USG CORP
Form 10-K
February 15, 2008

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2007

OR

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

For the transition period from __________ to __________

Commission File Number 1-8864

USG CORPORATION

(Exact name of Registrant as Specified in its Charter)

Delaware	**36-3329400**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
550 W. Adams Street, Chicago, Illinois	**60661-3676**
(Address of Principal Executive Offices)	(Zip Code)

Registrant s Telephone Number, Including Area Code: **(312) 436-4000**

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
Common Stock, $0.10 par value	New York Stock Exchange Chicago Stock Exchange
Preferred Stock Purchase Rights (subject to Rights Agreement dated December 21, 2006)	New York Stock Exchange Chicago Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes o No þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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 confirmed by a court. Yes þ No o 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 aggregate market value of the registrant s common stock held by non-affiliates computed by reference to the New York Stock Exchange closing price on June 30, 2007 (the last business day of the registrant s most recently completed second fiscal quarter) was approximately $4,824,488,000.

The number of shares of the registrant s common stock outstanding as of January 31, 2008 was 99,055,389.

Documents Incorporated By Reference: Certain sections of USG Corporation s definitive Proxy Statement for use in connection with its 2008 annual meeting of stockholders, to be filed subsequently, are incorporated by reference into Part III of this Form 10-K Report where indicated.

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PART I

Item 1. BUSINESS

In this annual report on Form 10-K, 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.

General

USG, through its subsidiaries, is a leading manufacturer and distributor of building materials, producing a wide range of products for use in new residential, new nonresidential, and repair and remodel construction as well as products used in certain industrial processes.

SEGMENTS

Our operations are organized into three reportable segments: North American Gypsum, Building Products Distribution and Worldwide Ceilings, the net sales of which accounted for approximately 48%, 38% and 14%, respectively, of our 2007 consolidated net sales.

North American Gypsum

BUSINESS

North American Gypsum, which manufactures and markets gypsum and related products in the United States, Canada and Mexico, includes United States Gypsum Company, or U.S. Gypsum, in the United States, the gypsum business of CGC Inc., or CGC, in Canada, and USG Mexico, S.A. de C.V., or USG Mexico, in Mexico. U.S. Gypsum is the largest manufacturer of gypsum wallboard in the United States and accounted for approximately 30% of total domestic gypsum wallboard sales in 2007. CGC is the largest manufacturer of gypsum wallboard in eastern Canada. USG Mexico is the largest manufacturer of gypsum wallboard in Mexico.

PRODUCTS

North American Gypsum s products are used in a variety of building applications to finish the interior walls, ceilings and floors in residential, commercial and institutional construction and in certain industrial applications. These products provide aesthetic as well as sound-dampening, fire-retarding, abuse-resistance and moisture-control value. The majority of these products are sold under the SHEETROCK® brand name. A line of joint compounds used for finishing wallboard joints is also sold under the SHEETROCK® brand name. The DUROCK® line of cement board and accessories provides water-damage-resistant and fire-resistant assemblies for both interior and exterior construction. The FIBEROCK® line of gypsum fiber panels includes abuse-resistant wall panels and floor underlayment as well as sheathing panels usable as a substrate for most exterior systems and as roof cover board sold under the SECUROCK® brand name. The LEVELROCK® line of poured gypsum underlayments provides surface leveling and enhanced sound performance for residential and commercial installations. We also produce a variety of construction plaster products used to provide a custom finish for residential and commercial interiors. Like SHEETROCK® brand gypsum wallboard, these products provide aesthetic, sound-dampening, fire-retarding and abuse-resistance value. Construction plaster products are sold under the trade names RED TOP®, IMPERIAL® and DIAMOND®. We also produce gypsum-based products for agricultural and industrial customers to use in a number of applications, including soil conditioning, road repair, fireproofing and ceramics.

MANUFACTURING

North American Gypsum manufactures products at 46 plants located throughout the United States, Canada and Mexico.

Gypsum rock is mined or quarried at 15 company-owned locations in North America. In 2007, these locations provided approximately 68% of the gypsum used by our plants in North America. As of December 31, 2007, our geologists estimated that our recoverable rock reserves are sufficient for more than 24 years of operation based on our average annual production of crude gypsum during the past five years of 9.5 million tons. Proven reserves contain approximately 235 million tons. Additional reserves of approximately 157 million tons are found on four properties not in operation.

