

Edgar Filing: USG CORP - Form 10-Q

USG CORP
Form 10-Q
October 26, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2007

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
(State or other jurisdiction of
incorporation or organization)

36-3329400
(I.R.S. Employer
Identification No.)

550 West Adams Street, Chicago, Illinois
(Address of principal executive offices)

60661-3676
(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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan

Edgar Filing: USG CORP - Form 10-Q

confirmed by a court. Yes [] No [] Not applicable. Although the registrant was involved in bankruptcy proceedings during the preceding five years, it did not distribute securities under its confirmed plan of reorganization.

The number of shares of the registrant's common stock outstanding as of September 30, 2007 was 99,042,373.

TABLE OF CONTENTS

	Page

PART I FINANCIAL INFORMATION	
Item 1. Financial Statements:	
Condensed Consolidated Statements of Earnings: Three Months and Nine Months Ended September 30, 2007 and 2006	3
Condensed Consolidated Balance Sheets: As of September 30, 2007 and December 31, 2006	4
Condensed Consolidated Statements of Cash Flows: Nine Months Ended September 30, 2007 and 2006	5
Notes to Condensed Consolidated Financial Statements	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	24
Item 4. Controls and Procedures	40
Report of Independent Registered Public Accounting Firm	41
PART II OTHER INFORMATION	
Item 1. Legal Proceedings	42
Item 2. Unregistered Sales Of Equity Securities And Use Of Proceeds	42
Item 6. Exhibits	42
Signatures	43

-2-

PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(DOLLARS IN MILLIONS EXCEPT PER-SHARE DATA)
(UNAUDITED)

Edgar Filing: USG CORP - Form 10-Q

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2007	2006	2007	2006
Net sales	\$ 1,335	\$ 1,478	\$ 4,002	\$ 4,516
Cost of products sold	1,217	1,132	3,470	3,413
Gross profit	118	346	532	1,103
Selling and administrative expenses	90	103	306	305
Provision for restructuring	3	--	18	--
Reversal of asbestos claims reserve	--	(17)	--	(44)
Chapter 11 reorganization expenses	--	2	--	10
Operating profit	25	258	208	832
Interest expense	22	16	85	539
Interest income	(5)	(16)	(18)	(23)
Other income, net	(2)	(2)	(4)	(2)
Earnings before income taxes	10	260	145	318
Income taxes	3	107	41	130
Net earnings	\$ 7	\$ 153	\$ 104	\$ 188
Earnings per Common Share:				
Basic	\$ 0.07	\$ 1.71	\$ 1.07	\$ 3.03
Diluted	0.07	1.71	1.07	3.03
Average common shares	98,998,334	89,849,117	96,435,985	62,120,058
Average diluted common shares	99,214,635	89,907,436	96,721,553	62,227,119

See accompanying Notes to Condensed Consolidated Financial Statements.

-3-

USG CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(DOLLARS IN MILLIONS)
(UNAUDITED)

	AS OF SEPTEMBER 30, 2007	AS OF DECEMBER 31, 2006
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 353	\$ 565
Restricted cash	--	6
Receivables (net of reserves - \$18 and \$16)	546	448
Inventories	379	348
Income taxes receivable	36	1,102
Deferred income taxes	42	169

Edgar Filing: USG CORP - Form 10-Q

Other current assets	78	69
	-----	-----
Total current assets	1,434	2,707
Property, plant and equipment (net of accumulated depreciation and depletion - \$1,209 and \$1,108)	2,477	2,210
Deferred income taxes	270	187
Goodwill	228	154
Other assets	262	107
	-----	-----
Total Assets	\$ 4,671	\$ 5,365
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 348	\$ 303
Accrued expenses	258	358
Income taxes payable	5	38
Short-term debt	--	1,065
	-----	-----
Total current liabilities	611	1,764
Long-term debt	1,238	1,439
Deferred income taxes	10	11
Other liabilities	684	617
Commitments and contingencies		
Stockholders' Equity:		
Preferred stock	--	--
Common stock	10	9
Treasury stock	(204)	(208)
Capital received in excess of par value	2,605	2,176
Accumulated other comprehensive (loss)	(78)	(136)
Retained earnings (deficit)	(205)	(307)
	-----	-----
Total stockholders' equity	2,128	1,534
	-----	-----
Total Liabilities and Stockholders' Equity	\$ 4,671	\$ 5,365
	=====	=====

See accompanying Notes to Condensed Consolidated Financial Statements.

-4-

USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN MILLIONS)
(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2007	2006
	-----	-----
OPERATING ACTIVITIES:		
Net earnings	\$ 104	\$ 188
Adjustments to reconcile net earnings to net cash:		
Reversal of asbestos claims reserve	--	(44)
Depreciation, depletion and amortization	133	101

Edgar Filing: USG CORP - Form 10-Q

Share-based compensation expense	18	7
Deferred income taxes	26	358
(Increase) decrease in working capital (net of acquisitions):		
Receivables	(24)	(117)
Income taxes receivable	1,065	(264)
Inventories	5	(32)
Payables	(2)	53
Accrued expenses	(41)	11
Increase in other assets	(43)	(33)
Increase in other liabilities	28	29
Payment to Section 524(g) asbestos trust	--	(890)
Reorganization distribution - other	(40)	(656)
Liabilities subject to compromise	--	521
Other, net	19	3
	-----	-----
Net cash provided by (used for) operating activities	1,248	(765)
	-----	-----
INVESTING ACTIVITIES:		
Capital expenditures	(341)	(237)
Acquisitions of businesses, net of cash acquired	(280)	(74)
Return of restricted cash	6	73
Net proceeds from asset dispositions	1	1
Purchases of marketable securities	--	(112)
Sales or maturities of marketable securities	--	677
	-----	-----
Net cash (used for) provided by investing activities	(614)	328
	-----	-----
FINANCING ACTIVITIES:		
Repayment of debt	(1,765)	--
Issuance of debt, net of discount	499	--
Proceeds from equity offering, net of fees	422	--
Payment of debt issuance fees	(3)	(22)
Tax benefit of share-based payments	(6)	6
Issuances of common stock upon exercise of stock options	--	13
Proceeds from rights offering, net of fees	--	1,720
Reorganization distribution - debt principal	--	(766)
	-----	-----
Net cash (used for) provided by financing activities	(853)	951
	-----	-----
Effect of exchange rate changes on cash	7	3
Net (decrease) increase in cash and cash equivalents	(212)	517
Cash and cash equivalents at beginning of period	565	936
	-----	-----
Cash and cash equivalents at end of period	\$ 353	\$1,453
	=====	=====
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Interest paid	\$ 70	\$ 541
Income taxes (refunded) paid, net	(1,046)	41

See accompanying Notes to Condensed Consolidated Financial Statements.

Edgar Filing: USG CORP - Form 10-Q

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 consolidated financial statements, except as otherwise indicated or as the context otherwise requires.

1. 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 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 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. These 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, 2006, which we filed with the Securities and Exchange Commission on February 16, 2007.

2. ACQUISITIONS

We record acquisitions using the purchase method of accounting and, accordingly, include the results of operations of the businesses acquired in our consolidated results as of the date of acquisition. We allocate the purchase price of acquisitions to the tangible assets, liabilities and intangible assets acquired based on fair values. The excess purchase price over those fair values is recorded as goodwill. The fair value assigned to assets acquired is based on valuations using management's estimates and assumptions. Pro forma combined results of operations for the 2007 and 2006 periods would not be materially different as a result of the acquisitions described below and therefore are not presented.

2007 ACQUISITIONS

California Wholesale Material Supply, Inc.: On March 30, 2007, L&W Supply Corporation, or L&W Supply, which makes up the Building Products Distribution operating segment, purchased the outstanding stock of California Wholesale Material Supply, Inc. and related entities (referred to collectively as CALPLY) for approximately \$267 million. This amount includes debt repaid at closing and acquisition-related expenses and is net of CALPLY's cash at closing. Subsequent to March 30, 2007, we paid approximately \$1 million of additional acquisition-related expenses. CALPLY sells building products and

-6-

provides services to acoustical contractors, drywall contractors, plaster contractors, roofing companies, manufactured housing companies, countertop fabricators, government institutions and exporters from its 30 locations in seven Western states and Mexico. This acquisition was part of L&W Supply's strategy to profitably grow its specialty dealer business.

During the third quarter of 2007, we allocated the purchase price of CALPLY to

Edgar Filing: USG CORP - Form 10-Q

its tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date using information available at that time. As a result, we may continue to adjust the purchase price allocation after obtaining more information regarding, among other things, asset valuations, liabilities assumed and revisions of preliminary estimates. The excess of the purchase price over the aggregate estimated fair values was recorded as goodwill, which is amortizable for tax purposes. The allocation of the purchase price for CALPLY is summarized below and reflects estimated fair values that are preliminary and subject to adjustment.

(millions)

Cash	\$ 4
Accounts receivable	74
Inventories	37
Property, plant and equipment	6
Goodwill	84
Intangible assets	115
Other assets acquired	4

Total assets acquired	\$324

Total liabilities assumed	\$ 52

Total net assets acquired	\$272

The amount shown for intangible assets consists principally of \$58 million related to customer relationships, which is amortizable over ten years, and \$56 million related to trade names, which have an indefinite life.

Grupo Supremo: On March 28, 2007, USG Mexico, S.A. de C.V., or USG Mexico, an indirect, wholly owned subsidiary of USG Corporation, purchased the assets of Grupo Supremo, located in the central north region of Mexico, whose businesses include extracting gypsum rock from several mines and manufacturing plaster products. The total purchase price was approximately \$12 million including acquisition-related expenses. Of this amount, \$6 million was allocated to intangible assets subject to amortization over periods of ten to 20 years.

2006 ACQUISITIONS

During the third quarter of 2007, we adjusted the allocation of the purchase price for certain acquisitions made in 2006, resulting in a reclassification of \$17 million from goodwill to intangible assets. This amount consisted of \$12 million related to customer relationships, which is amortizable over ten years, and \$5 million related to trade names, which have an indefinite life.

