USG CORP
Form 10-Q
July 25, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 1-8864
USG CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	36-3329400
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
550 West Adams Street, Chicago, Illinois	60661-3676
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code (312) 436-4000
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	þ	Accelerated filer	¨
Non-accelerated filer	¨	(Do not check if a smaller reporting company)	
		Smaller reporting company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
The number of shares of the registrant's common stock outstanding as of June 30, 2018 was 139,493,175.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(millions, except per-share and share data)	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Net sales	$880	$ 811	$1,666	$ 1,578
Cost of products sold	696	643	1,343	1,251
Gross profit	184	168	323	327
Selling and administrative expenses	109	73	202	148
Operating profit	75	95	121	179
Income from equity method investments	12	14	21	27
Interest expense	(15)	(19)	(29)	(39)
Interest income	2	—	3	1
Loss on extinguishment of debt	—	(22)	—	(22)
Other (expense) income, net	(3)	(2)	—	4
Income from continuing operations before income taxes	71	66	116	150
Income tax expense	(13)	(20)	(22)	(49)
Income from continuing operations	58	46	94	101
Income (loss) from discontinued operations, net of tax	—	(10)	1	(10)
Net income	$58	$ 36	$95	$ 91
Earnings per average common share - basic:				
Income from continuing operations	$0.41	$ 0.32	$0.66	$ 0.69
Income (loss) from discontinued operations	—	(0.07)	0.01	(0.07)
Net income	$0.41	$ 0.25	$0.67	$ 0.62
Earnings per average common share - diluted:				
Income from continuing operations	$0.41	$ 0.31	$0.65	$ 0.68
Income (loss) from discontinued operations	—	(0.07)	0.01	(0.07)
Net income	$0.41	$ 0.24	$0.66	$ 0.61
Average common shares	139,617,874	145,526,900	140,540,426	145,753,098
Dilutive awards under long-term incentive plan	1,262,046	2,113,193	2,222,766	2,317,971
Deferred shares for non-employee directors	—	220,846	—	220,404
Average diluted common shares	140,879,920	147,860,939	142,763,192	148,291,473

See accompanying Notes to Condensed Consolidated Financial Statements.

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USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(millions)	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Net income	$58	$36	$95	$91
Other comprehensive income (loss), net of tax:				
Derivatives qualifying as cash flow hedges:				
Gain (loss) on derivatives qualifying as cash flow hedges, net of tax (benefit) of $0, ($2), $0 and ($5), respectively	2	(2)	2	(8)
Less: Reclassification adjustment for loss on derivatives included in net income, net of tax of $0 in all periods	(2)	(1)	(2)	(1)
Net derivatives qualifying as cash flow hedges	4	(1)	4	(7)
Pension and postretirement benefits:				
Changes in pension and postretirement benefits, net of tax of $0, $2, $0 and $2, respectively	1	4	3	3
Less: Amortization of prior service cost included in net periodic pension cost, net of tax (benefit) of $0, ($7), ($1) and ($7), respectively	(2)	(12)	(3)	(12)
Net pension and postretirement benefits	3	16	6	15
Foreign currency translation:				
Changes in foreign currency translation, net of tax of $0 in all periods	(38)	8	(26)	48
Less: Translation loss realized upon sale of foreign equity method investment, net of tax (benefit) of ($2), $0, ($2) and $0, respectively	(4)	—	(4)	—
Net foreign currency translation	(34)	8	(22)	48
Other comprehensive income, net of tax	$(27)	$23	$(12)	$56
Comprehensive income	$31	$59	$83	$147

See accompanying Notes to Condensed Consolidated Financial Statements.

