49,680

The above amounts include the direct expenditures and carrying costs incurred by the Company but do not include any amounts for a return on its expenditures over the recovery period or for a reward.

4 Leases

Utilities has a capital lease covering its 70% undivided interest in nuclear fuel purchased for the DAEC. Future purchases of fuel may also be added to the fuel lease. This lease provides for annual one-year extensions and Utilities intends to continue exercising such extensions. Interest costs under the lease are based on commercial paper costs incurred by the lessor. Utilities is responsible for the payment of taxes, maintenance, operating cost, risk of loss and insurance relating to the leased fuel.

The lessor has a $45 million credit agreement with a bank supporting the nuclear fuel lease. The agreement continues on a year-to-year basis, unless either party provides at least a three-year notice of termination; no such notice of termination has been provided by either party.

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" in the Consolidated Statements of Income) for 1996-1994 were $18.2 million, $18.0 million and $17.8 million, respectively.

The Company's operating lease rental expenses for 1996-1994 were $8.3 million, $10.4 million and $11.1 million, respectively.

The Company's future minimum lease payments by year are as follows:

	(IN THOUSANDS)	
YEAR	CAPITAL LEASE	OPERATING LEASES
1997	$16,808	$ 6,891
1998	9,889	6,565
1999	6,969	4,741
2000	3,004	2,510
2001	861	1,370
Thereafter	307	197
	37,838	$22,274
Less: Amount representing interest	3,113	
Present value of net minimum capital lease payments	$34,725	

5 Utility Accounts Receivable

Customer accounts receivable, including unbilled revenues, arise primarily from the sale of electricity and natural gas. At December 31, 1996, Utilities was serving a diversified base of residential, commercial and industrial customers consisting of approximately 336,000 electric and 176,000 gas customers and did not have any significant concentrations of credit risk.

Utilities has entered into an agreement, which expires in 1999, with a financial institution to sell, with limited recourse, an undi-

vided fractional interest of up to $65 million in its pool of utility accounts receivable. Expenses related to the sale of receivables are paid to the financial organization under this contract and approximated a 5.86% annual rate during 1996. During 1996 and 1995, the monthly proceeds from the sale of accounts receivable averaged $62.9 million and $61.9 million, respectively. At December 31, 1996, $65 million was sold under the agreement.

SFAS 125, issued by the FASB in 1996 and effective for 1997, provides accounting and reporting standards for transfers and servicing of financial assets and extinguishment of liabilities. The accounting for Utilities' sale of accounts receivable agreement is impacted by this standard. As a result, the agreement is being modified to comply with the SFAS 125 requirements and thus the accounting and reporting for the sale of Utilities' receivables will remain unchanged.

6 Investments

(a) Foreign Entities – At December 31, 1996, the Company had $44.9 million of investments in foreign entities on its Consolidated Balance Sheet that included 1) investments in two New Zealand electric distribution entities, 2) a loan to a New Zealand company, 3) an investment in a cogeneration facility in China, and 4) an investment in an international venture capital fund. The Company accounts for the China investment under the equity method and the other investments under the cost method. The geographic concentration of the Company's investments in foreign entities at December 31, 1996, included investments of approximately $30.9 million in New Zealand, $13.6 in China and $0.4 million in other countries.

(b) McLeod, Inc. (McLeod) – At December 31, 1996, the Company had a $20.0 million investment in Class A common stock of McLeod, a $9.2 million investment in Class B common stock and vested options that, if exercised, would represent an additional investment of approximately $2.3 million. McLeod provides local, long-distance and other telecommunications services.

McLeod completed an Initial Public Offering (IPO) of its Class A common stock in June 1996 and a secondary offering in November 1996. As of December 31, 1996, the Company is the beneficial owner of approximately 10.6 million total shares on a fully diluted basis. Class B shares are convertible at the option of the Company into Class A shares at any time on a one-for-one basis. The rights of McLeod Class A common stock and Class B common stock are substantially identical except that Class A common stock has 1 vote per share and Class B common stock has 0.40 vote per share. The Company currently accounts for this investment under the cost method.

The Company has entered into an agreement with McLeod which provides that for two years commencing on June 10, 1996, the Company cannot sell or otherwise dispose of any of its securities of McLeod without the consent of the McLeod Board of Directors. This contractual sale restriction results in restricted stock under the provisions of Statement of Financial Accounting Standards No. 115 (SFAS No. 115), Accounting for Certain Investments in Debt and Equity Securities, until such time as the restrictions lapse and such shares became qualified for sale within a one year period. As a result, the Company currently carries this investment at cost.

The closing price of the McLeod Class A common stock on December 31, 1996, on the Nasdaq National Market, was $25.50 per share. The current market value of the shares the Company beneficially owns (approximately 10.6 million shares) is currently impacted by, among other things, the fact that the shares cannot be sold for a period of time and it is not possible to estimate what the market value of the shares will be at the point in time such sale restrictions are lifted. In addition, any gain upon an eventual sale of this investment would likely be subject to a tax.

Under the provisions of SFAS No. 115, the carrying value of the McLeod investment will be adjusted to estimated fair value at the time such shares become qualified for sale within a one year period; this will occur on June 10, 1997, which is one year before the contractual restrictions on sale are lifted. At that time, the adjustment to reflect the estimated fair value of this investment will be reflected as an increase in the investment carrying value with the unrealized gain reported as a net of tax amount in other common shareholders equity until realized (i.e., sold by the Company).

7 Income Taxes

The components of federal and state income taxes for the years ended December 31, were as follows:

(IN MILLIONS)	1996	1995	1994
Current tax expense	**$38.2**	$34.7	$37.5
Deferred tax expense	**11.8**	10.5	6.7
Amortization and adjustment of investment tax credits	**(2.6)**	(2.7)	(2.6)
	$47.4	$42.5	$41.6

The overall effective income tax rates shown below for the years ended December 31, were computed by dividing total income tax expense by income before income taxes.

	1996	1995	1994
Statutory federal income tax rate	**35.0%**	35.0%	35.0%
State income taxes, net of federal benefits	**6.6**	5.5	5.9
Effect of rate making on property related differences	**2.8**	2.6	1.6
Amortization of investment tax credits	**(2.4)**	(2.5)	(2.5)
Adjustment of prior period taxes	**1.4**	(0.4)	(1.6)
Other items, net	**0.4**	(0.4)	—
Overall effective income tax rate	**43.8%**	39.8%	38.4%

The accumulated deferred income taxes as set forth below in the Consolidated Balance Sheets at December 31, arise from the following temporary differences:

(IN MILLIONS)	1996	1995
Property related	$293	$296
Investment tax credit related	(24)	(26)
Decommissioning related	(15)	(14)
Other	9	1
	$263	$257

8 Benefit Plans

(a) Pension Plans – The Company has two non-contributory pension plans that, collectively, cover substantially all of its employees. Plan benefits are generally based on years of service and compensation during the employees' latter years of employment. Payments made from the pension funds to retired employees and beneficiaries during 1996 totaled $10.7 million.

The Company's policy is to fund the pension cost at an amount that is at least equal to the minimum funding requirements mandated by the Employee Retirement Income Security Act (ERISA) and that does not exceed the maximum tax deductible amount for the year. The Company has an investment policy governing asset allocation guidelines for its pension plans. The target ranges are as follows: 1) 37%-43% in large and mid-sized domestic company equity securities, 2) 7%-13% in foreign equity securities, 3) 7%-13% in small domestic company equity securities, 4) 0-5% in real estate, and 5) the remainder in fixed income securities. As of December 31, 1996, the plan's investment mix was consistent with the policy guidelines.