-7-

3. GOODWILL AND OTHER INTANGIBLE ASSETS

The change in the net carrying amount of goodwill by operating segment was as follows:

Edgar Filing: USG CORP - Form 10-Q

(millions)	North American Gypsum	Building Products Distribution	Worldwide Ceilings	Total
-----	-----	-----	-----	-----
Balance as of January 1, 2007	\$--	\$ 154	\$--	\$ 154
Acquisitions	6	197	--	203
Purchase accounting adjustments	--	8	--	8
Reclassification between segments	--	(12)	12	--
Reclassification to other intangible assets	(5)	(132)	--	(137)
	---	-----	---	-----
Balance as of September 30, 2007	\$ 1	\$ 215	\$12	\$ 228
	===	=====	===	=====

Goodwill increased \$74 million in the first nine months of 2007 primarily as a result of the first quarter acquisitions of CALPLY by L&W Supply and the assets of Grupo Supremo by USG Mexico. See Note 2 above for information related to these acquisitions.

Other intangible assets, which are included in other assets on the condensed consolidated balance sheets, are summarized as follows:

(millions)	As of September 30, 2007			As of December 31, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
-----	-----	-----	-----	-----	-----	-----
INTANGIBLE ASSETS WITH FINITE LIVES:						
Customer relationships	\$ 70	\$ 4	\$ 66	\$ 1	\$ 1	\$--
Other	10	2	8	--	--	--
	----	----	----	----	----	----
Subtotal	80	6	74	1	1	--
	----	----	----	----	----	----
INTANGIBLE ASSETS WITH INDEFINITE LIVES:						
Trade names	69	--	69	8	--	8
Other	8	--	8	--	--	--
	----	----	----	----	----	----
Subtotal	77	--	77	8	--	8
	----	----	----	----	----	----
Total	\$157	\$ 6	\$151	\$ 9	\$ 1	\$ 8
	=====	====	=====	====	====	=====

Total amortization expense for other intangible assets was \$4 million for the third quarter of 2007 and \$5 million for the first nine months of 2007. The amounts for the 2006 periods were immaterial. Estimated annual amortization expense for other intangible assets is \$7 million for 2007, \$8 million for each of the years 2008 through 2011 and \$7 million for 2012.

Edgar Filing: USG CORP - Form 10-Q

4. PROVISION FOR RESTRUCTURING

In the second quarter of 2007, we recorded provisions totaling \$15 million pretax (\$9 million after-tax) for restructuring activities that included a salaried workforce reduction program and the shutdown of a framing products manufacturing plant. We implemented these actions in response to current market conditions. In the third quarter of 2007, we recorded an additional provision of \$3 million pretax (\$2 million after-tax) related to the salaried workforce reduction program. Through the first nine months of 2007, the total provision for restructuring was \$17.5 million pretax (\$11 million after-tax).

The number of employees terminated and open positions eliminated under the salaried workforce reduction program as of September 30, 2007 was approximately 470. Included in the provision for restructuring for the first nine months of 2007 is a charge of \$14 million pretax (\$9 million after-tax) for severance and related costs for the employees terminated as of September 30, 2007. We expect to record approximately \$600 thousand of additional charges during the fourth quarter of 2007 for severance and related costs for several additional employees whose employment will be terminated as part of the program, but who are continuing to provide services after September 30th. Most of the payments associated with this program are being made in 2007.

In June 2007, we shut down our plant in Tuscaloosa, Alabama that manufactured framing products. Included in the provision for restructuring for the first nine months of 2007 is a charge of \$4 million pretax (\$2 million after-tax) related to this shutdown. This charge primarily reflects a writedown of property, plant and equipment and lease-termination costs.

A restructuring reserve of \$4 million is included in accrued expenses on the condensed consolidated balance sheet as of September 30, 2007. This reserve is summarized as follows:

(millions)	Provisions	Writedown of Assets to Net Realizable Value	Cash Payments	Total
-----	-----	-----	-----	-----
Salaried workforce reduction	\$14	\$--	\$(11)	\$3
Shutdown of Tuscaloosa plant	4	(3)	--	1
	---	---	---	--
Balance as of September 30, 2007	\$18	\$(3)	\$(11)	\$4
	===	===	====	==

Including the approximately \$600 thousand of additional charges related to the salaried workforce reduction program that we expect to record during the fourth quarter of 2007, our estimate of total restructuring expenses for 2007 is approximately \$18 million. On an operating segment basis, approximately \$14 million of this amount relates to North American Gypsum, approximately \$2 million relates to Worldwide Ceilings and approximately \$1 million relates to each of Building Products Distribution and Corporate.

-9-

5. OPERATING SEGMENTS

Our operations are organized into three operating segments: (i) North American

Edgar Filing: USG CORP - Form 10-Q

Gypsum, which manufactures SHEETROCK(R) brand gypsum wallboard and joint compound, DUROCK(R) brand cement board, FIBEROCK(R) brand gypsum fiber panels and other related building products in the United States, Canada and Mexico; (ii) Building Products Distribution, which distributes gypsum wallboard, drywall metal, ceiling products, joint compound and other building products in the United States and Mexico and (iii) Worldwide Ceilings, which manufactures ceiling tile in the United States and ceiling grid in the United States, Canada, Europe and the Asia-Pacific region. Operating segment results were as follows:

	Three Months ended September 30,		Nine Months ended September 30,	
(millions)	2007	2006	2007	2006
NET SALES:				
North American Gypsum	\$ 698	\$ 909	\$2,209	\$2,817
Building Products Distribution	614	642	1,772	1,926
Worldwide Ceilings	207	191	614	576
Eliminations	(184)	(264)	(593)	(803)
	\$1,335	\$1,478	\$4,002	\$4,516
	=====	=====	=====	=====
OPERATING PROFIT:				
North American Gypsum	\$ (2)	\$ 219	\$ 133	\$ 697
Building Products Distribution	22	53	93	164
Worldwide Ceilings	23	18	54	64
Corporate	(18)	(29)	(79)	(81)
Eliminations	--	(1)	7	(2)
Chapter 11 reorganization expenses	--	(2)	--	(10)
	\$ 25	\$ 258	\$ 208	\$ 832
	=====	=====	=====	=====

Operating profit for the 2007 periods includes provisions for restructuring of \$3 million pretax for the third quarter and \$17.5 million pretax for the first nine months. On an operating segment basis, \$14 million of the nine-months charge relates to North American Gypsum, \$1.5 million relates to Worldwide Ceilings and \$1 million relates to each of Building Products Distribution and Corporate. See Note 4 above for additional information related to the restructuring program and the estimated full-year provision by operating segment.

Operating profit for the 2006 periods for North American Gypsum includes reversals of an asbestos claims reserve. These reversals increased operating profit by \$17 million during the third quarter of 2006 and \$44 million during the first nine months of 2006.

-10-

6. EARNINGS PER SHARE

Basic earnings per share are based on the weighted average number of common shares outstanding. Diluted earnings per share are based on the weighted average number of common shares outstanding and the dilutive effect of restricted stock

Edgar Filing: USG CORP - Form 10-Q

units, or RSUs, performance shares and outstanding stock options. Average common shares and average diluted common shares outstanding for the third quarter and first nine months of 2006 reflect the effect of a rights offering we completed in the third quarter of 2006. The reconciliation of basic earnings per share to diluted earnings per share is shown in the following table (dollars in millions, except share data):

	Net Earnings	Shares (000)	Weighted Average Per-Share Amount
	-----	-----	-----
THREE MONTHS ENDED SEPTEMBER 30, 2007:			
Basic earnings	\$ 7	98,998	\$0.07
Dilutive effect of stock options		217	
	----	-----	-----
Diluted earnings	\$ 7	99,215	\$0.07
	=====	=====	=====
2006:			
Basic earnings	\$153	89,849	\$1.71
Dilutive effect of stock options		58	
	----	-----	-----
Diluted earnings	\$153	89,907	\$1.71
	=====	=====	=====
NINE MONTHS ENDED SEPTEMBER 30, 2007:			
Basic earnings	\$104	96,436	\$1.07
Dilutive effect of stock options		286	
	----	-----	-----
Diluted earnings	\$104	96,722	\$1.07
	=====	=====	=====
2006:			
Basic earnings	\$188	62,120	\$3.03
Dilutive effect of stock options		107	
	----	-----	-----
Diluted earnings	\$188	62,227	\$3.03
	=====	=====	=====

Options, RSUs and performance shares with respect to 1.6 million common shares were not included in the computation of diluted earnings per share for the third quarter and first nine months of 2007 because they were anti-dilutive. Options and RSUs with respect to 1.5 million common shares were not included in the computation of diluted earnings per share for the third quarter and first nine months of 2006 because they were anti-dilutive.

-11-

7. DEBT

Total debt consisted of the following:

As of

As of

Edgar Filing: USG CORP - Form 10-Q

(millions)	September 30, 2007	December 31, 2006
-----	-----	-----
7.75% senior notes	\$ 499	\$ --
6.3% senior notes	500	500
Industrial revenue bonds	239	239
Term loan	--	700
Tax bridge term loan	--	1,065
	-----	-----
Total	\$1,238	\$2,504
	=====	=====

7.75% SENIOR NOTES DUE 2018

In the third quarter of 2007, we sold \$500 million of 7.75% senior unsecured notes maturing in January 2018 in an underwritten public offering. We recorded the notes on the condensed consolidated balance sheet at \$499 million, which is net of debt discount of \$1 million. In addition, we recorded \$4 million of deferred financing fees related to the issuance of the notes. The interest rate payable on the notes is subject to adjustment from time to time by up to 2% in the aggregate if the debt ratings assigned to the notes decrease or thereafter increase. The notes are senior unsecured obligations and rank equally with all of our other existing and future unsecured senior indebtedness. The indenture governing the notes contains certain restrictions, including a limitation that restricts our ability and the ability of certain of our subsidiaries to create or incur secured indebtedness. We used the net proceeds from the sale of the notes, together with cash on hand, to repay the \$500 million balance outstanding under our term loan facility described below plus accrued interest on that balance.

6.3% SENIOR NOTES DUE 2016

In the second quarter of 2007, we completed the exchange of registered 6.3% senior unsecured notes maturing in November 2016 for the \$500 million of privately placed 6.3% senior unsecured notes, also due in 2016, that we issued in November 2006.

CREDIT FACILITIES

In the third quarter of 2006, we entered into a credit agreement with a syndicate of banks. JPMorgan Chase Bank, N.A. serves as administrative agent under the agreement. The credit agreement currently consists only of a \$650 million unsecured revolving credit facility with a \$250 million sublimit for letters of credit. This facility is available to fund working capital needs and for other general corporate purposes. As of September 30, 2007, we had not drawn upon the revolving credit facility except for approximately \$78 million of outstanding letters of credit.