Some of our manufacturing plants purchase or acquire synthetic gypsum and natural gypsum rock from outside sources. In 2007, outside purchases or

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acquisitions of synthetic gypsum and natural gypsum rock accounted for approximately 28% and 4%, respectively, of the gypsum used in our plants.

Synthetic gypsum is a byproduct of flue gas desulphurization carried out by electric generation or industrial plants that burn coal as a fuel. The suppliers of this kind of gypsum are primarily power companies, which are required to operate scrubbing equipment for their coal-fired generating plants under federal environmental regulations. We have entered into a number of long-term supply agreements to acquire synthetic gypsum. We generally take possession of the gypsum at the producer s facility and transport it to our wallboard plants by ship, river barge, railcar or truck. The supply of synthetic gypsum continues to increase as more power generation plants are fitted with desulphurization equipment. Ten of our 22 gypsum wallboard plants use synthetic gypsum for some or all of their needs.

We own eight paper mills located across the United States. Vertical integration in paper helps to ensure a continuous supply of high-quality paper that is tailored to the specific needs of our wallboard production processes. We augment our paper needs through purchases from outside suppliers when necessary. Less than 1% of our paper supply was purchased from outside suppliers during 2007.

MARKETING AND DISTRIBUTION

Our gypsum products are distributed through our wholly owned subsidiary, L&W Supply Corporation, and its subsidiaries, or L&W Supply, other specialty wallboard distributors, building materials dealers, home improvement centers and other retailers, and contractors. Sales of gypsum products are seasonal in the sense that sales are generally greater from spring through the middle of autumn than during the remaining part of the year. Based on our estimates using publicly available data, internal surveys and gypsum wallboard shipment data from the Gypsum Association, we estimate that during 2007:

- Residential and nonresidential repair and remodel activity generated about 43% of volume demand for gypsum wallboard;
- New residential construction generated about 41% of total industry volume demand;
- New nonresidential construction generated about 11% of volume demand; and
- Other activities such as exports and temporary construction generated the remaining 5% of volume demand.

COMPETITION

U.S. Gypsum accounts for approximately 30% of the total gypsum wallboard sales in the United States. In 2007, U.S. Gypsum shipped 9.0 billion square feet of wallboard. The Gypsum Association estimated that U.S. industry shipments (including imports) in 2007 were 30.7 billion square feet.

Our competitors in the United States are: National Gypsum Company, CertainTeed Corporation (a subsidiary of Compagnie de Saint-Gobain SA), Georgia-Pacific (a subsidiary of Koch Industries, Inc.), American Gypsum (a unit of Eagle Materials Inc.), Temple-Inland Forest Products Corporation, Lafarge North America, Inc., Federal Gypsum Company and PABCO Gypsum. Our competitors in Canada include CertainTeed Corporation, Georgia-Pacific, Lafarge North America, Inc. and Federal Gypsum Company. Our major competitors in Mexico are Panel Rey, S.A. and Comex-Lafarge. The principal methods of competition are quality of products, service, pricing, compatibility of systems and product design features.

Building Products Distribution

BUSINESS

Building Products Distribution consists of L&W Supply, the leading specialty building products distribution business in the United States. In 2007, L&W Supply distributed approximately 13% of all gypsum wallboard in the United States, including approximately 36% of U.S. Gypsum s wallboard production.

On March 30, 2007, L&W Supply purchased the outstanding stock of California Wholesale Material Supply, Inc. and related entities, referred to collectively as CALPLY. CALPLY sells building products and provides services from 29 locations in seven Western states and Mexico. This acquisition was part of L&W Supply s strategy to profitably grow its specialty dealer business.

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MARKETING AND DISTRIBUTION

L&W Supply was organized in 1971. It is a service-oriented business that stocks a wide range of construction materials. It delivers less-than-truckload quantities of construction materials to job sites and places them in areas where work is being done, thereby reducing the need for handling by contractors. L&W Supply specializes in the distribution of gypsum wallboard (which accounted for 43% of its 2007 net sales), joint compound and other gypsum products manufactured by U.S. Gypsum and others. It also distributes products manufactured by USG Interiors, Inc., such as acoustical ceiling tile and grid, as well as products of other manufacturers, including drywall metal, insulation, roofing products and accessories. L&W Supply leases approximately 90% of its facilities from third parties. Typical leases have terms of five years and include renewal options.