Pursuant to the provisions of SFAS 71, certain adjustments to Utilities' pension provision are necessary to reflect the accounting for pension costs allowed in its most recent rate cases.

The components of the pension provision for the years ended December 31, were as follows:

(IN THOUSANDS)	1996	1995	1994
Service cost	$ 5,997	$ 5,215	$ 5,863
Interest cost on projected benefit obligation	12,711	11,811	11,431
Assumed return on plans' assets	(14,976)	(12,567)	(12,593)
Early retirement benefits	4,713	—	—
Net amortization	906	268	841
Pension cost	9,351	4,727	5,542
Adjustment to funding level	(9,351)	(4,727)	(5,431)
Total pension costs paid to the Trustee	$ —	$ —	$ 111
Actual return on plans' assets	$26,297	$36,614	$ (97)

During 1996, the Company incurred a one-time charge of $4.7 million related to an early retirement program. Of such costs, $0.2 million was charged to expense and the remaining amount was deferred for future recovery through the regulatory process.

A reconciliation of the funded status of the plans to the amounts recognized in the Consolidated Balance Sheets at December 31, is presented below:

(IN THOUSANDS)	1996	1995
Fair market value of plans' assets	$212,394	$195,329
Actuarial present value of benefits rendered to date:		
Accumulated benefits based on compensation to date, including vested benefits of $130,334 and $119,996, respectively	142,515	131,274
Additional benefits based on estimated future salary levels	42,940	41,581
Projected benefit obligation	185,455	172,855
Plans' assets in excess of projected benefit obligation	26,939	22,474
Remaining unrecognized net asset existing at January 1, 1987, being amortized over 20 years	(3,179)	(3,511)
Unrecognized prior service cost	15,523	16,905
Unrecognized net gain	(54,442)	(41,795)
Accrued pension cost recognized in the Consolidated Balance Sheets	$ (15,159)	$ (5,927)
Assumed rate of return, all plans	9.00%	8.00%
Weighted average discount rate of projected benefit obligation, all plans	7.50%	7.50%
Assumed rate of increase in future compensation levels for the plans	4.75%	4.75%

The assumed rate of return was increased to 9.00% in 1996 based on actual historical performance of the previously stated investment mix.

The Company also sponsors defined contribution pension plans (401(k) plans) covering substantially all employees. The Company's contributions to the plans, which are based on the participants' level of contribution and cannot exceed 2.8% of the participants' salaries or wages, were $1.7 million, $1.5 million and $1.8 million in 1996, 1995 and 1994, respectively.

(b) Other Postemployment Benefit Plans – The Company provides certain benefits to retirees (primarily health care benefits). The IUB adopted rules stating that postretirement benefits other than pensions will be included in Utilities' rates pursuant to the provisions of SFAS 106. The rules permit Utilities to amortize the transition obligation as of January 1, 1993, over 20 years and require that all amounts collected are to be funded into an external trust to pay benefits as they become due. The gas and electric portions of these costs are being recovered through rates beginning in 1993 and 1995, respectively, including amounts that were deferred by the Company, pursuant to IUB rules, between when SFAS 106 was adopted and when recovery

through rates began. The amounts deferred are being amortized as they are collected through rates over a three-year period. Utilities' unamortized balance of these deferred costs was $1.5 million at December 31, 1996.

Pursuant to the provisions of SFAS 71, certain adjustments to Utilities' other postretirement benefit provisions are necessary to reflect the accounting for other postretirement benefit costs allowed in its most recent rate cases.

The components of postretirement benefit costs for the years ended December 31, were as follows:

(IN THOUSANDS)	1996	1995	1994
Service cost	**$1,888**	$1,387	$1,838
Interest cost on accumulated postretirement benefit obligation	**3,726**	3,175	3,275
Assumed return on plans' assets	**(388)**	(56)	(60)
Net amortization of transition obligation and other	**1,970**	1,813	2,037
Amortized/(deferred) postretirement benefit costs	**1,863**	2,220	(2,732)
Regulatory recognition of incurred cost	**49**	1,162	—
Net postretirement benefit costs	**$9,108**	$9,701	$4,358
Actual return on plans' assets	**$ 945**	$ 273	$ 47

A reconciliation of the funded status of the plans to the amounts recognized in the Consolidated Balance Sheets at December 31, is presented below:

(IN THOUSANDS)	1996	1995
Fair market value of plans' assets	**$12,312**	$ 6,515
Accumulated postretirement benefit obligation:		
Active employees not yet eligible	**19,056**	22,254
Active employees eligible	**4,866**	6,282
Retirees	**25,992**	22,575
Total accumulated postretirement benefit obligation	**49,914**	51,111
Accumulated postretirement benefit obligation in excess of plans' assets	**(37,602)**	(44,596)
Unrecognized transition obligation	**31,020**	34,415
Unrecognized net (gain)/loss	**(2,505)**	349
Unrecognized prior service cost	**(427)**	151
Accrued postretirement benefit cost in the Consolidated Balance Sheets	**$ (9,514)**	$ (9,681)
Assumed rate of return	**9.00%**	8.00%
Weighted average discount rate of accumulated postretirement benefit obligation	**7.50%**	7.50%
Medical trend on paid charges:		
Initial trend rate	**9.00%**	10.00%
Ultimate trend rate	**6.50%**	6.50%

The assumed rate of return was increased to 9.00% in 1996 based on actual historical performance of investments of a similar nature. The assumed medical trend rates are critical assumptions in determining the service and interest cost and accumulated postretirement benefit obligation related to postretirement benefit costs. A 1% change in the medical trend rates, holding all other assumptions constant, would have changed the 1996 service and interest cost by $1.2 million (21%) and the accumulated postretirement benefit obligation at December 31, 1996, by $8.5 million (17%).

9 Common, Preferred and Preference Stock

(a) Common Stock – The following table presents information relating to the changes in common stock.

	COMMON STOCK	
	NUMBER OF SHARES OUTSTANDING	AMOUNT (IN THOUSANDS)
Balance, December 31, 1993	28,304,188	$360,301
Shares issued in connection with acquisition of oil and gas companies	139,102	4,027
Purchases of treasury stock	(213,300)	(6,233)
Stock plan issuances*	547,056	15,395
Balance, December 31, 1994	28,777,046	373,490
Shares issued in connection with acquisition of oil and gas companies	75,638	1,925
Stock plan issuances*	655,731	15,854
Balance, December 31, 1995	29,508,415	391,269
Purchases of treasury stock	(9,448)	(269)
Stock plan issuances*	578,245	16,635
Balance, December 31, 1996	30,077,212	$407,635
Shares reserved for issuance pursuant to the Company's stock plans at December 31, 1996*	1,632,869	

** Dividend Reinvestment and Stock Purchase Plan, Employee Stock Purchase Plan, Employee Savings Plan, Long-Term Incentive Plan, IES Bonus Stock Ownership Plan and Whiting Stock Option Plans*

During 1996, Industries reacquired 9,448 shares of its common stock on the open market, at an average price of $28.44 per share, which were subsequently issued to various Company Directors and employees. During 1994, Industries reacquired 213,300 shares of its common stock on the open market, at an average price of $29.22 per share, which were subsequently issued to the Dividend Reinvestment Plan and certain of its benefit plans. At December 31, 1996, no shares remained held as treasury stock.