The credit agreement originally included a \$1 billion term loan facility and a \$1.15 billion tax bridge term loan facility, both of which have been terminated. The term loan facility was available to us in a single drawing of up to \$1 billion, and the tax bridge facility was available to us in a single drawing of

up to \$1.15 billion, in each case to be made on or before January 31, 2007. In December 2006, we borrowed \$700 million under the term loan facility and \$1.065

Edgar Filing: USG CORP - Form 10-Q

billion under the tax bridge facility. These borrowings, along with the net proceeds from the 6.3% senior note offering described above and cash on hand, were used to fund a \$3.05 billion payment in December 2006 to the asbestos trust created in connection with our plan of reorganization (see Notes 16 and 17 below).

In the first quarter of 2007, we received a \$1.057 billion federal tax refund as a result of tax deductions generated by the payments made to the asbestos trust. This refund, along with cash on hand, was used in March 2007 to repay the outstanding borrowing of \$1.065 billion under the tax bridge facility. We also repaid \$200 million of the outstanding borrowing under the term loan facility in March. As a result of these repayments, we recorded a charge to interest expense in the first quarter of 2007 of \$10 million pretax (\$6 million after-tax) to write off deferred financing fees associated with these borrowings.

In the third quarter of 2007, the credit agreement was amended and restated to:

- eliminate the requirement that our material domestic subsidiaries guarantee our obligations under the credit agreement,
- extend the maturity of the facility by one year to August 2, 2012,
- reduce the margin on borrowings and the facility fee on the revolving credit facility (which are based on the credit facilities' credit rating),
- reduce the maximum leverage ratio (as defined in the credit agreement) covenant from 4.50-to-1.00 to 4.25-to-1.00 after December 31, 2008, and
- allow for an increase in the amount of the revolving credit facility to \$1 billion, subject to the availability of additional commitments.

As mentioned above, in the third quarter of 2007, we repaid the remaining \$500 million outstanding under the term loan using the net proceeds from the sale of the 7.75% senior unsecured notes and cash on hand. As a result of this repayment, we recorded a charge to interest expense in the third quarter of 2007 of \$4 million pretax (\$3 million after-tax) to write off deferred financing fees associated with this borrowing.

The credit agreement requires that we meet and maintain certain financial ratios and tests and contains events of default and covenants that are customary for similar transactions and may limit our ability to take various actions. As of September 30, 2007, we were in compliance with all financial ratios, tests and covenants.

-13-

8. INVENTORIES

Total inventories consisted of the following:

(millions)	As of September 30, 2007	As of December 31, 2006
-----	-----	-----
Finished goods and work in progress	\$297	\$254
Raw materials	82	94

Edgar Filing: USG CORP - Form 10-Q

Total	----- \$379 =====	----- \$348 =====
-------	-------------------------	-------------------------

9. ASSET RETIREMENT OBLIGATIONS

Changes in the liability for asset retirement obligations consisted of the following:

(millions)	Nine Months ended September 30,	
	2007	2006
-----	-----	-----
Balance as of January 1	\$78	\$71
Accretion expense	4	3
Liabilities incurred	1	3
Foreign currency translation	2	1
	---	---
Balance as of September 30	\$85	\$78
	===	===

10. PUBLIC EQUITY OFFERING

In March 2007, we completed a public offering of 9,063,373 shares of our common stock at a price of \$48.60 per share. The net proceeds of the offering, after deducting underwriting discounts and commissions and offering expenses, were approximately \$422 million. We used the net proceeds of the equity offering to pay for the CALPLY acquisition and for general corporate purposes.

-14-

11. DERIVATIVE INSTRUMENTS

We use derivative instruments to manage selected commodity price and foreign currency exposures. We do not use derivative instruments for speculative trading purposes. All derivative instruments must be recorded on the balance sheet at fair value. For derivatives designated as fair value hedges, the changes in the fair values of both the derivative instrument and the hedged item are recognized in earnings in the current period. For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is recorded to accumulated other comprehensive income, or AOCI, and is reclassified to earnings when the underlying transaction has an impact on earnings. The ineffective portion of changes in the fair value of the derivative is reported in cost of products sold. For derivatives designated as net investment hedges, we record changes in value to AOCI. For derivatives not classified as fair value, cash flow or net investment hedges, all changes in market value are recorded to earnings.

COMMODITY DERIVATIVE INSTRUMENTS

Currently, we are using swap contracts to hedge a portion of our anticipated purchases of natural gas to be used in our manufacturing operations. We review our positions regularly and make adjustments as market conditions warrant. The

Edgar Filing: USG CORP - Form 10-Q

current contracts, all of which mature by December 31, 2009, are designated as cash flow hedges. As of September 30, 2007, we had swap contracts to exchange monthly payments on notional amounts of natural gas amounting to \$153 million. As of September 30, 2007, the fair value of these swap contracts, which remained in AOCI, was a \$15 million unrealized loss.

FOREIGN CURRENCY DERIVATIVE INSTRUMENTS

We have cross-currency swaps and foreign exchange forward agreements in place to hedge changes in the value of intercompany loans to certain foreign subsidiaries due to changes in foreign exchange rates. The notional amount of these hedges is \$63 million, and all contracts mature by March 31, 2009. As of September 30, 2007, the fair value of these hedges was a \$1 million pretax loss that was recorded to earnings. We also have foreign currency forward agreements to hedge a portion of our net investment in certain foreign subsidiaries. The notional amount of these hedges is \$48 million, and all contracts mature by June 8, 2012. As of September 30, 2007, the fair value of these hedges, which was a loss of \$2 million, was recorded to AOCI.

COUNTERPARTY RISK

We are exposed to credit losses in the event of nonperformance by the counterparties on our financial instruments. All counterparties have investment grade credit ratings; accordingly, we anticipate that these counterparties will be able to fully satisfy their obligations under the contracts. We receive collateral from our counterparties based on the provisions in certain credit support agreements. Similarly, we may be required to post collateral under certain conditions. Currently, we have no collateral requirement. We enter into master agreements which contain netting arrangements that minimize counterparty credit exposure.

-15-

12. COMPREHENSIVE INCOME

The components of comprehensive income are summarized in the following table:

(millions) -----	Three Months ended September 30,		Nine Months ended September 30,	
	2007	2006	2007	2006
Net earnings	\$ 7	\$153	\$104	\$ 188
Pretax gain (loss) on derivatives	--	(31)	24	(149)
Income tax benefit (expense)	--	12	(10)	58
After-tax gain (loss) on derivatives	--	(19)	14	(91)
Loss on unrecognized pension and postretirement benefit costs, net of tax*	--	--	(3)	--
Foreign currency translation	20	3	47	9
Unrealized gain on marketable securities, net of tax	--	--	--	1

Edgar Filing: USG CORP - Form 10-Q

Total comprehensive income	\$27	\$137	\$162	\$ 107
	===	=====	=====	=====

* Includes the impact of the actual results of the 2007 actuarial valuations for the pension and postretirement benefit plans.

There was no tax impact on the foreign currency translation adjustments.

AOCI consisted of the following:

(millions)	As of September 30, 2007	As of December 31, 2006
-----	-----	-----
Loss on derivatives, net of tax	\$ (12)	\$ (26)
Unrecognized pension and postretirement benefit costs, net of tax	(137)	(134)
Foreign currency translation	71	24
	-----	-----
Total	\$ (78)	\$ (136)
	=====	=====

Reclassifications of net after-tax gains or losses from AOCI to earnings during the third quarter of 2007 were as follows:

(millions)	

Loss on derivatives, net of tax of \$5 million	\$ (9)
Loss on unrecognized pension and postretirement benefit costs, net of tax of \$1 million	(2)

Total	\$ (11)
	=====

As of September 30, 2007, we estimate the net after-tax gains or losses that we will reclassify from AOCI to earnings within the next 12 months to be a \$9 million loss on derivatives and a \$5 million loss on unrecognized pension and postretirement benefit costs.

-16-

13. EMPLOYEE RETIREMENT PLANS

The components of net pension and postretirement benefits costs are summarized in the following table:

Three Months ended September 30,	Nine Months ended September 30,
-------------------------------------	------------------------------------

Edgar Filing: USG CORP - Form 10-Q

(millions)	2007	2006	2007	2006
PENSION:				
Service cost of benefits earned	\$ 10	\$ 10	\$ 30	\$ 29
Interest cost on projected benefit obligation	17	15	50	46
Expected return on plan assets	(18)	(15)	(54)	(47)
Net amortization	3	4	8	14
	----	----	----	----
Net cost	\$ 12	\$ 14	\$ 34	\$ 42
	=====	=====	=====	=====
POSTRETIREMENT:				
Service cost of benefits earned	\$ 3	\$ 3	\$ 11	\$ 11
Interest cost on projected benefit obligation	6	5	18	16
Recognized loss	--	--	(2)	(2)
	----	----	----	----
Net cost	\$ 9	\$ 8	\$ 27	\$ 25
	=====	=====	=====	=====

In accordance with our funding policy, we currently plan to contribute approximately \$68 million of cash to our pension plans in 2007.

14. SHARE-BASED COMPENSATION

We recognize compensation expense on all share-based grants over the service period, which is the shorter of the period until the employees' retirement eligibility date or the service period of the award.

STOCK OPTIONS

We granted options to purchase 551,895 shares of common stock under our Long-Term Incentive Plan, or LTIP, during the first quarter of 2007 with an exercise price of \$49.61 per share, which was the closing price of a share of USG common stock on the date of grant. The options generally become exercisable in four equal annual installments beginning one year from the date of grant, or earlier in the event of death, disability, retirement or a change in control. The options generally expire 10 years from the date of grant, or earlier in the event of death, disability or retirement. Expense is recognized, net of estimated forfeitures, over the vesting period of the options.

We estimated the fair value of each stock option granted under the LTIP to be \$21.73 on the date of grant using a Black-Scholes option valuation model that uses the assumptions noted below. We based expected volatility on a 50% weighting of peer volatilities and 50% weighting of implied volatility of our common stock. We did not consider historical volatility of our common stock

-17-

price to be an appropriate measure of future volatility because of the impact of our Chapter 11 proceedings on our historical stock price. The risk-free rate was based on zero coupon U.S. government issues at the time of grant. The expected term was developed using the simplified method, as permitted by the SEC's Staff Accounting Bulletin No. 107.

The assumptions used in the valuation were as follows: expected volatility 35.5%, risk-free rate 4.55%, expected term (in years) 6.25, expected annual forfeitures 2.5% and expected dividends 0.