L&W Supply remains focused on opportunities to profitably grow its specialty business as well as optimize asset utilization. L&W Supply increased the number of its locations, largely through acquisitions, to 247 in 37 states and Mexico as of December 31, 2007, compared with 220 locations as of December 31, 2006 and 192 locations as of December 31, 2005.

COMPETITION

L&W Supply competes with a number of specialty wallboard distributors, lumber dealers, hardware stores, home improvement centers and acoustical ceiling tile distributors. Its competitors include Gypsum Management Supply with locations in the southern, central and western United States, KCG, Inc. in the southwestern and central United States, The Strober Organization, Inc. in the northeastern and mid-Atlantic states, and Allied Building Products Corporation in the northeastern, central and western United States. Principal methods of competition are location, service, range of products and pricing.

Worldwide Ceilings

BUSINESS

Worldwide Ceilings, which manufactures and markets interior systems products worldwide, includes USG Interiors, Inc., or USG Interiors, the international interior systems business managed as USG International, and the ceilings business of CGC. Worldwide Ceilings is a leading supplier of interior ceilings products used primarily in commercial applications. We estimate that we are the largest manufacturer of ceiling grid and the second-largest manufacturer/marketer of acoustical ceiling tile in the world.

In the third quarter of 2007, we entered into a new joint venture agreement with a leading Chinese building materials company to manufacture a complete line of acoustical ceiling tile and grid systems in China.

PRODUCTS

Worldwide Ceilings manufactures ceiling tile in the United States and ceiling grid in the United States, Canada, Europe and the Asia-Pacific region. It markets both ceiling tile and ceiling grid in the United States, Canada, Mexico, Europe, Latin America and the Asia-Pacific region. Our integrated line of ceilings products provides qualities such as sound absorption, fire retardation and convenient access to the space above the ceiling for electrical and mechanical systems, air distribution and maintenance. USG Interiors significant trade names include the AURATONE® and ACOUSTONE® brands of ceiling tile and the DONN®, DX®, FINELINE®, CENTRICITEE®, CURVATURA® and COMPASSO® brands of ceiling grid.

MANUFACTURING

Worldwide Ceilings manufactures products at 17 plants located in North America, Europe and the Asia-Pacific region. Principal raw materials used to produce Worldwide Ceilings products include mineral fiber, steel, perlite, starch and high-pressure laminates. We produce some of these raw materials internally and obtain others from outside suppliers.

MARKETING AND DISTRIBUTION

Worldwide Ceilings sells products primarily in markets related to the construction and renovation of nonresidential buildings. Ceilings products are marketed and distributed through a network of distributors, installation contractors, L&W Supply locations and home improvement centers.

COMPETITION

Our principal competitors in ceiling grid include WAVE (a joint venture between Armstrong World Industries, Inc. and Worthington Industries) and Chicago Metallic Corporation. Our principal competitors in acoustical ceiling tile include Armstrong World Industries, Inc., OWA

Faserplattenwerk GmbH (Odenwald), CertainTeed Corporation and AMF Mineralplatten GmbH Betriebs KG (owned by Gebr. Knauf Verwaltungsgellschaft KG). Principal methods of competition are quality of products, service, pricing, compatibility of systems and product design features.

Executive Officers of the Registrant

See Part III, Item 10, Directors, Executive Officers and Corporate Governance Executive Officers of the Registrant (as of February 15, 2008).

Other Information

RESEARCH AND DEVELOPMENT

To maintain our high standards and remain a leader in the building materials industry, we perform extensive research and development at the USG Research and Technology Innovation Center in Libertyville, Ill. Research team members provide product support and new product development for our operating units. With unique fire, acoustical, structural and environmental testing capabilities, the research center can evaluate products and systems. Chemical analysis and materials characterization support product development and safety/quality assessment programs. Development activities can be taken to an on-site pilot plant before being transferred to a full-size plant. We also conduct research at a satellite location where industrial designers and fabricators work on new ceiling grid concepts and prototypes.

We charge research and development expenditures to earnings as incurred. These expenditures amounted to $23 million in 2007, $20 million in 2006 and $17 million in 2005.

ENERGY

Our primary supplies of energy have been adequate, and we have not been required to curtail operations as a result of insufficient supplies. Supplies are likely to remain sufficient for our projected requirements. Currently, we use energy price swap agreements to hedge the cost of a majority of purchased natural gas. Generally, we have a majority of our anticipated purchases of natural gas over the next 12 months hedged; however, we review our positions regularly and make adjustments as market conditions warrant.