(b) Preferred and Preference Stock – Utilities has 466,406 shares of Cumulative Preferred Stock, $50 par value, authorized for issuance at December 31, 1996, of which the 6.10%, 4.80% and 4.30% Series had 100,000, 146,406 and 120,000 shares, respectively, outstanding at both December 31, 1996 and 1995. These shares are redeemable at the option of Utilities upon 30 days notice at $51.00, $50.25 and $51.00 per share, respectively, plus accrued dividends.

There are 5,000,000 shares of Industries Cumulative Preferred Stock (no par value) and 700,000 shares of Utilities Cumulative Preference Stock ($100 par value) authorized for issuance, of which none were outstanding at December 31, 1996.

10 Debt

(a) Long-Term Debt – In September 1996, Utilities repaid at maturity $15 million of Series J, 6.25% First Mortgage Bonds and, in a separate transaction, issued $60 million of Collateral Trust Bonds, 7.25%, due 2006.

Utilities' Indentures and Deeds of Trust securing its First Mortgage Bonds constitute direct first mortgage liens upon substantially all tangible public utility property. Utilities' Indenture and Deed of Trust securing its Collateral Trust Bonds constitutes a second lien on substantially all tangible public utility property while First Mortgage Bonds remain outstanding.

Diversified has a variable rate credit facility that extends through November 20, 1999, with two one-year extensions potentially available to Diversified. The unborrowed portion of the agreement is also used to support Diversified's commercial paper program. A combined maximum of $300 million of borrowings under the agreement and commercial paper program may be outstanding at any one time. Interest rates and maturities are set at the time of borrowing for direct borrowings under the agreement and for issuances of commercial paper. The interest rate options are based upon quoted market rates and the maturities are less than one year. At December 31, 1996, $23 million was borrowed under this facility, bearing an interest rate of 5.75%, maturing in the first quarter of 1997. Diversified had $149.1 million of commercial paper outstanding at December 31, 1996, with interest rates ranging from 5.50% to 7.10% and maturity dates in the first quarter of 1997. Diversified intends to continue borrowing under the renewal options of the facility and no conditions exist at December 31, 1996, that would prevent such borrowings. Accordingly, this debt is classified as long-term in the Consolidated Balance Sheets. Refer to Note 12(a) for a discussion of an interest rate swap agreement Diversified entered into relating to this facility.

Total sinking fund requirements, which Utilities intends to meet by pledging additional property under the terms of its Indentures and Deeds of Trust, and debt maturities for 1997-2001 are $9 million, $1 million, $61 million, $67 million and $255 million, respectively. The Company intends to refinance the majority of the debt maturities with long-term securities.

(b) Short-Term Debt – At December 31, 1996, the Company had bank lines of credit aggregating $136.1 million. Utilities was using $110 million to support commercial paper and $11.1 million to support certain pollution control obligations. Commitment fees are paid to maintain these lines and there are no conditions which restrict the unused lines of credit. In addition to the above, Utilities has an uncommitted credit facility with a financial institution whereby it can borrow up to $40 million. Rates are set at the time of borrowing and no fees are paid to maintain this facility. Information regarding short-term debt is as follows:

(DOLLARS IN THOUSANDS)	1996	1995	1994
As of end of year:			
Commercial paper outstanding	**$110,000**	$101,000	$37,000
Notes payable outstanding	**25,000**	—	—
Weighted average interest rate on commercial paper	**5.70%**	5.81%	6.13%
Weighted average interest rate on notes payable	**6.28%**	—	—
For the year ended:			
Maximum month-end amount of short-term debt	**$145,000**	$132,000	$37,000
Average daily amount outstanding	**120,112**	79,159	5,269
Weighted average interest rate	**5.52%**	5.97%	5.31%

11 Estimated Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Current Assets and Current Liabilities – The carrying amount approximates fair value because of the short maturity of such financial instruments.

Nuclear Decommissioning Trust Funds – The carrying amount represents the fair value of these trust funds, as reported by the trustee. The balance of the "Nuclear decommissioning trust funds" as shown in the Consolidated Balance Sheets included $9.4 million of unrealized gains at December 31, 1996, and $5.3 million of unrealized gains at December 31, 1995, on the investments held in the trust funds. The accumulated reserve for decommissioning costs was adjusted by a corresponding amount.

Cumulative Preferred Stock of Utilities – Based upon the market yield of similar securities and quoted market prices.

Long-Term Debt – Based upon the market yield of similar securities and quoted market prices.

Investments Carried at Cost – Fair value of the McLeod investment is based on quoted market prices at December 31, 1996 (including an assumed exercise of the Company's options at the December 31, 1996 market price less the exercise price); the 1995 fair value is based on the carrying value as there was no quoted market price prior to the 1996 IPO. Fair value of the New Zealand investments is based on quoted market prices; while the market is not of a breadth and scope comparable to a U.S. market as required for SFAS 115 accounting purposes, the Company does believe it produces a reasonable representation of the fair market value of the investment. Fair value of the other investments is based on quoted market prices where available, and cost when not available as the Company believes the carrying value approximates fair value for such investments.

The following table presents the carrying amount and estimated fair value of certain financial instruments as of December 31:

(IN MILLIONS)	1996 CARRYING VALUE	1996 FAIR VALUE	1995 CARRYING VALUE	1995 FAIR VALUE
Cumulative preferred stock of Utilities	**$ 18**	**$ 12**	$ 18	$ 11
Long-term debt, including current portion	**712**	**722**	620	644
Investments carried at cost:				
Investment in McLeod, Inc. (Note 6(b))	**29**	**267**	9	9
Investments in New Zealand (Note 6(a))	**31**	**45**	25	22
Other	**3**	**4**	3	5

Since Utilities is subject to regulation, any gains or losses related to the difference between the carrying amount and the fair value of its financial instruments may not be realized by the Company's shareholders.

12 Derivative Financial Instruments

The Company has a policy that financial derivatives are to be used only to mitigate business risks and not for speculative purposes. Derivatives have been used by the Company on a very limited basis.

(a) Interest Rate Swap Agreement – In February 1996, Diversified entered into an interest rate swap agreement on a variable rate borrowing of $100 million converting this debt into a fixed-rate borrowing at a rate of 4.7 percent. The swap period is for two years with an additional one-year option available to the counterparty and the agreement includes quarterly settlement dates. Diversified realized approximately $0.7 million in interest expense savings in 1996 under the agreement. The fair value of this financial instrument is based on the amounts estimated to terminate or settle the agreement. At December 31, 1996, the agreement, if settled on that date, would have required the counterparty to pay the Company approximately $1.2 million. Such value is based on the difference in the interest rates as well as the amount of time remaining in the agreement. The Company has no intention of terminating the agreement at this time.

(b) Gas Futures Contracts – Industrial Energy Applications, Inc. (IEA), a wholly-owned subsidiary under Diversified, has entered into natural gas contracts on the New York Mercantile Exchange (NYMEX) in the notional amount of $6.4 million at December 31, 1996. The original contract terms range from one to seventeen months. The contracts are intended to mitigate risk from fluctuations in the price of natural gas that will be required to satisfy sales commitments for future deliveries to customers and for sales from storage. Gains and losses on these hedging contracts are deferred and recognized in income when the transactions being hedged are finalized.