Edgar Filing: USG CORP - Form 10-Q

RESTRICTED STOCK UNITS

We granted RSUs under the LTIP with respect to 140,755 shares of common stock during the first quarter of 2007 and 2,000 shares of common stock during the second quarter of 2007. The RSUs generally vest in four equal annual installments beginning one year from the date of grant, except that 64,000 of the RSUs were granted as special retention awards that generally will vest 100% after either four or five years. Generally, all RSUs may vest earlier in the case of death, disability, retirement or a change in control. Each RSU is settled in a share of our stock after the vesting period. The fair value of each RSU granted is equal to the closing market price of our common stock on the date of grant. Expense is generally recognized, net of estimated forfeitures, using the straight-line method over the vesting period of the award.

PERFORMANCE SHARES

We granted 87,160 performance shares under the LTIP during the first quarter of 2007. The performance shares generally vest after a three-year period based on our total stockholder return relative to the performance of the Dow Jones U.S. Construction and Materials Index, with adjustments in certain circumstances, for the three-year period. Vesting will be pro-rated based on the number of full months employed during the performance period in the case of death, disability, retirement or a change-in-control, and pro-rated awards earned will be paid out at the end of the three-year period. The number of performance shares earned will vary from 0 to 200% of the number of performance shares awarded depending on that relative performance. Each performance share earned will be settled in a share of our common stock. Expense is recognized, net of estimated forfeitures, over the vesting period of the performance shares.

We estimated the fair value of each performance share granted under the LTIP to be \$45.17 on the date of grant using a Monte Carlo simulation that uses the assumptions noted below. Expected volatility is based on implied volatility of our common stock. The risk-free rate was based on zero coupon U.S. government issues at the time of grant. The expected term represents the period from the grant date to the end of the performance period.

The assumptions used in the valuation were as follows: expected volatility 30.7%, risk-free rate 4.55%, expected term (in years) 2.78, expected annual forfeitures 2.5% and expected dividends 0.

-18-

15. INCOME TAXES

Income tax expense was \$41 million in the first nine months of 2007, including a \$6.6 million favorable tax adjustment in the first quarter and a \$6.7 million unfavorable tax adjustment in the third quarter resulting from corrections to deferred tax balances from prior years. The net effect of these adjustments for the first nine months of 2007 is immaterial.

In the first quarter of 2007, we received a \$1.057 billion federal tax refund as a result of tax deductions generated by the payments made to the asbestos trust in 2006 and the carryback of the resulting federal net operating loss to the 10 preceding taxable years. Additionally, in the first quarter of 2007, we received a \$14 million federal tax refund resulting from the overpayment of our 2005 federal income taxes. These refunds reduced the \$1.102 billion of income taxes receivable reported on our consolidated balance sheet as of December 31, 2006.

Edgar Filing: USG CORP - Form 10-Q

We have net operating loss and tax credit carryforwards in varying amounts in the U.S. and numerous U.S. state and foreign jurisdictions. As a result of the federal income tax deduction for amounts paid to the asbestos trust in 2006, we incurred a federal and state net operating loss, or NOL, in 2006. While most of the federal NOL was carried back and offset against the federal taxable income we reported in the 10 preceding taxable years, \$447 million of the NOL will be carried forward and offset against federal taxable income arising in 2007 and later years. In addition, the carryback of the 2006 federal NOL resulted in the carryforward of \$81 million of federal tax credits (primarily alternative minimum tax and foreign tax credits) that can be offset against federal income tax in future years. The federal NOL can be carried forward for 20 years; the alternative minimum tax credits can be carried forward indefinitely; and the foreign tax credits can be carried forward for 10 years from the date of origin. At the state level, most of the 2006 state NOL will be carried forward since most states do not allow the carryback of a NOL in any significant amount. The 2006 state NOL, as well as other NOL and tax credit carryforwards arising in prior years in various state and foreign jurisdictions, will expire over periods ranging from five to 20 years from the date of origin.

We have a valuation allowance for deferred tax assets relating to certain U.S. federal and state and foreign net operating loss and tax credit carryforwards due to uncertainty regarding their ultimate realization. During the third quarter of 2007, we decreased our valuation allowance for deferred tax assets by a total of \$2 million due to a change in our judgment about the realizability of the deferred tax assets relating to certain foreign and U.S. state net operating loss and tax credit carryforwards in future years. Of the total valuation allowance as of September 30, 2007, \$66 million relates to U.S. state net operating loss and tax credit carryforwards, \$11 million relates to foreign net operating loss and tax credit carryforwards and \$1 million relates to U.S. federal foreign tax credit carryforwards.

-19-

In June 2006, the Financial Accounting Standards Board, or FASB, issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an Interpretation of Financial Accounting Standards Board Statement No. 109." This interpretation clarifies the accounting and disclosures relating to the uncertainty about whether a tax return position will ultimately be sustained by the respective tax authorities. We adopted this interpretation on January 1, 2007. As part of the adoption, we recorded an increase in our liability for unrecognized tax benefits of \$19 million, \$18 million of which was accounted for as an increase in long-term deferred taxes and \$1 million of which reduced our January 1, 2007 balance of retained earnings. As of the date of adoption, the total amount of our unrecognized tax benefits was \$55 million and the total amount of interest and penalties recognized on our condensed consolidated balance sheet was \$7 million. We classify interest expense and penalties related to unrecognized tax benefits and interest income on tax overpayments as components of income tax expense. The total amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate is \$36 million.

Our U.S. income tax returns for 2004 and prior years have been audited by the Internal Revenue Service, or the IRS. The U.S. federal statute of limitations remains open for the year 2003 and later years. The IRS commenced an audit of the federal income tax returns filed by USG and its subsidiaries for the years 2005 and 2006 and is expected to complete the audit by June 30, 2008. The IRS has not proposed any material adjustments for 2005 or 2006 as of September 30, 2007. We are also under examination currently in various U.S. state and foreign jurisdictions. Foreign and U.S. state jurisdictions have statutes of limitations generally ranging from 3 to 5 years.

Edgar Filing: USG CORP - Form 10-Q

It is reasonably possible that the amount of our unrecognized tax benefits will change in the next 12 months as a result of the expected completion of the IRS audit. At this time, an estimate of a change, if any, to the amount of unrecognized tax benefits cannot be made. However, based on the information available at this time, we do not expect any change to have a significant impact on our results of operations, financial position or cash flows.

16. RESOLUTION OF USG'S REORGANIZATION PROCEEDINGS

In the second quarter of 2006, USG Corporation and 10 of its United States subsidiaries, collectively referred to as the debtors, emerged from Chapter 11 reorganization proceedings as a result of a plan of reorganization that was confirmed by the United States Bankruptcy Court for the District of Delaware and the United States District Court for the District of Delaware.

Pursuant to the plan of reorganization, we resolved the present and future asbestos personal injury liabilities of the debtors by creating and funding a trust under Section 524(g) of the United States Bankruptcy Code. In 2006, we made payments totaling \$3.95 billion to the asbestos trust. We have no further payment obligations to the trust.

-20-

The following subsidiaries were debtors in the Chapter 11 proceedings: United States Gypsum Company, or U.S. Gypsum; USG Interiors, Inc.; USG Interiors International, Inc.; L&W Supply; Beadex Manufacturing, LLC, or Beadex; B-R Pipeline Company; La Mirada Products Co., Inc.; Stocking Specialists, Inc.; USG Industries, Inc.; and USG Pipeline Company.

FINANCIAL STATEMENT PRESENTATION

During the time the debtors were operating under the protection of Chapter 11 of the United States Bankruptcy Code, our consolidated financial statements were prepared in accordance with American Institute of Certified Public Accountants Statement of Position 90-7.

The debtors' estimates of known or potential pre-petition claims and related post-petition amounts to be resolved in connection with the Chapter 11 proceedings were reflected in the consolidated financial statements as liabilities subject to compromise. As of June 30, 2006, these liabilities were reclassified on our condensed consolidated balance sheet.

Interest expense for the third quarter of 2006 included charges for post-petition interest and fees totaling \$8 million (\$5 million after-tax) related to pre-petition obligations. Interest expense for the first nine months of 2006 included charges for post-petition interest and fees totaling \$528 million (\$326 million after-tax) related to pre-petition obligations.

17. LITIGATION

ASBESTOS LITIGATION

Asbestos Personal Injury Litigation: Our plan of reorganization confirmed in 2006 resolved the debtors' liability for all present and future asbestos personal injury and related claims. Pursuant to the plan, we created and funded a trust under Section 524(g) of the Bankruptcy Code for the payment of all of the present and future asbestos personal injury liabilities of the debtors. In 2006, we made payments totaling \$3.95 billion to the asbestos personal injury

Edgar Filing: USG CORP - Form 10-Q

trust. We have no further payment obligations to the trust.

The asbestos personal injury trust is administered by independent trustees appointed under the plan. The trust will pay qualifying asbestos personal injury and related claims against the debtors pursuant to trust distribution procedures that are part of the confirmed plan.

A key component of our plan of reorganization is the channeling injunction which provides that all present and future asbestos personal injury claims against the debtors must be brought against the trust and no one may bring such a claim against the debtors. This channeling injunction applies to all present and future asbestos personal injury claims for which any debtor is alleged to be liable, including any asbestos personal injury claims against U.S. Gypsum, L&W Supply or Beadex, as well as any asbestos personal injury claims against the debtors relating to A.P. Green Refractories Co., which was formerly one of our subsidiaries. Our plan of reorganization and the

-21-

channeling injunction do not apply to any of our non-U.S. subsidiaries, any companies we acquired during our reorganization proceedings, or any companies that we acquired or may acquire after our emergence from reorganization.

Asbestos Property Damage Litigation: Asbestos property damage claims against the debtors were not part of the asbestos trust or the channeling injunction. Our plan of reorganization provided that all settled or otherwise resolved asbestos property damage claims that were timely filed in our reorganization proceedings would be paid in full. During our reorganization proceedings, the court entered an order requiring that asbestos property damage claims against the debtors be filed by January 15, 2003. In response to that deadline, approximately 1,400 asbestos property damage claims were timely filed in the debtors' Chapter 11 proceedings and an additional 70 claims were filed after the deadline. During our reorganization proceedings, more than 950 claims were disallowed or withdrawn, leaving approximately 520 claims pending.