SIGNIFICANT CUSTOMER

On a worldwide basis, The Home Depot, Inc. accounted for approximately 11% of our consolidated net sales in each of 2007, 2006 and 2005.

OTHER

Because we fill orders upon receipt, no segment has any significant order backlog.

None of our segments has any special working capital requirements.

Loss of one or more of our patents or licenses would not have a material impact on our business or our ability to continue operations.

No material part of any of our business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the government.

As of December 31, 2007, we had approximately 14,800 employees worldwide.

See Note 16 to the Consolidated Financial Statements for financial information pertaining to our segments and Item 1A, Risk Factors, for information regarding the possible effects that compliance with environmental laws and regulations may have on our businesses and operating results.

Available Information

We maintain a website at www.usg.com and make available at this website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission, or SEC. If you wish to receive a paper copy of any exhibit to our reports filed with or furnished to the SEC, the exhibit may be obtained, upon payment of reasonable expenses, by writing to: Corporate Secretary, USG Corporation, 550 West Adams Street, Chicago, Illinois 60661.

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Item 1A. RISK FACTORS

Our business, operations and financial condition are subject to various risks and uncertainties. We have described below significant factors that may adversely affect our business, operations, financial performance and condition or industry. You should carefully consider these factors, together with all of the other information in this annual report on Form 10-K and in other documents that we file with the SEC, before making any investment decision about our securities. Adverse developments or changes related to any of the factors listed below could affect our business, financial condition, results of operations and growth.

Our businesses are cyclical in nature, and prolonged periods of weak demand or excess supply may have a material adverse effect on our business, financial condition and operating results.

Our businesses are cyclical in nature and sensitive to changes in general economic conditions, including, in particular, conditions in the North American housing and construction-based markets. The rate of new home construction in the United States dropped by 25% during 2007 compared to 2006, and current forecasts indicate a similar percentage decline in 2008 compared to 2007.

Prices for our products and services are affected by overall supply and demand in the markets for our products and for our competitors products. Market prices of building products historically have been volatile and cyclical. Currently, there is significant excess wallboard production capacity industry-wide in the United States, and we expect approximately three billion square feet of additional capacity, net of recent closures, to become operational in the United States in 2008, with more new capacity expected in 2009. Currently, industry capacity in the United States is approximately 40 billion square feet. Prolonged periods of weak demand or excess supply in any of our businesses may have a material adverse effect on our revenues and margins and harm our business, financial condition and operating results.

The markets that we serve, including in particular the housing and construction-based markets, are affected by the movement of interest rates. Higher interest rates could have a material adverse effect on our business, financial condition and results of operations. Our business is also affected by a variety of other factors beyond our control, including employment levels, foreign currency exchange rates, office vacancy rates, the inventory of unsold homes, which is currently at a record level, housing affordability, the availability of mortgage financing, unforeseen inflationary pressures and consumer confidence, which is at its lowest level in four years.

Since our operations occur in a variety of geographic markets, our businesses are subject to the economic conditions in each of these geographic markets. General economic downturns or localized downturns in the regions where we have operations may have a material adverse effect on our business, financial condition and operating results.

We face competition in each of our businesses. If we cannot successfully compete in the marketplace, our business, financial condition and operating results may be materially and adversely affected.

We face competition in each of our businesses. Principal methods of competition include quality and range of products, service, location, pricing, compatibility of systems and product design features. Actions of our competitors, or the entry of new competitors in our markets, could lead to lower pricing by us in an effort to maintain market share and could also lead to lower sales volumes. To achieve and/or maintain leadership positions in key product categories, we must continue to develop brand recognition and loyalty, enhance product quality and performance and develop our manufacturing and distribution capabilities.

We also compete through our use and improvement of information technology. In order to remain competitive, we need to provide customers with timely, accurate, easy-to-access information about product availability, orders and delivery status using state-of-the-art systems. While we have provided manual processes for short-term failures and disaster recovery capability, a prolonged disruption of systems or other failure to meet customers expectations regarding the capabilities and reliability of our systems may materially and adversely affect our operating results particularly during any prolonged period of disruption.

We intend to continue making investments in research and development to develop new and improved products and more efficient production methods in order to maintain our market leadership position. If we do not make these investments, or our

investments are not successful, our revenues, operating results and market share could be adversely affected. In addition, there can be no assurance that revenue from new products or enhancements will be sufficient to recover the research and development expenses associated with their development.