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USG CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(millions, except share data)	June 30, 2018	December 31, 2017
Assets		
Cash and cash equivalents	$246	$ 394
Short-term marketable securities	58	62
Receivables (net of reserves 2018 - $10 and 2017 - $9)	342	233
Inventories	265	252
Income taxes receivable	16	15
Other current assets	36	35
Total current assets	963	991
Long-term marketable securities	38	37
Property, plant and equipment (net of accumulated depreciation and depletion - 2018 - $2,111 and 2017 - $2,053)	1,793	1,762
Deferred income taxes	264	287
Equity method investments	666	686
Goodwill and intangible assets	42	43
Other assets	47	45
Total assets	$3,813	$ 3,851
Liabilities and Stockholders’ Equity		
Accounts payable	$281	$ 280
Accrued expenses	130	135
Income taxes payable	1	—
Total current liabilities	412	415
Long-term debt	1,078	1,078
Deferred income taxes	4	4
Pension and other postretirement benefits	277	326
Other liabilities	179	183
Total liabilities	1,950	2,006
Stockholders' Equity:		
Preferred stock	—	—
Common stock	15	15
Treasury stock at cost	(219)	(169)
Additional paid-in capital	3,040	3,057
Accumulated other comprehensive loss	(401)	(389)
Retained earnings (accumulated deficit)	(572)	(669)
Total stockholders’ equity	1,863	1,845
Total liabilities and stockholders’ equity	$3,813	$ 3,851

See accompanying Notes to Condensed Consolidated Financial Statements.

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USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(millions)	Six months ended June 30, 2018	2017
Operating Activities		
Net income	$95	$91
Less: Income (loss) from discontinued operations, net of tax	1	(10)
Income from continuing operations	94	101
Adjustments to reconcile net income from continuing operations to net cash:		
Depreciation, depletion and amortization	76	65
Loss on extinguishment of debt	—	22
Share-based compensation expense	10	9
Deferred income taxes	20	48
Gain on asset dispositions	(13)	(1)
Loss on sale of equity method investment	8	—
Income from equity method investments	(21)	(27)
Dividends received from equity method investments	16	23
Pension settlement	—	7
Change in operating assets and liabilities	(176)	(117)
Other, net	4	(1)
Net cash provided by operating activities of continuing operations	18	129
Net cash provided by (used for) operating activities of discontinued operations	1	(1)
Net cash provided by operating activities	19	128
Investing Activities		
Purchases of marketable securities	(49)	(54)
Sales or maturities of marketable securities	51	53
Capital expenditures	(109)	(72)
Net proceeds from asset dispositions	14	2
Net proceeds from sale of equity method investment	3	—
Working capital adjustment from acquisition of business	2	—
Insurance proceeds	—	1
Net cash used for investing activities of continuing operations	(88)	(70)
Net cash provided by investing activities of discontinued operations	—	6
Net cash used for investing activities	(88)	(64)
Financing Activities		
Issuance of debt	—	500
Repayment of debt	—	(520)
Payment of debt issuance fees	—	(8)
Issuance of common stock	6	3
Repurchase of common stock	(76)	(97)
Repurchases of common stock to satisfy employee tax withholding obligations	(7)	(4)
Net cash used for financing activities of continuing operations	(77)	(126)
Effect of exchange rate changes on cash from continuing operations	(2)	6
Net decrease in cash and cash equivalents from continuing operations	(149)	(61)
Net increase in cash and cash equivalents from discontinued operations	1	5

Net decrease in cash and cash equivalents	(148)	(56)
Cash and cash equivalents at beginning of period	394	427
Cash and cash equivalents at end of period	$246	$371
Supplemental Cash Flow Disclosures:		
Interest paid, net of capitalized interest	$27	$48
Income taxes paid, net of refunds received	4	9
Noncash Investing and Financing Activities:		
Amount in accounts payable for capital expenditures	13	7

See accompanying Notes to Condensed Consolidated Financial Statements.

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USG CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

In the following Notes to Condensed Consolidated Financial Statements, “USG,” “we,” “our” and “us” refer to USG Corporation, a Delaware corporation, and its subsidiaries included in the condensed consolidated financial statements, except as otherwise indicated or as the context otherwise requires.

1. Organization, Consolidation and Presentation of Financial Statements

PREPARATION OF FINANCIAL STATEMENTS

We prepared the accompanying unaudited condensed consolidated financial statements of USG Corporation in accordance with applicable United States Securities and Exchange Commission, or SEC, guidelines pertaining to interim financial information. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ materially from those estimates. In the opinion of our management, the financial statements reflect all adjustments, which are of a normal recurring nature, necessary for a fair presentation of our financial results for the interim periods. The results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the results of operations to be expected for the entire year.