In 2006 and 2007, we reached agreements to settle all of the remaining asbestos property damage claims filed in our reorganization proceedings. In 2006, we made total payments of approximately \$99 million for certain of these asbestos property damage settlements. Based on our evaluation of our asbestos property damage settlements, we reversed \$27 million of our reserve for asbestos-related claims in the second quarter of 2006 and an additional \$17 million in the third quarter of 2006.

In 2007 to date, we made total payments of approximately \$40 million for asbestos property damage settlements. The current estimate of the cost of the remaining asbestos property damage settlements that have not yet been paid, and associated legal fees, is approximately \$8 million and is included in accrued expenses and other liabilities on the condensed consolidated balance sheet as of September 30, 2007.

ENVIRONMENTAL LITIGATION

We have been notified by state and federal environmental protection agencies of possible involvement as one of numerous "potentially responsible parties" in a number of so-called "Superfund" sites in the United States. In most of these sites, our involvement is expected to be minimal. We believe that appropriate reserves have been established for our potential liability in connection with all Superfund sites, but we continue to review our accruals as additional information becomes available. Our reserves take into account all known or

Edgar Filing: USG CORP - Form 10-Q

estimated undiscounted costs associated with these sites, including site investigations and feasibility costs, site cleanup and remediation, certain legal costs, and fines and penalties, if any. In addition, environmental costs connected with other site cleanups on property we own are covered by reserves we establish based on these same considerations.

We believe that neither the environmental or asbestos-related matters discussed above nor any other litigation involving USG will have a material adverse effect upon our results of operations, financial position or cash flows.

-22-

18. NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued Statement of Financial Accounting Standards, or SFAS, No. 157, "Fair Value Measurements." This statement defines fair value in generally accepted accounting principles and expands disclosures about fair value measurements that are required or permitted under other accounting pronouncements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently reviewing this pronouncement to determine the impact that it may have on our financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115." This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is effective as of the beginning of the first fiscal year beginning after November 15, 2007. We are currently reviewing this pronouncement to determine the impact that it may have on our financial statements.

-23-

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In the following Management's Discussion and Analysis of Financial Condition and Results of Operations, "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.

OVERVIEW

FINANCIAL INFORMATION

Consolidated net sales in the third quarter of 2007 were \$1.335 billion, down 10% from the third quarter of 2006. Operating profit was \$25 million, down from \$258 million for the prior-year period. Net earnings were \$7 million, or \$0.07 per diluted share, for the third quarter of 2007 compared with net earnings of \$153 million, or \$1.71 per diluted share, for the third quarter of 2006.

For the third quarter of 2007, housing starts dropped 24% compared with the third quarter of 2006 as the inventory of unsold homes continued to build and the availability of mortgage financing tightened. The residential repair and remodeling market softened as well. As expected, this has led to lower wallboard

Edgar Filing: USG CORP - Form 10-Q

shipments and prices and has significantly reduced our sales and profits compared to last year.

Shipments of United States Gypsum Company's SHEETROCK(R) brand gypsum wallboard in the third quarter of 2007 were down 10% compared with the third quarter of 2006. Capacity utilization rates for our gypsum wallboard plants were approximately 80% for the third quarter of 2007. These plants operated at 90% of capacity during the third quarter of 2006. The decrease in demand caused U.S. Gypsum's nationwide average realized selling price for SHEETROCK(R) brand gypsum wallboard to fall to \$122.68 per thousand square feet for the third quarter of 2007 compared with \$141.97 for the second quarter of 2007 and \$188.37 for the third quarter of 2006. Gypsum wallboard selling prices trended downward during the third quarter, but at a slower rate compared to earlier in the year. Prices have continued to trend downward since quarter-end and remain under pressure. During the third quarter of 2007, manufacturing costs for SHEETROCK(R) brand gypsum wallboard were adversely affected by higher prices for energy, wastepaper and other raw materials compared to 2006, but these costs have decreased since the first quarter of this year.

MARKET TRENDS AND OUTLOOK

Industry shipments of gypsum wallboard in the United States were an estimated 7.80 billion square feet in the third quarter of 2007, an 11% decrease from 8.75 billion square feet in the third quarter of 2006 and a 4% decrease from 8.16 billion square feet in the second quarter of 2007.

-24-

The housing market continued to deteriorate during the third quarter of 2007. Market conditions suggest that new residential construction will remain weak during the remainder of the year and at least through 2008. Residential repair and remodeling expenditures also are expected to decline due to lower sales of existing homes and weakness in housing prices. We expect low single-digit growth in the non-residential markets to continue well into 2008, although the growth will not be sufficient to significantly offset the effects of lower demand for wallboard from the residential construction and repair and remodeling markets. Demand for gypsum wallboard in the fourth quarter of 2007 is expected to be lower than in the fourth quarter of 2006. Overall, we expect industry demand for gypsum wallboard in 2007 to be down approximately 13% from last year. Industry capacity utilization rates are expected to be below 80% for the year. At these levels of capacity utilization, we expect to see continued pressure on wallboard selling prices.

We have responded to the lower level of demand for our products by balancing wallboard production volumes and pricing in an effort to maximize operating results. We have also made significant adjustments to our manufacturing capacity by idling or closing approximately 2.6 billion square feet of mostly older, higher-cost wallboard capacity from operations in the last year. This figure includes wallboard capacity that was previously curtailed at our New Orleans, Louisiana plant. In the fourth quarter of 2007, we will idle the remainder of the wallboard capacity at the New Orleans plant. We have also eliminated 1,100 hourly and salaried positions and closed four L&W Supply locations. We will continue adjusting our operations as conditions warrant.

STRATEGIC ACTIONS

We intend to continue to seek opportunities to grow our business and improve operating results by:

Edgar Filing: USG CORP - Form 10-Q

- enhancing customer service through information technology investments that enhance operations and customer satisfaction and the introduction of new products and systems that complement our current product lines;
- continuing to invest in new, low-cost gypsum wallboard manufacturing capacity to improve operating margins, replacing older, higher-cost capacity and reducing costs by improving production efficiencies;
- making selective acquisitions to grow our Building Products Distribution business;
- making selective acquisitions and entering into joint ventures to grow our non-U.S. businesses; and
- adjusting our workforce in response to market conditions.

-25-

CONSOLIDATED RESULTS OF OPERATIONS

The following is a summary of our condensed consolidated statements of earnings:

(dollars in millions, except per-share data)	2007	2006	Increase (Decrease)
-----	-----	-----	-----
THREE MONTHS ENDED SEPTEMBER 30:			
Net sales	\$1,335	\$1,478	(10)%
Cost of products sold	1,217	1,132	8%
Gross profit	118	346	(66)%
Selling and administrative expenses	90	103	(13)%
Provision for restructuring	3	--	--
Reversal of asbestos claims reserve	--	(17)	--
Chapter 11 reorganization expenses	--	2	--
Operating profit	25	258	(90)%
Interest expense	22	16	38%
Interest income	(5)	(16)	(69)%
Other income, net	(2)	(2)	--
Income taxes	3	107	(97)%
Net earnings	7	153	(95)%
Diluted earning per share	0.07	1.71	(96)%
NINE MONTHS ENDED SEPTEMBER 30:			
Net sales	\$4,002	\$4,516	(11)%
Cost of products sold	3,470	3,413	2%
Gross profit	532	1,103	(52)%
Selling and administrative expenses	306	305	--
Provision for restructuring	18	--	--
Reversal of asbestos claims reserve	--	(44)	--
Chapter 11 reorganization expenses	--	10	--
Operating profit	208	832	(75)%
Interest expense	85	539	(84)%
Interest income	(18)	(23)	(22)%
Other income, net	(4)	(2)	100%
Income taxes	41	130	(68)%
Net earnings	104	188	(45)%
Diluted earnings per share	1.07	3.03	(65)%

Edgar Filing: USG CORP - Form 10-Q

NET SALES

Consolidated net sales in the third quarter and first nine months of 2007 declined 10% and 11% from the respective 2006 periods primarily due to decreased demand for building products and lower selling prices for gypsum wallboard. As explained below under Core Business Results of Operations, net sales in the third quarter and first nine months of 2007 for North American Gypsum and Building Products Distribution decreased compared with the same periods in 2006. Net sales in the third quarter and first nine months of 2007 for Worldwide Ceilings improved compared with the respective prior-year periods.

-26-

COST OF PRODUCTS SOLD

Cost of products sold increased 8% in the third quarter of 2007 compared with the third quarter of 2006 and 2% in the first nine months of 2007 compared with the same period in 2006. These increases primarily reflect higher prices for energy, wastepaper and other raw materials, partially offset by lower product volumes.

GROSS PROFIT

Gross profit for the third quarter and first nine months of 2007 decreased 66% and 52% from the respective 2006 periods primarily due to lower demand for gypsum wallboard, lower gypsum wallboard selling prices and higher manufacturing costs. The gross margin percentage was 8.8% in the third quarter of 2007, down from 23.4% in the third quarter of 2006. For the first nine months of 2007, the gross margin percentage was 13.3%, down from 24.4% for the first nine months of 2006.

SELLING AND ADMINISTRATIVE EXPENSES

Selling and administrative expenses for the third quarter of 2007 decreased 13% from the third quarter of 2006 primarily due to lower levels of incentive compensation, the impact of our salaried workforce reduction program and the company-wide emphasis on reducing expenses. As a percent of net sales, selling and administrative expenses were 6.7% for the third quarter of 2007, down from 7.0% for the third quarter of 2006.

Selling and administrative expenses for the first nine months of 2007 increased \$1 million from the first nine months of 2006 primarily due to higher levels of compensation and benefits and costs associated with our first quarter 2007 move to a new corporate office, largely offset by lower accruals for incentive compensation and a company-wide emphasis on reducing expenses. As a percent of net sales, selling and administrative expenses were 7.6% for the first nine months of 2007, up from 6.8% for the first nine months of 2006.

PROVISION FOR RESTRUCTURING

In the third quarter of 2007, we recorded a provision of \$3 million pretax (\$2 million after-tax) related to our salaried workforce reduction program. Through the first nine months of 2007, the total provision for restructuring was \$17.5 million pretax (\$11 million after-tax). Our restructuring activities include the salaried workforce reduction program and the shutdown of a framing products manufacturing plant. We implemented these actions beginning in the second quarter of 2007 in response to current market conditions. See Note 4 to the

Edgar Filing: USG CORP - Form 10-Q

Condensed Consolidated Financial Statements for additional information related to this restructuring program.