We intend to pursue acquisitions, joint ventures and other transactions that complement or expand our businesses. We may not be able to complete proposed transactions, and even if completed, the transactions may involve a number of risks that may result in a material adverse effect on our business, financial condition and operating results.

During the past several years, we have completed a number of acquisitions of businesses that contribute to our success. We intend to continue to pursue opportunities to acquire businesses or technologies that could complement, enhance or expand our current businesses or product lines or that might otherwise offer us growth opportunities. We may have difficulty identifying appropriate opportunities or, if we do identify opportunities, we may not be successful in completing transactions for a number of reasons. Any transactions that we are able to identify and complete may involve one or more of a number of risks, including:

- the diversion of management s attention from our existing businesses to integrate the operations and personnel of the acquired or combined business or joint venture;
- possible adverse effects on our operating results during the integration process;
- failure of the acquired business to achieve expected operational, profitability and investment return objectives; and
- our possible inability to achieve other intended objectives of the transaction.

In addition, we may not be able to successfully or profitably integrate, operate, maintain and manage our newly acquired operations or their employees. We may not be able to maintain uniform standards, controls, procedures and policies, which may lead to operational inefficiencies. In addition, future acquisitions may result in dilutive issuances of equity securities or the incurrence of additional indebtedness.

If costs of key raw materials, energy, fuel or employee benefits increase, or the availability of key raw materials and energy decreases, our cost of products sold will increase, and our operating results may be materially and adversely affected.

The cost and availability of raw materials and energy are critical to our operations. For example, we use substantial quantities of gypsum, wastepaper, mineral fiber, steel, perlite, starch and high pressure laminates. The cost of certain of these items has been volatile, and availability has sometimes been limited. We obtain some of these materials from a limited number of suppliers, which increases the risk of unavailability. As a result of recent market conditions, we have been unable to pass increased raw material costs on to our customers. We may not be able to pass increased raw materials prices on to our customers in the future if the market or existing agreements with our customers do not allow us to raise the prices of our finished products. If price adjustments for our finished products significantly trail the increase in raw materials prices or if we cannot effectively hedge against price increases, our operating results may be materially and adversely affected.

Wastepaper prices are affected by market conditions, principally supply. We buy various grades of wastepaper, and shortages occur periodically in one or more grades and may vary among geographic regions. As a result, we have experienced, and expect in the future to experience, volatility in wastepaper availability and its cost, affecting the mix of products manufactured at particular locations or the cost of producing them.

Approximately one quarter of the gypsum used in our plants is synthetic gypsum, which is a byproduct resulting primarily from flue gas desulphurization carried out by electric generation or industrial plants burning coal as a fuel. The suppliers of synthetic gypsum are primarily power companies, which are required under federal environmental regulations to operate scrubbing equipment for their coal-fired generating plants. Environmental regulatory changes or changes in methods used to comply with environmental regulations could have an impact on the price and availability of synthetic gypsum.

Energy costs also are affected by various market

factors, including the availability of supplies of particular forms of energy, energy prices and local and national regulatory decisions. Prices for natural gas and electrical power, which are significant components of the costs associated with our gypsum and interior systems products, have both increased significantly and become more volatile in recent years. There may be substantial increases in the price, or a decline in the availability, of energy in the future, especially in light of instability in some energy markets. In addition, significant increases in the cost of fuel can result in material increases in the cost of transportation, which could materially and adversely affect our operating profits. As is the case with raw materials, we may not be able to pass on increased costs through increases in the prices of our products.

In addition, our profit margins are affected by costs related to maintaining our employee benefit plans (pension and medical insurance for active employees and retirees). The recognition of costs and liabilities associated with these plans for financial reporting purposes is affected by assumptions made by management and used by actuaries engaged by us to calculate the projected and accumulated benefit obligations and the annual expense recognized for these plans. The assumptions used in developing the required estimates primarily include discount rates, expected return on plan assets for the funded plans, compensation increase rates, retirement rates, mortality rates and, for postretirement benefits, health-care-cost trend rates. Economic and market factors and conditions could affect any of these assumptions and may affect our estimated and actual employee benefit plan costs and our business, financial condition and operating results.

If the market price of natural gas declines, it may have a material adverse effect on our business, financial condition and operating results as a result of our hedging transactions and fixed-price supply agreements for natural gas.