13 Commitments and Contingencies

(a) Construction Program – The Company's construction and acquisition program anticipates expenditures of approximately $225 million for 1997, which includes $147 million at Utilities and $78 million at Diversified. Substantial commitments have been made in connection with these expenditures.

(b) Purchased Power, Coal and Natural Gas Contracts – Utilities has entered into purchased power capacity and coal contracts and its minimum commitments are as follows (dollars and tons in thousands):

	PURCHASED POWER DOLLARS	PURCHASED POWER MW'S	COAL DOLLARS	COAL TONS
1997	$11,175	69 - 144	$68,323	4,472
1998	3,415	9 - 109	17,250	886
1999	3,283	1 - 101	17,509	874
2000	283	1	15,696	762
2001	283	1	15,913	751

The Company has several purchased power contracts for the annual six-month summer season and thus the minimum and maximum of the noted range represent the power purchased during the winter and summer seasons, respectively. The Company expects to supplement its coal contracts with spot market purchases to fulfill its future fossil fuel needs.

Utilities also has various natural gas supply, transportation and storage contracts outstanding. The gas supply commitments are all index based and the minimum dekatherm commitments, in thousands, for 1997-2001 are 10,699, 5,074, 5,074, 3,574 and 3,574, respectively. The minimum transportation and storage commitments for 1997-2001, in thousands, are $32,080, $31,842, $29,220, $27,050 and $24,008, respectively. The Company expects to supplement its natural gas supply with spot market purchases as needed.

(c) Information Technology Services – The Company entered into an agreement, expiring in 2004, with Electronic Data Systems Corporation (EDS) for information technology services. The con-

tract is subject to declining termination fees. The Company's anticipated operating and capital expenditures under the agreement for 1997 are estimated to total approximately $12.5 million. Future costs under the agreement are variable and are dependent upon the Company's level of usage of technological services from EDS.

(d) Financial Guarantees – The Company has financial guarantees amounting to $22.9 million outstanding at December 31, 1996, which are not reflected in the consolidated financial statements. Such guarantees are generally issued to support third-party borrowing arrangements and similar transactions. The Company believes that the likelihood of material cash payments by the Company under these agreements is remote.

(e) Nuclear Insurance Programs – Public liability for nuclear accidents is governed by the Price Anderson Act of 1988 which sets a statutory limit of $8.9 billion for liability to the public for a single nuclear power plant incident and requires nuclear power plant operators to provide financial protection for this amount. As required, Utilities provides this financial protection for a nuclear incident at the DAEC through a combination of liability insurance ($200 million) and industry-wide retrospective payment plans ($8.7 billion). Under the industry-wide plan, each operating licensed nuclear reactor in the United States is subject to an assessment in the event of a nuclear incident at any nuclear plant in the United States. Based on its ownership of the DAEC, Utilities could be assessed a maximum of $79.3 million per nuclear incident, with a maximum of $10 million per incident per year (of which Utilities' 70% ownership portion would be approximately $55 million and $7 million, respectively) if losses relating to the incident exceeded $200 million. These limits are subject to adjustments for changes in the number of participants and inflation in future years.

Utilities is a member of Nuclear Mutual Limited (NML) and Nuclear Electric Insurance Limited (NEIL). These companies provide $1.9 billion of insurance coverage on certain property losses at DAEC for property damage, decontamination and premature decommissioning. The proceeds from such insurance, however, must first be used for reactor stabilization and site decontamination before they can be used for plant repair and premature decommissioning. NEIL also provides separate coverage for the cost of replacement power during certain outages. Owners of nuclear generating stations insured through NML and NEIL are subject to retroactive premium adjustments if losses exceed accumulated reserve funds. NML and NEIL's accumulated reserve funds are currently sufficient to more than cover its exposure in the event of a single incident under the primary and excess property damage or replacement power coverages. However, Utilities could be assessed annually a maximum of $3.0 million under NML, $6.4 million for NEIL property and $0.7 million for NEIL replacement power if losses exceed the accumulated reserve funds. Utilities is not aware of any losses that it believes are likely to result in an assessment.

In the unlikely event of a catastrophic loss at DAEC, the amount of insurance available may not be adequate to cover property damage, decontamination and premature decommissioning. Uninsured losses, to the extent not recovered through rates, would be borne by Utilities and could have a material adverse effect on Utilities' financial position and results of operations.

(f) Environmental Liabilities – The Company has recorded environmental liabilities of approximately $53 million in its Consolidated Balance Sheets at December 31, 1996. The Company's significant environmental liabilities are discussed below.

Former Manufactured Gas Plant (FMGP) Sites

Utilities has been named as a Potentially Responsible Party (PRP) by various federal and state environmental agencies for 28 FMGP sites, but believes it is not responsible for two of these sites based on extensive reviews of the ownership records and historical information available for the two sites. Utilities has notified the appropriate regulatory agency that it believes it does not have any responsibility as relates to these two sites, but no response has been received from the agency on this issue. Utilities is also aware of six other sites that it may have owned or operated in the past and for which, as a result, it may be designated as a PRP in the future in the event that environmental concerns arise at these sites. Utilities is working pursuant to the requirements of the various agencies to investigate, mitigate, prevent and remediate, where necessary, damage to property, including damage to natural resources, at and around the sites in order to protect public health and the environment. Utilities believes it has completed the remediation of ten sites although it is in the process of obtaining final approval from the applicable environmental agencies on this issue for each site. Utilities is in various stages of the investigation and/or remediation processes for the remaining 16 sites and estimates the range of additional costs to be incurred for investigation, remediation and monitoring of the sites to be approximately $24 million to $54 million.

Utilities has recorded environmental liabilities related to the FMGP sites of approximately $36 million (including $4.7 million as current liabilities) at December 31, 1996. These amounts are based upon Utilities' best current estimate of the amount to be incurred for investigation, remediation and monitoring costs for those sites where the investigation process has been or is substantially completed, and the minimum of the estimated cost range for those sites where the investigation is in its earlier stages. It is possible that future cost estimates will be greater than the current estimates as the investigation process proceeds and as additional facts become known. Regulatory assets of approximately $36 million, which reflect the future recovery that is being provided through Utilities' rates, have been recorded in the Consolidated Balance Sheets. Considering the current rate treatment allowed by the IUB, management believes that the clean-up costs incurred by Utilities for these FMGP sites will not have a material adverse effect on its financial position or results of operations.

In April 1996, Utilities filed a lawsuit against certain of its insurance carriers seeking reimbursement for investigation, mitigation, prevention, remediation and monitoring costs associated with the FMGP sites. Settlement discussions are proceeding between Utilities and its insurance carriers regarding the recovery of these FMGP-related costs. Settlement has been reached with two carriers and an agreement in principle has been reached with three other carriers thus far. Any amounts received from insurance carriers will be deferred pending a determination of the regulatory treatment of such recoveries.

National Energy Policy Act of 1992

The National Energy Policy Act of 1992 requires owners of nuclear power plants to pay a special assessment into a "Uranium Enrichment Decontamination and Decommissioning Fund." The assessment is based upon prior nuclear fuel purchases and, for the DAEC, averages $1.4 million annually through 2007, of which Utilities' 70% share is $1.0 million. Utilities is recovering the costs associated with this assessment through its electric fuel adjustment clauses over the period the costs are assessed. Utilities' 70% share of the future assessment, $9.9 million payable through 2007, has been recorded as a liability in the Consolidated Balance Sheets, including $0.9 million included in "Current liabilities – Environmental liabilities," with a related regulatory asset for the unrecovered amount.