SEGMENTS

Our reportable segments are determined considering both qualitative and quantitative metrics for aggregation of the product type within geographies for which discrete financial information is available. We have five reportable segments: U.S. Wallboard and Surfaces, U.S. Performance Materials, U.S. Ceilings, Canada, and USG Boral Building Products, or UBBP. Our U.S. Wallboard and Surfaces, U.S. Performance Materials and U.S. Ceilings reportable segments are identified based on products manufactured and marketed. Our Canada segment is a separately reportable segment, as while it has similar qualitative factors to U.S. operations, it has different quantitative metrics and, therefore, cannot be aggregated. Our operating segments in Mexico and Latin America are included in Other as reconciling items to our consolidated segments. This segment structure was effective for the quarter ended December 31, 2017. Our prior period results have been recast to reflect these changes and present comparative year over year information by segment. See Note 4, Segments.

These condensed consolidated financial statements and notes are to be read in conjunction with the financial statements and notes included in USG’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017, which we filed with the SEC on February 14, 2018.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

We adopted Accounting Standard Update, or ASU, 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income," in the first quarter of 2018. The ASU allows for the reclassification of stranded tax effects on items resulting from the Tax Cuts and Jobs Act, or the 2017 Tax Act, from accumulated other comprehensive income, or AOCI, to retained earnings. Tax effects unrelated to the 2017 Tax Act are released from AOCI using either the specific identification approach or the portfolio approach based on the nature of the underlying item. We elected not to reclassify the income tax effects of the 2017 Tax Act.

We adopted ASU 2017-07, “Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost,” on January 1, 2018 using the practical expedient. This ASU required us to disaggregate and present current service cost along with other current compensation costs for employees while presenting other net benefit cost components below operating profit. In addition, only the service cost component of net benefit cost is eligible for capitalization in our inventory and fixed assets. We retrospectively adopted the presentation of service cost and prospectively adopted the capitalization of only service cost into inventory and fixed assets.

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The effect of the adoption of ASU 2017-07 on our condensed consolidated statements of income for the three and six months ended June 30, 2017 was as follows.

(millions)	Three months ended June 30, 2017			Six months ended June 30, 2017		
	As Restated	Adjustment for Adoption of ASU 2017-07	As Previously Reported	As Restated	Adjustment for Adoption of ASU 2017-07	As Previously Reported
Gross profit	$168	$ —	$ 168	$327	$ (5)	$ 332
Operating profit	95	(1)	96	179	(8)	187
Other income, net	(2)	1	(3)	4	8	(4)
Net income	36	—	36	91	—	91

We adopted ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," and all related amendments on January 1, 2018 using the modified retrospective method using practical expedients. Topic 606 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)" and requires entities to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Upon adoption, we recorded an increase of $2 million to our opening balance of retained earnings for the cumulative effect of adopting Topic 606. The adjustment related to a change to the point in time at which we record revenue for most customers. Prior period amounts have not been restated and continue to be reported under the legacy accounting guidance of Topic 605. As of and for the three and six months ended June 30, 2018, the impact of applying Topic 606 as compared to applying Topic 605 is immaterial to our financial statements.

In addition to our cumulative effect adjustment, our adoption of Topic 606 resulted in additional quantitative disclosure of revenue by product and in the modification of certain significant accounting policies. See Note 4, Segments, for our revenue disaggregated by product and the revised polices below.

Revenue Recognition

We recognize revenue upon transfer of control of our products to the customer which generally occurs upon shipment. We enter into agreements with customers to offer rebates, generally based on achievement of specified sales levels and various marketing allowances that are common industry practice. Reductions to revenue for customer programs and incentive offerings, including promotions and other volume-based incentives, are estimated using the most likely amount method and recorded in the period in which the sale occurs. Provisions for early payment discounts are accrued in the same period in which the sale occurs. We do not have any material payment terms as payment is received shortly after the point of sale. We pay commissions to third parties to obtain contracts. As these contracts are less than one year, these costs are expensed as incurred.