REVERSAL OF ASBESTOS CLAIMS RESERVE

In the third quarter of 2006, we reversed \$17 million pretax (\$10 million after-tax) of a reserve for asbestos-related claims. This reversal, which is reflected as income in the condensed consolidated statements of earnings, was based on our evaluation of our asbestos property damage settlements and the remaining unresolved asbestos property damage claims at that time. Through the first nine months of 2006, a total of \$44 million pretax (\$27 million after-

-27-

tax) of the reserve for asbestos-related claims was reversed.

CHAPTER 11 REORGANIZATION EXPENSES

In connection with our bankruptcy proceedings that concluded in 2006, we recorded Chapter 11 reorganization expenses of \$2 million in the third quarter of 2006 and \$10 million for the first nine months of 2006.

INTEREST EXPENSE

Interest expense of \$22 million for the third quarter of 2007 included a charge of \$4 million pretax (\$3 million after-tax) to write off deferred financing fees due to the repayment of our bank term loan. Interest expense of \$85 million for the first nine months of 2007 included charges totaling \$14 million pretax (\$9 million after-tax) to write off deferred financing fees primarily due to the first quarter repayment of our tax bridge loan and the third quarter repayment of the bank term loan.

Interest expense of \$16 million for the third quarter of 2006 included charges for post-petition interest and fees totaling \$8 million pretax (\$5 million after-tax) related to pre-petition obligations. Interest expense of \$539 million for the first nine months of 2006 included charges for post-petition interest and fees totaling \$528 million pretax (\$326 million after-tax) related to pre-petition obligations.

INCOME TAXES

Income tax expense was \$3 million for the third quarter of 2007 compared with \$107 million for the third quarter of 2006. The effective tax rate was 27.8% for the third quarter of 2007 compared with 40.9% for last year's third quarter. The difference in the third quarter effective tax rates is primarily attributable to a larger portion of our consolidated operating earnings arising in lower taxed non-U.S. jurisdictions and lower state income tax expense in 2007, offset in part by a \$6.7 million unfavorable tax adjustment described below.

Income tax expense was \$41 million for first nine months of 2007 compared with \$130 million for the corresponding 2006 period. The effective tax rates were 28.2% for the first nine months of 2007 and 40.7% for the first nine months of 2006. The difference in the nine months effective tax rates is primarily attributable to a larger portion of our consolidated operating earnings arising in lower taxed non-U.S. jurisdictions and lower state income tax expense in 2007, the favorable effects of state tax law changes enacted in the first nine months of 2007 and a tax expense of \$4 million related to post-petition interest on pre-petition tax obligations that was recorded in the first quarter of 2006. In addition, a \$6.6 million favorable tax adjustment was recorded in the first

Edgar Filing: USG CORP - Form 10-Q

quarter of 2007 and a \$6.7 million unfavorable tax adjustment was recorded in the third quarter of 2007 resulting from corrections to deferred tax balances from prior years.

-28-

NET EARNINGS

2007: Net earnings for the third quarter of 2007 were \$7 million, or \$0.07 per diluted share. Net earnings for the first nine months of 2007 were \$104 million, or \$1.07 per diluted share.

Net earnings and earnings per share for the 2007 periods include charges for the restructuring program described above. These charges, on an after-tax basis, were \$2 million, or \$0.02 per diluted share, for the third quarter of 2007 and \$11 million, or \$0.11 per diluted share, for the first nine months of 2007.

Net earnings and earnings per share for the 2007 periods also include charges for the write-off of deferred financing fees described above. These charges, on an after-tax basis, were \$3 million, or \$0.03 per diluted share, for the third quarter of 2007 and \$9 million, or \$0.09 per diluted share, for the first nine months of 2007.

In addition, a \$6.7 million, or \$0.07 per diluted share, unfavorable tax adjustment was recorded in the third quarter of 2007. In the first quarter of 2007, we recorded a \$6.6 million, or \$0.07 per diluted share, favorable tax adjustment. These adjustments resulted from corrections of the deferred tax balances from prior years.

2006: For the third quarter of 2006, net earnings were \$153 million, or \$1.71 per diluted share. For the first nine months of 2006, net earnings totaled \$188 million, or \$3.03 per diluted share.

Net earnings and earnings per share for the 2006 periods include the charges for post-petition interest and fees related to pre-petition obligations described above. These charges, on an after-tax basis, were \$5 million, or \$0.06 per diluted share, for the third quarter of 2006 and \$326 million, or \$5.24 per diluted share, for the first nine months of 2006.

Net earnings and earnings per share for the 2006 periods also include the reversals of a reserve for asbestos-related claims described above. The after-tax income from the reversals amounted to \$10 million, or \$0.11 per diluted share, for the third quarter of 2006 and \$27 million, or \$0.43 per diluted share, for the first nine months of 2006.

-29-

CORE BUSINESS RESULTS OF OPERATIONS

(millions)	Three Months		Nine Months	
	ended September 30,		ended September 30,	
-----	2007	2006	2007	2006
-----	-----	-----	-----	-----

Edgar Filing: USG CORP - Form 10-Q

NET SALES:

NORTH AMERICAN GYPSUM:

United States Gypsum Company	\$ 592	\$ 801	\$1,908	\$2,513
CGC Inc. (gypsum)	79	85	235	262
USG Mexico, S.A. de C.V.	52	47	142	130
Other subsidiaries*	22	25	61	70
Eliminations	(47)	(49)	(137)	(158)
	-----	-----	-----	-----
Total	\$ 698	\$ 909	\$2,209	\$2,817
	-----	-----	-----	-----

BUILDING PRODUCTS DISTRIBUTION:

L&W Supply Corporation	614	642	1,772	1,926
	-----	-----	-----	-----

WORLDWIDE CEILINGS:

USG Interiors, Inc.	136	124	396	388
USG International	66	64	206	177
CGC Inc. (ceilings)	15	14	45	44
Eliminations	(10)	(11)	(33)	(33)
	-----	-----	-----	-----

Total	\$ 207	\$ 191	\$ 614	\$ 576
	-----	-----	-----	-----

Eliminations	(184)	(264)	(593)	(803)
	-----	-----	-----	-----

Total USG Corporation	\$1,335	\$1,478	\$4,002	\$4,516
	=====	=====	=====	=====

OPERATING PROFIT**:

NORTH AMERICAN GYPSUM:

United States Gypsum Company	\$ (14)	\$ 192	\$ 97	\$ 623
CGC Inc. (gypsum)	--	13	7	39
USG Mexico, S.A. de C.V.	7	8	20	23
Other subsidiaries*	5	6	9	12
	-----	-----	-----	-----

Total	\$ (2)	\$ 219	\$ 133	\$ 697
	-----	-----	-----	-----

BUILDING PRODUCTS DISTRIBUTION:

L&W Supply Corporation	22	53	93	164
	-----	-----	-----	-----

WORLDWIDE CEILINGS:

USG Interiors, Inc.	17	11	37	42
USG International	4	5	10	13
CGC Inc. (ceilings)	2	2	7	9
	-----	-----	-----	-----

Total	\$ 23	\$ 18	\$ 54	\$ 64
	-----	-----	-----	-----

Corporate	(18)	(29)	(79)	(81)
-----------	------	------	------	------

Eliminations	--	(1)	7	(2)
--------------	----	-----	---	-----

Chapter 11 reorganization expenses	--	(2)	--	(10)
	-----	-----	-----	-----

Total USG Corporation	\$ 25	\$ 258	\$ 208	\$ 832
	=====	=====	=====	=====

* Includes Gypsum Transportation Limited, a shipping company in Bermuda, and USG Canadian Mining Ltd., a mining operation in Nova Scotia.

** Operating profit for the 2007 periods includes provisions for restructuring of \$3 million pretax for the third quarter and \$17.5 million pretax for the first nine months. On an operating segment basis, \$14 million of the nine-months charge relates to North American Gypsum, \$1.5 million relates Worldwide Ceilings and \$1 million relates to each of Building Products Distribution and Corporate.

Edgar Filing: USG CORP - Form 10-Q

Operating profit for the 2006 periods for North American Gypsum includes reversals of an asbestos claims reserve. These reversals amounted to \$17 million for the third quarter and \$44 million for the first nine months of 2006.

-30-

NORTH AMERICAN GYPSUM

Net sales of \$698 million in the third quarter of 2007 were down 23% from the third quarter of 2006, while an operating loss of \$2 million compared with operating profit of \$219 million for the prior-year period. For the first nine months of 2007, net sales of \$2.209 billion were down 22% and operating profit of \$133 million dropped 81% compared with the first nine months of 2006. Operating profit in 2007 for North American Gypsum included restructuring charges of \$2 million for the third quarter and \$14 million for the first nine months. Operating profit in 2006 was favorably affected by reversals of a reserve for asbestos-related claims. These reversals amounted to \$17 million for the third quarter and \$44 million for the first nine months of 2006.

United States Gypsum Company: Third quarter 2007 net sales for U.S. Gypsum decreased \$209 million, or 26%, compared with the third quarter of 2006. An operating loss of \$14 million was recorded in the third quarter of 2007 compared with operating profit of \$192 in the third quarter of 2006. The decline in operating results largely reflected lower shipments, lower average realized selling prices and higher manufacturing costs for SHEETROCK(R) brand gypsum wallboard. U.S. Gypsum's operating loss for the third quarter of 2007 included a restructuring charge of \$1 million related to our salaried workforce reduction program. Operating profit for the third quarter of 2006 was favorably affected by the \$17 million reversal of a reserve for asbestos-related claims.

Shipments of SHEETROCK(R) brand gypsum wallboard totaled 2.35 billion square feet during the third quarter of 2007, down 10% from 2.60 billion square feet in the third quarter of 2006. U.S. Gypsum's wallboard plants operated at approximately 80% of capacity in the third quarter of 2007 compared with 90% of capacity in the third quarter of 2006. Industry shipments of gypsum wallboard in the United States were down approximately 11% from the third quarter of 2006.

The decrease in demand caused U.S. Gypsum's nationwide average realized selling price for SHEETROCK(R) brand gypsum wallboard to fall to \$122.68 per thousand square feet for the third quarter of 2007, a 35% drop compared to the all-time record average price of \$188.37 attained in the third quarter of 2006 and a 14% decrease from the average price of \$141.97 for the second quarter of 2007. Gypsum wallboard prices trended downward during the third quarter of 2007, but at a slower rate compared to earlier in the year. Prices have continued to trend downward since quarter-end and remain under pressure.