Oil and Gas Properties Dismantlement and Abandonment Costs

Whiting is responsible for certain dismantlement and abandonment costs related to various off-shore oil and gas properties, the most significant of which is located off the coast of California. The Company estimates the total costs for these properties to be approximately $16 million and the expenditures are not expected to be incurred for approximately five years. Whiting accrues these costs as reserves are extracted and such costs are included in "Depreciation and amortization" in the Consolidated Statements of Income, resulting in a liability of $7.0 million at December 31, 1996, in the Consolidated Balance Sheets.

The Company adopted the provisions of Statement of Position 96-1 (SOP-96-1), Environmental Remediation Liabilities, in 1996. This statement provides authoritative guidance for recognition, measurement and disclosure of environmental remediation liabilities in financial statements. Upon adoption of SOP-96-1, the Company's estimated liability increased by approximately $2.2 million, primarily resulting from the recording of Utilities' anticipated FMGP post-remediation monitoring costs, and a related increase to regulatory assets was also recorded.

(g) Air Quality Issues – The Clean Air Act Amendments of 1990 (Act) requires emission reductions of sulfur dioxide (SO2) and nitrogen oxides (NOx) to achieve reductions of atmospheric chemicals believed to cause acid rain. The provisions of the Act are being implemented in two phases; the Phase I requirements have been met and the Phase II requirements affect eleven other fossil units beginning in the year 2000. Utilities expects to meet the requirements of Phase II by switching to lower sulfur fuels, capital expenditures primarily related to fuel burning equipment and boiler modifications, and the possible purchase of SO2 allowances. Utilities estimates capital expenditures at approximately $12.9 million, including $0.6 million in 1997, in order to meet the acid rain requirements of the Act.

The acid rain program under the Act also governs SO2 allowances. An allowance is defined as an authorization for an owner to emit one ton of SO2 into the atmosphere. Currently, Utilities receives a sufficient number of allowances annually to offset its emissions of SO2 from its Phase I units. It is anticipated that in the year 2000, Utilities may have an insufficient number of allowances annually to offset its estimated emissions and may have to purchase additional allowances, or make modifications to the plants or limit operations to reduce emissions. Utilities is reviewing its options to ensure that it will have sufficient allowances to offset its emissions in the future. Utilities believes that the potential cost of ensuring sufficient allowances will not have a material adverse effect on its financial position or results of operations.

The Act and other federal laws also require the United States Environmental Protection Agency (EPA) to study and regulate, if necessary, additional issues that potentially affect the electric utility industry, including emissions relating to NOx, ozone transport, mercury and particulate control; toxic release inventories and modifications to the PCB rules. In December 1996, the EPA issued proposed rules that would tighten the National Ambient Air Quality Standards (NAAQS) for ozone and particulate matter emissions. Also in the fourth quarter of 1996, the EPA announced that it would issue a notice in March 1997 requiring the 37 states in the Ozone Transport Assessment Group (OTAG), which includes Iowa, to implement further controls on NOx. These proposals could result in the Company having to incur additional capital expenditures to further reduce its emissions of NOx, ozone and particulate matter. Currently, the impacts of these potential regulations are too speculative to quantify.

In 1995, the EPA published the Sulfur Dioxide Network Design Review for Cedar Rapids, Iowa, which, based on the EPA's assumptions and worst-case modeling method suggests that the Cedar Rapids area could be classified as "nonattainment" for the NAAQS established for SO2. The worst-case modeling study suggested that two of Utilities' generating facilities contribute to the modeled exceedences and recommended that additional monitors be located near Utilities' sources to assess actual ambient air quality. As a result of these exceedences, Utilities is entering into a Consent Agreement with the Iowa Department of Natural Resources. The intent of this agreement, as currently proposed, is to develop a three-year plan for a process to explore and implement options to modify one of Utilities fossil generating facilities to reduce SO2 emissions. In addition, Utilities is proposing to resolve the remainder of EPA's nonattainment concerns by either modifying the current stack or installing a new stack at the other generating facility contributing to the modeled

exceedences at a potential aggregate capital cost of up to $4.5 million over the next two years.

Pursuant to a routine internal review of operations, Utilities determined that certain changes undertaken during the previous three years at one of its power plants may have required a federal Prevention of Significant Deterioration (PSD) permit. Utilities initiated discussions with its regulators on the matter and is preparing the PSD permit application for filing in the first quarter of 1997. Utilities may be required to accept operational limits or to install additional controls and may be subject to liability for not having obtained the permit previously; however, Utilities believes that any likely actions resulting from this matter will not have a material adverse effect on its financial position or results of operations.

(h) Spent Nuclear Fuel – The Nuclear Waste Policy Act of 1982 assigned responsibility to the U.S. Department of Energy (DOE) to establish a facility for the ultimate disposition of high level waste and spent nuclear fuel and authorized the DOE to enter into contracts with parties for the disposal of such material beginning in January 1998. Utilities entered into such a contract and has made the agreed payments to the Nuclear Waste Fund (NWF) held by the U.S. Treasury. The DOE, however, has experienced significant delays in its efforts and material acceptance is now expected to occur no earlier than 2010 with the possibility of further delay being likely. Utilities has been storing spent nuclear fuel on-site since plant operations began in 1974 and has current on-site capability to store spent fuel until 2001. Utilities is aggressively reviewing options for expanding on-site storage. Utilities has been formally notified by the DOE that they anticipate being unable to begin acceptance of spent nuclear fuel by January 31, 1998. Utilities is evaluating courses of action to protect the interests of its customers and its rights under the DOE contract. Utilities is also evaluating legislation proposed to the Congress addressing this issue.

(i) Legal Proceedings – The Company is involved in other legal and administrative proceedings before various courts and agencies with respect to matters arising in the ordinary course of business. Although unable to predict the outcome of these matters, the Company believes that appropriate liabilities have been established and final disposition of these actions will not have a material adverse effect on its financial position or results of operations.

14 Jointly-Owned Electric Utility Plant

Under joint ownership agreements with other Iowa utilities, Utilities has undivided ownership interests in jointly-owned electric generating stations and related transmission facilities. Each of the respective owners is responsible for the financing of 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 Utilities' ownership interest in these facilities at December 31, 1996 is as follows:

(DOLLARS IN MILLIONS)	DAEC (NUCLEAR)	OTTUMWA UNIT 1 (COAL)	NEAL UNIT 3 (COAL)
Utility plant in service	$501.0	$190.2	$60.7
Accumulated depreciation	$217.2	$ 91.0	$28.8
Construction work in progress	$ 1.2	$ 0.1	$ 0.1
Plant capacity – Mw	520	716	515
Percent ownership	70%	48%	28%
In-service date	1974	1981	1975

15 Segments of Business

The principal business segments of Industries are the generation, transmission, distribution and sale of electric energy by Utilities and the purchase, distribution, transportation and sale of natural gas by Utilities and IEA. Certain financial information relating to Industries' significant segments of business is presented below:

(IN THOUSANDS)	YEAR ENDED DECEMBER 31 **1996**	1995	1994
Operating results:			
Revenues:			
Electric	**$ 574,273**	$ 560,471	$ 537,327
Gas	**273,979**	190,339	165,569
Operating income:			
Electric	**132,278**	130,390	125,487
Gas	**14,978**	11,056	8,762
Other information:			
Depreciation and amortization:			
Electric	**77,578**	72,487	68,640
Gas	**6,200**	6,176	6,214
Construction and acquisition expenditures:*			
Electric	**115,810**	108,356	112,773
Gas	**20,980**	9,368	10,066
Assets:			
Identifiable assets:			
Electric	**1,438,370**	1,395,666	1,347,024
Gas	**228,780**	199,050	192,397
	1,667,150	1,594,716	1,539,421
Other corporate assets	**458,412**	390,875	309,672
Total consolidated assets	**$2,125,562**	$1,985,591	$1,849,093