Shipping and Handling Costs

We include shipping and handling costs billed to customers in net sales. We account for related costs as fulfillment activities and present the costs in cost of products sold when control of our products transfers to the customer.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which supersedes existing lease guidance to require lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by long-term leases and to disclose additional quantitative and qualitative information about leasing arrangements. Subsequently, the FASB has issued various ASUs to provide further clarification around certain aspects of Topic 842. We will adopt the new standard on January 1, 2019 using the modified retrospective approach. As a result of the new standard, we will implement a new lease accounting system, new processes and accounting policies. Further, we anticipate the adoption of ASU 2016-02 will have a significant impact to our condensed consolidated balance sheets and disclosures. We are currently finalizing our accounting policies, implementing a new leasing system, determining changes needed in current processes for lease accounting and verifying the completeness of our lease population and, thus, we are unable to quantify the financial statement impact at this time.

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2. Acquisitions and Dispositions

Acquisition of Ceilings Plus

On November 30, 2017, we completed our acquisition of Ceilings Plus for $50 million, net of working capital adjustments. The addition of Ceilings Plus to our U.S. Ceilings segment expands our operations in the specialty ceilings markets. We finalized our valuation in the second quarter of 2018. The fair value of tangible assets acquired, less liabilities assumed, in connection with the Ceilings Plus acquisition was $15 million. The fair value of intangible assets acquired, which included customer relationships and trade names, totaled $20 million. The resulting goodwill recorded was $15 million and all is expected to be deductible for tax purposes. The goodwill resulting from this acquisition consists largely of Ceilings Plus' expected future product sales and synergies with the existing U.S. Ceilings product offerings.

Discontinued Operations

On October 31, 2016, we completed the sale of our L&W Supply, or L&W, distribution business to ABC Supply. For the three and six months ended June 30, 2017, we recorded a loss of $9 million, net of tax, for L&W to "Income (loss) from discontinued operations", which primarily reflected a pension settlement charge related to lump sum benefits paid to former employees of L&W.

Upon the close of the sale, we entered into a supply agreement with L&W, and for the three and six months ended June 30, 2018, we recorded sales of $122 million and $217 million, respectively, and cash inflows related to payments on trade receivables during those same periods of $107 million and $211 million, respectively. For the comparative periods in 2017, we recorded sales of $134 million and $265 million, respectively, and cash inflows related to payments on trade receivables of $143 million and $252 million, respectively.

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3. Equity Method Investments

Equity method investments as of June 30, 2018 and December 31, 2017, were as follows:

	June 30, 2018		December 31, 2017	
(dollars in millions)	Carrying Value	Ownership Percentage	Carrying Value	Ownership Percentage
USG Boral Building Products	$ 664	50%	$ 679	50%
Other equity method investments	2	50%	7	33% - 50%
Total equity method investments	$ 666		$ 686	

INVESTMENT IN USG BORAL BUILDING PRODUCTS

UBBP is our 50/50 joint ventures with Boral Limited, or Boral. We account for our investment in UBBP using the equity method of accounting. During the second quarter of 2018, UBBP paid cash dividends on its earnings through March 2018 of which our 50% share totaled $16 million. As of June 30, 2018, the amount of our consolidated retained earnings which represents undistributed earnings from UBBP is $66 million.

In the event certain U.S. Dollar denominated performance targets are satisfied by UBBP, we will be obligated to pay Boral an earnout payment of up to $50 million based on performance through 2019. We have not recorded a liability for this earnout payment as we have concluded that it is currently not probable that the five-year performance target will be achieved. If our conclusion on the probability of achievement changes, we will record a liability representing the present value of the earnout payment with a corresponding increase to our investment.

UBBP is operated in accordance with the terms of a Shareholders Agreement. If we are subject to a change of control as defined by the Shareholders Agreement, including the proposed acquisition of USG by Gebr. Knauf KG, a limited partnership (Kommanditgesellschaft) organized under the laws of Germany, or Knauf, we may be required to sell our entire interest in UBBP at fair market value, as determined in accordance with the Shareholders Agreement.