During the third quarter of 2007, manufacturing costs for SHEETROCK(R) brand gypsum wallboard were adversely affected by higher prices for energy, wastepaper and other raw materials. Gypsum wallboard unit costs were up 6% in the third quarter of 2007 compared with last year's third quarter.

Third quarter 2007 sales and profit for DUROCK(R) brand cement board and FIBEROCK(R) brand gypsum fiber panels improved versus last year's third quarter due to higher selling prices and lower costs. Pricing also improved for

-31-

Edgar Filing: USG CORP - Form 10-Q

SHEETROCK(R) brand joint treatment products, but this improvement was offset by higher manufacturing costs and lower shipments for those products.

During the third quarter of 2007, U.S. Gypsum successfully opened two new manufacturing facilities on the East coast. A new, low-cost wallboard facility in Norfolk, Virginia replaced a high-cost 50-year-old line at the same location. The company also opened a new joint treatment facility in Baltimore, Maryland during the quarter. These facilities are expected to improve customer service in the Mid-Atlantic region and reduce costs.

CGC Inc.: Third quarter 2007 net sales for the gypsum business of Canada-based CGC Inc. fell \$6 million, or 7%, compared to the third quarter of 2006. Operating profit was break-even for the third quarter of 2007 compared with \$13 million for last year's third quarter. The decline in net sales was largely attributable to lower selling prices for SHEETROCK(R) brand gypsum wallboard and lower wallboard shipments, particularly to the United States. Operating profit also was adversely affected by higher gypsum wallboard manufacturing costs, especially higher paper and other raw material costs. Operating profit for the third quarter of 2007 also included a restructuring charge of \$1 million related to our salaried workforce reduction program.

USG Mexico, S.A. de C.V.: Net sales in the third quarter of 2007 for our Mexico-based subsidiary were up \$5 million, or 11%, compared with the third quarter of 2006 largely due to increased sales of complementary products such as construction plasters and DUROCK(R) brand cement board. However, operating profit was down \$1 million from the comparable 2006 period largely due to higher energy and raw materials costs. A new gypsum wallboard manufacturing facility in Tecoman, Colima, Mexico began operations in the third quarter of 2007 and is serving Western Mexico and Latin America.

BUILDING PRODUCTS DISTRIBUTION

L&W Supply Corporation's net sales in the third quarter of 2007 were \$614 million, down \$28 million, or 4%, compared with the third quarter of 2006. This decline was primarily attributable to lower product volumes and gypsum wallboard selling prices resulting from the weak residential construction market. The impact of recent acquisitions and increased sales related to non-residential construction activity partially offset these results.

Overall, gypsum wallboard shipments declined 5%, while sales of other products increased 22% compared with last year's third quarter. The modest decline in wallboard shipments and the increase in sales of non-wallboard products reflects the positive impact of recently acquired businesses. L&W Supply's sales of ceilings products were up 53% compared to the third quarter of 2006, also largely due to recent acquisitions. Acquisitions completed in the past year, including California Wholesale Material Supply, Inc., which was acquired in late March, and All Interiors Supply, which was acquired in the fourth quarter of 2006, contributed \$154 million to third quarter 2007 net sales. Driven by lower product volumes and gypsum wallboard prices, same-location net sales for the third quarter of 2007 decreased 28% compared with the third quarter of 2006.

-32-

Operating profit in the third quarter of 2007 was \$22 million, down \$31 million, or 58%, compared with \$53 million for the third quarter of 2006. The declines in gypsum wallboard shipments and profit margins that resulted from the weak residential construction market were the primary reasons for the lower level of

Edgar Filing: USG CORP - Form 10-Q

operating profit. Profit margins for most other product lines experienced only modest declines. Amortization expense related to intangible assets associated with recent acquisitions was \$4 million in the third quarter of 2007 and further reduced operating profit. There was no comparable charge in the third quarter of 2006.

For the first nine months of 2007, net sales of \$1.772 billion were down 8% and operating profit of \$93 million was down 43% compared with the first nine months of 2006. On a same-location basis, net sales in the first nine months of 2007 declined 25% versus the first nine months of 2006. During the first nine months of 2007, L&W Supply closed four locations in response to weak market conditions, but it continues to serve their customers in these markets from other locations.

L&W Supply operated 248 locations in the United States and Mexico as of September 30, 2007 compared with 212 locations in the United States only as of September 30, 2006.

WORLDWIDE CEILINGS

Net sales of \$207 million in the third quarter of 2007 were up 8% from the third quarter of 2006, while operating profit increased 28% to \$23 million. For the first nine months of 2007, net sales of \$614 million increased 7%, while operating profit of \$54 million fell 16% compared with the first nine months of 2006. Worldwide Ceilings operating profit for the first nine months of 2007 included a restructuring charge of \$1.5 million related to our salaried workforce reduction program.

USG Interiors, Inc.: USG Interiors reported third quarter 2007 net sales of \$136 million and operating profit of \$17 million. These results compared favorably with net sales of \$124 million and operating profit of \$11 million in the third quarter of 2006. The improved results for the 2007 period primarily reflect higher average realized selling prices for ceiling tile and increased shipments of ceiling grid, partially offset by higher ceiling tile and grid manufacturing costs.

USG International: USG International reported net sales of \$66 million and operating profit of \$4 million in the third quarter of 2007. This compared with net sales of \$64 million and operating profit of \$5 million for the same period a year ago. The improvement in net sales primarily reflected increased demand for ceiling grid and joint treatment in Europe and the favorable effects of currency translation. Operating profit fell largely due to lower volume and selling prices in Latin America and higher selling and administrative expenses.

CGC Inc.: The ceilings division of CGC Inc. reported net sales of \$15 million and operating profit of \$2 million in the third quarter of 2007. Net sales and

-33-

operating profit for the same period a year ago were \$14 million and \$2 million, respectively. Improved pricing for ceiling grid was partially offset by lower selling prices for ceiling tile and higher grid manufacturing costs.

LIQUIDITY AND CAPITAL RESOURCES

LIQUIDITY

As of September 30, 2007, we had cash and cash equivalents of \$353 million compared with \$380 million as of June 30, 2007 and \$565 million as of December 31, 2006. We believe that cash on hand, cash available from future

Edgar Filing: USG CORP - Form 10-Q

operations and the other sources of liquidity described below will provide sufficient liquidity to allow our businesses to carry on normal operations. Normal-course cash requirements include, among other things, capital expenditures, working capital needs and contractual obligations. Additionally, from time to time we consider selective strategic transactions that we believe will create value and improve performance, including acquisitions, joint ventures, partnerships, restructurings and dispositions. Transactions of these types may result in material cash expenditures or proceeds.

We have a credit agreement, which was amended and restated in the third quarter of 2007, with a syndicate of banks that includes a \$650 million revolving credit facility with a \$250 million sublimit for letters of credit. As of September 30, 2007, we had not drawn upon the revolving credit facility except for approximately \$78 million of outstanding letters of credit. See Note 7 to the Condensed Consolidated Financial Statements for information regarding the credit agreement as amended and restated.

We plan to fund future growth projects from cash on hand, future cash available from operations and, if determined to be appropriate and they are available, borrowings under our revolving credit facility. Also to fund future growth projects, we may from time to time consider other debt or equity financing alternatives to supplement, or as an alternative to, financing under the revolving credit facility.

CASH FLOWS

The following table presents a summary of our cash flows:

(millions)	Nine Months ended September 30	
-----	2007	2006
Net cash provided by (used for):		
Operating activities	\$1,248	\$(765)
Investing activities	(614)	328
Financing activities	(853)	951
Effect of exchange rate changes on cash	7	3
	-----	-----
Net (decrease) increase in cash and cash equivalents	\$ (212)	\$ 517
	=====	=====

-34-

Operating Activities: The variation between the 2007 and 2006 periods primarily reflects our first quarter 2007 receipt of the federal tax refund of \$1.057 billion and our second quarter 2006 payment of \$890 million to the asbestos trust.

Investing Activities: The variation between the 2007 and 2006 periods primarily reflects increased spending in 2007 for acquisitions (up \$206 million) and capital projects (up \$104 million) and a cash inflow of \$565 million in the first nine months of 2006 from the net sales of marketable securities.

Financing Activities: The variation between the 2007 and 2006 periods primarily reflects 2007 repayments of a \$1.065 billion borrowing under our tax bridge

Edgar Filing: USG CORP - Form 10-Q

facility and \$700 million of borrowings under our term loan facility. These repayments were partially offset by the issuance of \$499 million of 7.75% senior notes, net of discount, in the third quarter of 2007 and the net proceeds of \$422 million from a public equity offering that we completed in the first quarter of 2007.

CAPITAL EXPENDITURES

Capital spending amounted to \$341 million in the first nine months of 2007 compared with \$237 million in the corresponding 2006 period. As of September 30, 2007, capital expenditure commitments for the replacement, modernization and expansion of operations amounted to \$443 million compared with \$494 million as of December 31, 2006. We expect to fund our capital expenditures program with cash from operations and, if determined to be appropriate and they are available, borrowings under our revolving credit facility or other alternative financings. Capital projects commenced as of September 30, 2007 include the following projects with the total estimated costs indicated:

- approximately \$210 million for a new low-cost gypsum wallboard plant in Washingtonville, Pennsylvania that will serve the Northeastern United States region. Construction of this plant began in late 2006 and is expected to be completed in 2008;
- approximately \$110 million for the acquisition of a paper mill in Otsego, Michigan in 2006 and to subsequently convert it to manufacture high-quality, low-cost paper for U.S. Gypsum's wallboard plants. The plant is expected to begin production in 2008;
- approximately \$75 million for a new 40,000-ton self-unloading ship expected to lower the delivered cost of gypsum rock to East Coast wallboard plants. The new ship is expected to become operational in 2008; and
- approximately \$220 million for a new, low-cost gypsum wallboard plant in Stockton, California that will serve Northern California. Construction of this plant is scheduled to begin in 2008 and is scheduled to be completed in 2010.

-35-

WORKING CAPITAL

As of September 30, 2007, working capital (current assets less current liabilities) amounted to \$825 million, and the ratio of current assets to current liabilities was 2.35-to-1. As of December 31, 2006, working capital amounted to \$943 million, and the ratio of current assets to current liabilities was 1.53-to-1.