** Excludes intercompany acquisitions which are eliminated for consolidated financial statement purposes.*

Selected Consolidated Financial Data

	1996	1995	1994	1993	1992	1986
Income statement data (000's):						
Operating revenues	**$ 973,912**	$ 851,010	$ 785,864	$ 801,266	$ 678,296	$ 604,952
Operating income	**164,308**	151,712	147,933	151,269	109,024	111,603
Net income	**60,907**	64,176	66,818	67,938	48,711	44,255
Common stock data (per share except percentages):						
Earnings	**$ 2.04**	$ 2.20	$ 2.34	$ 2.45	$ 1.92	$ 1.96
Dividends declared	**2.10**	2.10	2.10	2.10	2.10	1.64
Return on average common equity	**9.9%**	10.7%	11.5%	12.4%	10.3%	12.4%
Market price at year-end	**$ 29.88**	$ 26.50	$ 25.25	$ 31.25	$ 29.50	$ 23.38
Book value at year-end	**20.84**	20.75	20.56	20.21	18.89	16.04
Ratio of market price to book value at year-end	**143%**	128%	123%	155%	156%	146%
Capitalization:						
Common equity	**47%**	49%	50%	51%	48%	48%
Preferred and preference stock	**1**	2	2	2	2	5
Long-term debt	**52**	49	48	47	50	47
	100%	100%	100%	100%	100%	100%
Other selected financial data:						
Total assets (000's)	**$2,125,562**	$1,985,591	$1,849,093	$1,699,819	$1,594,382	$1,172,224
Non-utility assets (000's) (1)	**352,824**	282,433	206,411	153,853	153,491	48,779
Long-term obligations, net (000's)	**744,298**	654,090	623,359	574,488	551,335	415,367
Construction and acquisition expenditures (000's)	**238,378**	218,099	206,548	169,017	192,520 (2)	52,782
Times interest earned before income taxes	**2.99**	3.12	3.38	3.38	2.63	3.30
Selected financial data for IES Utilities Inc.:						
Utility plant in service (000's)	**$2,310,161**	$2,172,378	$2,042,179	$1,932,558	$1,852,733	$1,318,060
Accumulated depreciation of utility plant in service (000's)	**1,030,390**	950,524	880,888	813,312	759,754	458,855
Construction and acquisition expenditures (000's) (3)	**143,648**	129,441	148,103	113,212	171,013 (2)	50,200
Times interest earned before income taxes	**3.44**	3.26	3.39	3.64	2.67	3.39
Electric Kwh sales (excluding off-system) (000's)	**9,953,204**	9,783,514	9,291,575	8,905,522	7,132,671	6,155,712
Gas Dth sales (including transported volumes) (000's)	**42,140**	39,805	37,975	39,006	37,035	38,285

(1) Includes non-utility assets of IES Utilities Inc.
(2) Includes $61 million for the acquisition of the Iowa service territory from Union Electric Company.
(3) Includes acquisitions from affiliated companies and Utilities' non-utility expenditures.

Electric Operating Comparison

	1996	1995	1994	1993	1992	1986
Operating revenues (000's):						
Residential and rural	**$212,799**	$216,270	$199,587	$203,870	$176,811	$160,267
General service	**98,196**	97,496	97,454	99,221	87,202	75,649
Large general service	**213,223**	199,840	191,601	184,657	140,496	127,034
Street lighting	**8,778**	8,810	8,521	8,404	7,241	7,194
Total from ultimate consumers	**532,996**	522,416	497,163	496,152	411,750	370,144
Sales for resale	**17,894**	17,554	19,195	20,254	18,602	14,963
Off-system	**19,490**	17,802	18,077	29,400	28,304	34,397
Other	**3,893**	2,699	2,892	4,715	4,343	2,091
	$574,273	$560,471	$537,327	$550,521	$462,999	$421,595
Energy sales (000's Kwh):						
Residential and rural	**2,633,704**	2,680,340	2,484,089	2,518,580	2,146,079	2,122,204
General service	**1,231,115**	1,242,373	1,170,923	1,166,072	1,061,444	914,665
Large general service	**5,500,606**	5,283,694	4,990,890	4,581,590	3,320,439	2,629,046
Street lighting	**73,381**	77,388	77,952	78,004	75,957	78,754
Total to ultimate consumers	**9,438,806**	9,283,795	8,723,854	8,344,246	6,603,919	5,744,669
Sales for resale	**514,398**	499,719	567,721	561,276	528,752	411,043
Sales of electricity to customers	**9,953,204**	9,783,514	9,291,575	8,905,522	7,132,671	6,155,712
Off-system	**1,231,298**	1,086,121	1,137,219	2,068,015	2,275,616	2,349,985
	11,184,502	10,869,635	10,428,794	10,973,537	9,408,287	8,505,697
Sources of electric energy (000's Kwh):						
Generation:						
Fossil, primarily coal	**4,972,736**	5,775,002	5,522,966	5,356,930	4,317,154	3,983,607
Nuclear (1)	**2,753,542**	2,610,979	2,875,867	2,264,507	2,402,501	2,095,334
Hydro	**7,081**	7,690	8,205	7,201	7,579	5,595
	7,733,359	8,393,671	8,407,038	7,628,638	6,727,234	6,084,536
Purchases	**4,176,700**	3,012,934	2,646,673	3,949,296	3,322,182	2,930,845
	11,910,059	11,406,605	11,053,711	11,577,934	10,049,416	9,015,381
Net capability at time of peak load (Kw):						
Generating capability	**1,864,390**	1,873,300	1,741,100	1,733,700	1,718,600	1,626,600
Purchase capability	**232,000**	207,100	280,000	248,000	207,000	100,000
	2,096,390	2,080,400	2,021,100	1,981,700	1,925,600	1,726,600
Net peak load (Kw) (2)	**1,833,203**	1,824,100	1,779,627	1,716,380	1,425,441	1,380,391
Cooling degree days as percentage of normal	**89%**	128%	99%	89%	72%	106%
Number of customers at year-end	**336,048**	333,489	330,405	327,265	325,172	299,506
Revenue per Kwh (excluding off-system) in cents	**5.57**	5.55	5.59	5.85	6.09	6.29

(1) Represents IES Utilities' 70% undivided interest in the Duane Arnold Energy Center, which is operated by IES Utilities Inc.

(2) 60 minutes integrated.