Our underlying net assets in our investments are denominated in a foreign currency, and translation gains or losses will impact the recorded value of our investments. Translation gains or losses recorded in other comprehensive income were as follows:

	Three months ended June 30,		Six months ended June 30,	
(millions)	2018	2017	2018	2017
Translation (loss) gain	$(24)	$(1)	$(21)	$ 23

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Summarized financial information for UBBP is as follows:

(millions)	Three months ended June 30, 2018	2017	Six months ended June 30, 2018	2017
USG Boral Building Products				
Net sales	$297	$287	$584	$563
Gross profit	83	91	162	177
Operating profit	31	40	59	75
Income from continuing operations before income taxes	35	44	67	82
Net income	25	28	45	54
Net income attributable to USG Boral Building Products	24	28	43	53
USG share of income from investment accounted for using the equity method	12	14	21	27

TRANSACTIONS WITH UBBP

Our U.S. Wallboard and Surfaces and U.S. Performance Materials segments sell products to UBBP. Total sales to UBBP for the three and six months ended June 30, 2018 and 2017 were immaterial.

In 2014, in connection with the formation of UBBP, we contributed our ownership interest in a joint venture in China to UBBP, but retained our loan receivable from this joint venture. As of June 30, 2018 and December 31, 2017, the loan receivable, including interest, totaled $13 million and is included in "Other assets" on our accompanying condensed consolidated balance sheets.

INVESTMENT IN SOUTH AFRICA JOINT VENTURE

During the second quarter of 2018, we completed the sale of our 33% interest in a joint venture in South Africa for approximately $3 million. We recorded a loss of $8 million, or $5 million net of tax, on the sale in "Other (expense) income, net" on our accompanying condensed consolidated income statements. The loss was driven primarily by foreign currency losses included in equity that were recognized upon the disposition of the joint venture and was recorded within Other as it does not relate to a reportable segment.

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4. Segments

During the fourth quarter of 2017, as part of the realignment of our operating structure, we changed the composition of our reportable segments, effective for the quarter ended December 31, 2017. See Note 1, Organization, Consolidation and Presentation of Financial Statements, for additional information regarding our five reportable segments. See Note 3, Equity Method Investments, for segment results for UBBP. Segment results for our U.S. Wallboard and Surfaces, U.S. Performance Materials, U.S. Ceilings and Canada segments were as follows:

	Three months ended June 30,		Six months ended June 30,	
(millions)	2018	2017	2018	2017
Net Sales:				
U.S. Wallboard and Surfaces	$512	$482	$953	$951
U.S. Performance Materials	105	100	197	186
U.S. Ceilings	139	118	277	230
Canada	121	104	232	200
Other	65	59	125	115
Eliminations	(62)	(52)	(118)	(104)
Total	$880	$811	$1,666	$1,578
Operating Profit (Loss):				
U.S. Wallboard and Surfaces	$81	$78	$130	$157
U.S. Performance Materials	(6)	8	(5)	14
U.S. Ceilings	23	23	42	43
Canada	8	2	10	4
Other	4	1	8	2
Corporate	(35)	(17)	(64)	(41)
Total	$75	$95	$121	$179

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Net sales disaggregated by product type were as follows:

(millions)	Three months ended June 30, 2018 U.S. Wallboard and Surfaces	U.S. Performance Materials	U.S. Ceilings	Canada	Other	Total
Wallboard	$270	$ —	$ —	$ 68	$ 19	$357
Surfaces and industrial products	151	—	—	23	7	181
Underlayment	—	70	—	3	11	84
Building envelope and structural	—	23	—	1	1	25
Ceiling tile and grid	—	—	121	12	8	141
Specialty ceilings	—	—	17	2	—	19
Other products	26	—	—	5	17	48
Total product sales	447	93	138	114	63	855
Other miscellaneous sales [a]	65	12	1	7	2	87
Total sales before eliminations	512	105	139	121	65	942
Eliminations	(30)	(7)	(15)	(10)	—	(62)
Total net sales	$482	$ 98	$ 124	$ 111	$ 65	$880