Receivables increased to \$546 million as of September 30, 2007 from \$448 million as of December 31, 2006. During the same period, inventories increased to \$379 million from \$348 million, and accounts payable increased to \$348 million from \$303 million. These increases were attributable in part to additional receivables, inventories and payables from businesses acquired in 2007. The higher level of receivables also reflected a 7% increase in net sales for the month of September 2007 compared with December 2006. Accrued expenses decreased to \$258 million as of September 30, 2007 from \$358 million as of December 31, 2006 largely due to payments made in 2007 for asbestos property damage settlements and employee incentive compensation.

DEBT

Edgar Filing: USG CORP - Form 10-Q

Total debt amounted to \$1.238 billion as of September 30, 2007 compared with \$2.504 billion as of December 31, 2006. In the third quarter of 2007, we sold \$500 million of 7.75% senior unsecured notes due January 2018 in an underwritten public offering. We used the net proceeds from the sale of the notes, together with cash on hand, to repay the \$500 million balance outstanding under our term loan facility. See Note 7 to the Condensed Consolidated Financial Statements for additional information on our debt.

REALIZATION OF DEFERRED TAX ASSET

Our condensed consolidated balance sheet as of September 30, 2007 includes a gross deferred tax asset of \$425 million relating to the U.S. federal, state and foreign income tax benefits expected to be realized in future periods with respect to various net operating loss and tax credit carryforwards arising in 2006 and prior years primarily as a result of the amounts paid to the asbestos trust in 2006. We have concluded, based on the weight of available evidence, that all but \$78 million of these tax benefits are more likely than not to be realized in the future.

In arriving at this conclusion, we considered both future reversals of existing taxable temporary differences and, where appropriate, projections of future taxable income. As a result of U.S. federal taxable income projected to be realized in future years, we expect to utilize all but \$1 million of the \$193 million of federal income tax benefits relating to our federal net operating loss and tax credit carryforwards.

In contrast to the results under the federal Internal Revenue Code, most U.S. states do not allow the carryback of a net operating loss in any significant amount. As a result, most of the state tax benefits resulting from the amounts paid to the asbestos trust in 2006 will be realized through a reduction of future state income tax liabilities by offsetting the net operating losses resulting from our payments to the asbestos trust against future state taxable

-36-

income. Based on projections of future taxable income (consistent with historical results and anticipated future trends) in the U.S. states in which we conduct business operations and the loss carryforward periods allowed by current state laws (generally five to 20 years), we have concluded that all but \$66 million of the \$220 million of state income tax benefits relating to our state net operating loss and tax credit carryforwards is more likely than not to be realized.

We also have net operating loss and tax credit carryforwards in various foreign jurisdictions that, as a result of significant losses and limited tax liabilities in recent years in those jurisdictions, are doubtful of being utilized. As a result, we have concluded that \$1 million of the \$12 million of income tax benefits relating to our foreign net operating loss and tax credit carryforwards is more likely than not to be realized.

During the third quarter of 2007, we decreased our valuation allowance for deferred tax assets by a total of \$2 million due to a change in our judgment about the realizability of the deferred tax assets relating to certain foreign and U.S. state net operating loss and tax credit carryforwards in future years.

LEGAL CONTINGENCIES

USG and certain of its subsidiaries have been notified by state and federal

Edgar Filing: USG CORP - Form 10-Q

environmental protection agencies of possible involvement as one of numerous "potentially responsible parties" in a number of so-called "Superfund" sites in the United States. See Note 17 to the Condensed Consolidated Financial Statements for additional information on environmental litigation and for information concerning asbestos and related bankruptcy litigation. We believe that neither the environmental, asbestos-related matters nor any other litigation involving USG will have a material adverse effect upon our results of operations, financial position or cash flows.

CRITICAL ACCOUNTING POLICIES

The preparation of our financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses during the periods presented. USG's Annual Report on Form 10-K for the fiscal year ended December 31, 2006, which we filed on February 16, 2007, includes a summary of the critical accounting policies we believe are the most important to aid in understanding our financial results. There have been no material changes to these critical accounting policies that impacted our reported amounts of assets, liabilities, revenues or expenses during the first nine months of 2007.

-37-

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board, or FASB, issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an Interpretation of Financial Accounting Standards Board Statement No. 109." This interpretation clarifies the accounting and disclosures relating to the uncertainty about whether a tax return position will ultimately be sustained by the respective tax authorities. We adopted this interpretation on January 1, 2007. As part of the adoption, we recorded an increase in our liability for unrecognized tax benefits of \$19 million, \$18 million of which was accounted for as an increase in long-term deferred taxes and \$1 million of which reduced our January 1, 2007 balance of retained earnings. As of the date of adoption, the total amount of our unrecognized tax benefits was \$55 million and the total amount of interest and penalties recognized on our condensed consolidated balance sheet was \$7 million. We classify interest expense and penalties related to unrecognized tax benefits and interest income on tax overpayments as components of income tax expense. The total amount of unrecognized tax benefits that, if recognized, would affect our effective tax rate is \$36 million. It is reasonably possible that the amount of our unrecognized tax benefits will change in the next 12 months as a result of the expected completion of the IRS's audit of our 2005 and 2006 federal income tax returns. At this time, an estimate of a change, if any, to the amount of unrecognized tax benefits cannot be made. However, based on the information available at this time, we do not expect any change to have a significant impact on our results of operations, financial position or cash flows.

In September 2006, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 157, "Fair Value Measurements." This statement defines fair value in generally accepted accounting principles and expands disclosures about fair value measurements that are required or permitted under other accounting pronouncements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently reviewing this pronouncement to determine the impact that it may have on our financial statements.

Edgar Filing: USG CORP - Form 10-Q

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115." This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is effective as of the beginning of the first fiscal year beginning after November 15, 2007. We are currently reviewing this pronouncement to determine the impact that it may have on our financial statements.

-38-

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 related to management's expectations about future conditions. Actual business, market or other conditions may differ from management's expectations and accordingly may affect our sales and profitability or other results and liquidity. Actual results may differ due to various other factors, including:

- economic conditions, such as the levels of new home and other construction activity, employment levels, the availability of mortgage financing, mortgage and other interest rates, housing affordability and supply, currency exchange rates and consumer confidence;
- competitive conditions, such as price, service and product competition;
- shortages in raw materials;
- increases in raw material, energy, transportation and employee benefit costs;
- the timing of commencement of operation of new and upgraded manufacturing facilities;
- the loss of one or more major customers;
- capacity utilization rates;
- capital markets conditions and the availability of borrowings under our credit agreement;
- the results of a review by the Congressional Joint Committee on Taxation relating to the tax refund we received related to the payments we made to the asbestos trust;
- our success in integrating acquired businesses;
- changes in laws or regulations, including environmental and safety regulations;
- the effects of acts of terrorism or war upon domestic and international economies and financial markets; and
- acts of God.

We assume no obligation to update any forward-looking information contained in this report.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures.

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our "disclosure controls and procedures" (as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, or the Act), have concluded that, as of the end of the quarter covered by this report, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting.

During the third quarter of 2007, we completed the roll out of a new supply chain management system in the United States and Canada. On July 1, 2007, we began to roll out a new human resource and payroll system in the United States and Canada. The human resource and payroll system roll out is expected to continue into the first quarter of 2008.

Changes related to the new systems represented the only changes in our "internal control over financial reporting" (as defined in Rule 13a-15(f) promulgated under the Act) identified in connection with the evaluation required by Rule 13a-15(d) promulgated under the Act that occurred during the fiscal quarter ended September 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

We anticipate that we will continue to have future investments in many of our technology systems and will continue to review the impact of any future changes to our internal controls over financial reporting as the new systems are implemented.

California Wholesale Material Supply, Inc., or CALPLY, has accounting processes and internal controls different from those at USG. We do not consider the acquisition of CALPLY to materially affect our internal control over financial reporting and we do not expect to extend our Sarbanes-Oxley Section 404 attestation to include CALPLY until 2008.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of USG Corporation:

We have reviewed the accompanying condensed consolidated balance sheet of USG Corporation and subsidiaries (the "Corporation") as of September 30, 2007, and the related condensed consolidated statements of earnings for the three-month

Edgar Filing: USG CORP - Form 10-Q

and nine-month periods ended September 30, 2007 and 2006 and of cash flows for the nine-month periods ended September 30, 2007 and 2006. These interim financial statements are the responsibility of the Corporation's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to such consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 15, the Corporation adopted Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an Interpretation of Financial Accounting Standards Board Statement No. 109" effective January 1, 2007.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of USG Corporation and subsidiaries as of December 31, 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated February 13, 2007, we expressed an unqualified opinion (which included an explanatory paragraph concerning a change in the method of accounting due to the Corporation's adoption of Financial Accounting Standards Board Interpretation No. 47, "Accounting for Conditional Asset Retirements" in 2005, Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment", and Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" in 2006) on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2006 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ DELOITTE & TOUCHE LLP
Chicago, Illinois
October 26, 2007

-41-

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Part I, Item 1, Note 17, Litigation, for information concerning asbestos and related bankruptcy litigation and environmental litigation.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) Pursuant to the Corporation's Stock Compensation Program for Non-Employee Directors, on July 1, 2007, the Corporation's non-employee directors were entitled to receive an \$80,000 annual grant, payable at their election in

Edgar Filing: USG CORP - Form 10-Q

cash or common stock with an equivalent value. Pursuant to this provision, effective July 1, 2007, a total of 9,752 shares of common stock were issued to eight non-employee directors based on the fair market value of a share of common stock on June 29, 2007. The issuance of these shares was effected through a private placement under Section 4(2) of the Securities Act and was exempt from registration under Section 5 of the Securities Act.

ITEM 6. EXHIBITS

4. Form of 7.75% Senior Note due 2018 (incorporated by reference to Exhibit 4.1 to USG Corporation's Current Report on Form 8-K filed September 26, 2007)
15. Letter from Deloitte & Touche LLP regarding unaudited financial information
 - 31.1 Rule 13a-14(a) Certifications of USG Corporation's Chief Executive Officer
 - 31.2 Rule 13a-14(a) Certifications of USG Corporation's Chief Financial Officer
 - 32.1 Section 1350 Certifications of USG Corporation's Chief Executive Officer
 - 32.2 Section 1350 Certifications of USG Corporation's Chief Financial Officer

-42-

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

USG CORPORATION

By /s/ William C. Foote

William C. Foote,
Chairman and Chief Executive Officer

By /s/ Richard H. Fleming

Richard H. Fleming,
Executive Vice President and
Chief Financial Officer

By /s/ D. Rick Lowes

D. Rick Lowes,
Senior Vice President and Controller

October 26, 2007

-43-