Gas Operating Comparison

	1996	1995	1994	1993	1992	1986
Operating revenues (000's):						
IES Utilities Inc.:						
Residential	**$ 97,708**	$ 84,562	$ 82,795	$ 90,462	$ 78,685	$ 79,176
Commercial	**46,966**	40,390	40,912	45,528	39,780	42,608
Industrial	**12,256**	8,790	12,515	15,593	18,649	39,485
	156,930	133,742	136,222	151,583	137,114	161,269
Other	**3,934**	3,550	2,811	2,735	2,341	881
Total revenues	**160,864**	137,292	139,033	154,318	139,455	162,150
Industrial Energy Applications, Inc.	**113,115**	53,047	26,536	27,605	27,627	—
	$273,979	$190,339	$165,569	$181,923	$167,082	$162,150
Energy sales (000's dekatherms):						
IES Utilities Inc.:						
Residential	**17,680**	16,302	15,766	16,971	15,098	15,825
Commercial	**10,323**	9,534	9,298	10,133	8,479	9,707
Industrial	**3,796**	3,098	4,010	4,618	6,175	11,722
	31,799	28,934	29,074	31,722	29,752	37,254
Industrial–transported volumes*	**10,341**	10,871	8,901	7,284	7,283	1,031
Total volumes delivered	**42,140**	39,805	37,975	39,006	37,035	38,285
Industrial Energy Applications, Inc.*	**43,055**	31,916	14,443	12,493	14,830	—
	85,195	71,721	52,418	51,499	51,865	38,285
*IEA energy sales that are also included as transported volumes of IES Utilities Inc.	**4,383**	4,232	3,134	2,883	2,955	—
Operating statistics for IES Utilities Inc.:						
Cost per dekatherm of gas purchased for resale	**$ 3.29**	$ 3.13	$ 3.31	$ 3.49	$ 3.36	$ 3.62
Peak daily sendout in dekatherms	**290,987**	269,545	288,352	268,419	254,989	282,956
Heating degree days as percentage of normal	**109%**	101%	96%	103%	93%	94%
Number of customers at year-end	**176,238**	174,470	172,829	170,719	167,813	164,670
Revenue per dekatherm sold for IES Utilities Inc. (excluding transported volumes)	**$ 4.94**	$ 4.62	$ 4.69	$ 4.78	$ 4.61	$ 4.33

Glossary of Terms

Alliances:
Partnerships developed with customers, vendors and suppliers through which both parties have incentives to have a successful relationship.

Business units:
The collective activities and infrastructure of a specific business process.

Cogeneration:
The simultaneous production of electric energy and useful thermal (heat or steam) energy for industrial and commercial heating or cooling purposes or manufacturing processes.

Deregulation:
The process of easing or removing regulatory controls and barriers that affect how and where a company can do business.

Diversification:
The practice of investing in a variety of businesses to spread economic risk and encourage growth.

Economic development:
The process of attracting new business and encouraging existing businesses to expand in a specific geographic area, particularly a utility service territory. Economic development efforts can include activities such as trade missions, incentives for business locations and relocations or community marketing support.

Energy solutions:
A package that combines an appropriate mix of products and services tailored to an individual customer.

Federal Energy Regulatory Commission (FERC):
A federal agency with broad regulatory authority over the interstate electric power and natural gas industries.

Generation:
The large-scale production of electricity in a central power plant.

Kilowatt-hour:
A unit of measurement equaling 1,000 watts of electric energy supplied to or taken from an electric circuit continuously for one hour.

Outage:
The period during which a generating unit, transmission line or other facility is out of service.

Peaking generation:
Electric power production during periods of maximum demand.

Process Improvement efforts:
A company initiative designed to improve and streamline how the business operates, either as a single process or as an entire company.

Rapid Responders:
Utility customer response personnel equipped with technology to enable real-time responses to customer requests.

Standby generation:
Electric energy production that is used on an as-needed basis, and which is available in place of or in addition to the usual source of supply. Standby generation is used to allow customers to take advantage of a utility's interruptible pricing programs or to ensure uninterrupted service.

Transloading:
Moving products or packages of products from one vessel or container to another, such as from a railcar to a truck.

Weather-normalized:
An adjustment to energy sales or consumption figures which eliminates the effect of that particular period's weather impacts, by reflecting what the sales would have been under "normal" weather conditions.

Shareholder Information

Stock Exchange Listing

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

General Inquiries

Shareholder inquires, 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:

IES Industries Inc., Attn: Shareholder Services,
P.O. Box 351, Cedar Rapids, Iowa 52406
1-800-247-9785 or 319-398-7755
e-mail: http://ies-energy.com

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. IES Industries Inc., Shareholder Services, P.O. Box 351, Cedar Rapids, Iowa 52406 acts as the Plan Administrator. A prospectus describing the Dividend Reinvestment and Stock Purchase Plan can be obtained by writing to Shareholder Services.

Safekeeping

Safekeeping is a convenient feature of the Dividend Reinvestment and Stock Purchase Plan designed for shareholders who prefer to have their shares held on account rather than receive a stock certificate. You do not have to reinvest your dividends to take advantage of Safekeeping. When you sign up for Safekeeping, you will receive a Safekeeping receipt in place of your certificate. Contact Shareholder Services for a Safekeeping form and additional information.

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 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 sales less any brokerage commission.

If you are an IES Utilities Inc. customer you may purchase stock directly from the Company and be enrolled in the Dividend Reinvestment and Stock Purchase Plan. Contact Shareholder Services to receive a Direct Purchase form.

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 shareholders list unless the shareholder requests that duplicates can be eliminated. To eliminate duplicate mailings, please send a written request to Shareholder Services.

1996 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 1996 Form 10-K without charge. Requests should be made to Shareholder Services, P.O. Box 351, Cedar Rapids, Iowa 52406.

Dividend Payment Dates

Scheduled Dividend Record and Payment Dates for 1997 are:

Record Dates	Payment Dates
March 14, 1997	April 1, 1997
June 13, 1997	July 1, 1997
September 12, 1997	October 1, 1997
December 12, 1997	January 1, 1998

Dividends paid on common stock in 1996 were fully taxable for federal income tax purposes.

Dividend Direct Deposit

We can send your dividend electronically to your financial institution for deposit. Contact Shareholder Services to receive a Dividend Deposit Form.

Transfer Agent and Required Registrar

IES Industries Inc., Stock Transfer Dept.,
200 First Street SE, Cedar Rapids, Iowa 52401
1-800-247-9785 or 319-398-7755
IES Industries Inc.–Common Stock
IES Utilities Inc.–Preferred Stock

Stock Held in Brokerage Accounts – "Street Name"

When you purchase your stock and it is held for you by your broker, it is listed with the Company in the broker's name, or "street name." IES Industries Inc. does not know the identity of individual shareholders who hold their shares in this manner–we simply know that a broker holds a certain number of shares which may be for any number of customers.

Accounts held in street name are not eligible to participate in IES Industries Inc. Dividend Reinvestment and Stock Purchase Plan. Also, you receive all dividend payments, annual reports and proxy materials through your broker. Other financial reports may be obtained directly from the Company by contacting Shareholder Services, P.O. Box 351, Cedar Rapids, Iowa 52406.

Trustee

The First National Bank of Chicago, Chicago, Illinois
IES Utilities Inc.
Iowa Electric Light and Power Company–
Mortgage and Deed of Trust – dated August 1, 1940
Mortgage and Deed of Trust – dated September 1, 1993
Iowa Southern Utilities Company – Deed of Trust

Special Notice

In June 1995, the period allowed for the settlement of most stock transactions was reduced to three days from the previous five days. As a result, many brokers are urging customers to move their securities from registered ownership to street name ownership.

There is no requirement that securities be held in street name ownership by a broker. As an investor, you retain the power to choose the form of ownership best suited to your needs. The choice is still yours. We encourage you to keep your IES Industries Inc. Common Stock registered with the Company. If you have questions or concerns call IES Industries Inc. Shareholder Services at 1-800-247-9785 or 319-398-7755.

How to Reach Us

IES Industries Shareholder Services:
1-800-247-9785 or 319-398-7755
IES Utilities Customer Service Center: 1-800-822-4348
IES Industries World Wide Web Address: http://ies-energy.com
IES Industries Corporate Communications: 319-398-4350

Board of Directors

IES Industries Inc.

C.R.S. Anderson ■ ▲
Retired Chairman of the Board of the Company, Sanibel, Florida

J. Wayne Bevis ▲ ●
Vice Chairman, Pella Corporation (Window and Door Manufacturing), Pella, Iowa

Lee Liu ■ ◆
Chairman of the Board & Chief Executive Officer of the Company

Jack R. Newman ● ▲
Partner, Morgan, Lewis & Bockius (Law Firm), Washington, DC

Robert D. Ray ▲ ◆
Retired President and Chief Executive Officer, IASD Health Services Inc., Des Moines, Iowa

David Q. Reed ■ ◆
Attorney and Counselor at Law, Kansas City, Missouri

Henry Royer ■ ●
President and Chief Executive Officer, River City Bank, Sacramento, California

Robert W. Schlutz ▲ ◆
President, Schlutz Enterprises (Diversified Farming and Retailing), Columbus Junction, Iowa

Anthony R. Weiler ◆ ●
Senior Vice President, Merchandising, Heilig-Meyers Company (Furniture Retailer), Richmond, Virginia

■ *Member Executive Committee*
▲ *Member Audit Committee*
● *Member Compensation Committee*
◆ *Member Nominating Committee*

Officers

IES Industries Inc.

Lee Liu (63, 39)
Chairman of the Board & Chief Executive Officer

Larry D. Root (60, 25)*
President & Chief Operating Officer

James E. Hoffman (44, 2)
Executive Vice President

Thomas M. Walker (49, 0)
Executive Vice President & Chief Financial Officer *(effective 12/16/96)*

Peter W. Dietrich (57, 9)
Vice President, Corporate Development

Dean E. Ekstrom (49, 11)
Vice President, Administration

Stephen W. Southwick (50, 21)
Vice President, General Counsel & Secretary

John E. Ebright (53, 0)
Controller & Chief Accounting Officer *(effective 7/8/96)*

Dennis B. Vass (47, 6)
Treasurer

IES Utilities Inc.

Lee Liu (63, 39)
Chairman of the Board & Chief Executive Officer

Larry D. Root (60, 25)*
President & Chief Operating Officer

James E. Hoffman (44, 2)
Executive Vice President, Customer Service & Energy Delivery

Thomas M. Walker (49, 0)
Executive Vice President & Chief Financial Officer *(effective 12/16/96)*

John F. Franz, Jr. (57, 5)
Vice President, Nuclear

Harold W. Rehrauer (59, 24)
Vice President, Field Operations

Stephen W. Southwick (50, 21)
Vice President, General Counsel & Secretary

Philip D. Ward (56, 23)
Vice President, Generation

John E. Ebright (53, 0)
Controller & Chief Accounting Officer *(effective 7/8/96)*

Dennis B. Vass (47, 6)
Treasurer

Figures in parenthesis represent age and years of service

* *Retired 12/31/95; re-elected 11/6/96.*

Operating Company Leadership

IES Industries Inc.

Larry J. Duncan
Assistant Treasurer/Manager Cash Management

Susan C. Hinds
Assistant Secretary

John K. Helbling
Director of Economic Development

Christopher J. Lindell
Director of Quality Improvement

Diane H. Ramsey
Director of Corporate Communications

David K. Stevens
Director of Information and Measurement Systems

IES Utilities Inc.

Daniel L. Mineck
Assistant Vice President, Corporate Engineering

Dundeana K. Langer
Assistant Vice President, Field Operations *(effective 3/1/97)*

Erik C. Madsen
Director of Pricing, Marketing and Process Redesign

Grant G. Harper
General Manager, Key Accounts

Theresa M. Mulford
General Manager, Major Accounts

Kenneth V. Rieck
General Manager, Supply Chain

Gary VanMiddlesworth
Plant Manager, Nuclear and Assistant Plant Superintendent, Duane Arnold Energy Center

IES Utilities Inc. GenCo

Douglas A. Alexander
Ottumwa Generating Station Facility Leader

Alan J. Arnold
General Manager, Regulatory Management

John J. Blase
General Manager, Energy Transactions

William J. Cherrier
General Manager, Business Operations

Jay W. Dixson
Sutherland Generating Station Facility Leader

Rick L. Hannen
Sixth Street Generating Station Facility Leader

Michael E. McDermott
General Manager, Technical Support/Shared Resources

Jay A. Thordsen
Burlington Generating Station Facility Leader

David L. Wilson
Prairie Creek Generating Station Facility Leader

IES Utilities Inc. LineCo

Steven C. Baker
General Manager-Resource Services

Edward C. Greiner
General Manager-Maintenance

Christopher A. Hampsher
General Manager-Business Process

Scott V. Jones
General Manager-Construction

John O. Larsen
General Manager-Integrated Resources

IES Energy Inc.

David Frawley
President & Chief Executive Officer, Whiting Petroleum Corp.

Timothy J. Eibes
General Manager, Industrial Energy Applications, Inc.

IES Transportation Inc.

Paul H. Treangen
Vice President

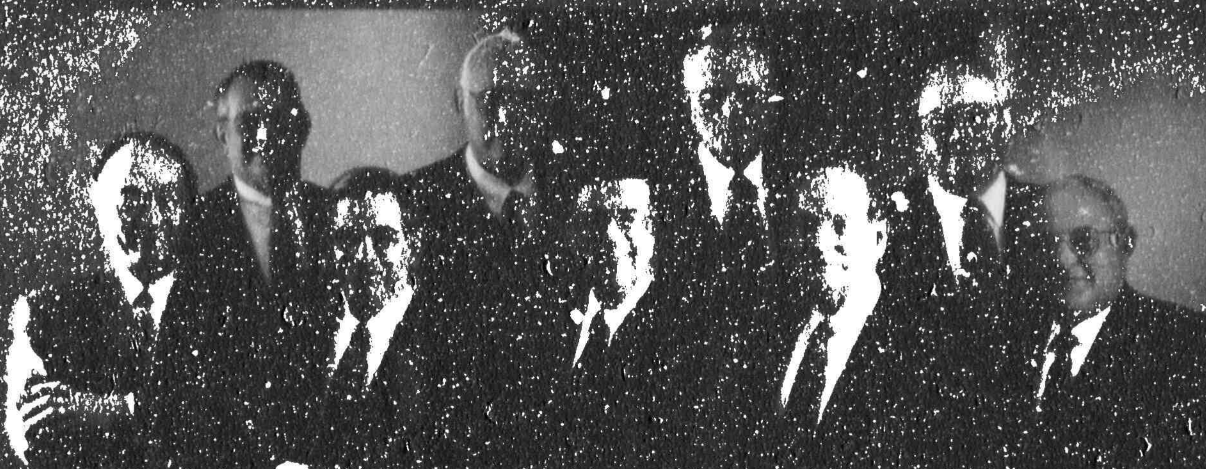
IES Investments Inc.

Thomas L. Aller
Vice President

Kenneth R. Whiting
Vice President, International Business

The majority of photography was provided by ZAP

Directors and Officers



Board of Directors

[illegible]

Officers

[illegible]

IES Industries Inc.
200 First Street SE
Cedar Rapids, Iowa 52401

INDUSTRIES