We use natural gas extensively in the production of gypsum and interior systems products. As a result, our revenues, profitability, operating cash flows and future rate of growth are highly dependent on the price of natural gas, which has been historically very volatile and is affected by numerous factors beyond our control. We are not always able to pass on increases in energy costs to our customers through increases in product prices. In an attempt to reduce our price risk related to fluctuations in natural gas prices, we periodically enter into hedging transactions and fixed-price supply agreements. Although we benefit from those agreements when spot prices exceed contractually specified prices, if the market price for natural gas declines, we may not be able to take advantage of decreasing market prices while our competitors may be able to do so. Any substantial or extended decline in prices of, or demand for, natural gas could cause our production costs to be greater than that of our competitors. As a result, a decline in prices may have a material adverse effect on our business, financial condition and operating results.

In addition, the results of our hedging transactions could be positive, neutral or negative in any period depending on price changes in the hedged exposures. Further, changes to the price of natural gas could result in changes to the value of our hedging contracts, which could impact our results of operations for a particular period. Our hedging activities are not designed to mitigate long-term natural gas price fluctuations and, therefore, will not protect us from long-term natural gas price increases.

The loss of sales to one or more of our major customers may have a material adverse effect on our business, financial condition and operating results.

We face strong competition for our major customers. If one or more of our major customers reduces, delays or cancels substantial orders, our business, financial condition and operating results may be materially and adversely affected, particularly for the quarter in which the reduction, delay or cancellation occurs.

Certain of our customers have been expanding and may continue to expand through consolidation and internal growth, thereby possibly developing increased buying power over us, which may materially and adversely affect our revenues and results of operations.

Certain of our important customers are large companies with significant buying power over suppliers. In addition, potential further consolidation in the distribution channels could enhance the ability of certain of our customers to seek more favorable terms, including pricing, for the products that they purchase from us. Accordingly, our ability to maintain or raise prices in the future may be limited,

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including during periods of raw material and other cost increases. If we are forced to reduce prices or to maintain prices during periods of increased costs, or if we lose customers because of pricing or other methods of competition, our revenues and operating results may be materially and adversely affected.

Our substantial indebtedness may adversely affect our business, financial condition and operating results.

Our substantial indebtedness may have material adverse effects on our business, including to:

- make it more difficult for us to satisfy our debt service obligations;
- limit our ability to obtain additional financing to fund our working capital requirements, capital expenditures, acquisitions, investments, debt service obligations and other general corporate requirements;
- require us to dedicate a substantial portion of our cash flows from operations to payments on our indebtedness, thereby reducing the availability of our cash flows to fund working capital, capital expenditures and other general operating requirements;
- restrict us from making strategic acquisitions or taking advantage of favorable business opportunities;
- place us at a relative competitive disadvantage compared to our competitors that have proportionately less debt;
- limit our flexibility to plan for, or react to, changes in our business and the industries in which we operate, which may adversely affect our operating results and ability to meet our debt service obligations with respect to our outstanding indebtedness;
- increase our vulnerability to adverse general economic and industry conditions, including recessions; and
- limit our ability, or increase the cost, to refinance indebtedness.

If we do incur additional indebtedness, the risks related to our substantial indebtedness may intensify.

We require a significant amount of liquidity to service our indebtedness and fund operations, capital expenditures, research and development efforts, acquisitions and other corporate expenses.

Our ability to fund operations, capital expenditures, research and development efforts, acquisitions and other corporate expenses, including repayment of our indebtedness, depends on our ability to generate cash through future operating performance, which is subject to economic, financial, competitive, legislative, regulatory and other factors. Many of these factors are beyond our control. We cannot assure that our business will generate sufficient cash flow from operations or that future borrowings will be available to us in an amount sufficient to fund our needs.

If we are unable to generate sufficient cash flow to fund our needs, we may need to pursue one or more alternatives, such as to:

- curtail operations;
- reduce or delay planned capital expenditures, research and development or acquisitions;
- obtain additional financing or restructure or refinance all or a portion of our indebtedness on or before maturity;
- sell assets or businesses; and
- sell additional equity.

Any curtailment of operations, reduction or delay in planned capital expenditures, research and development or acquisitions or sale of assets or businesses may materially and adversely affect our future revenue prospects. In addition, we cannot assure that we will be able to raise additional equity capital, restructure or refinance any of our indebtedness or obtain additional financing on commercially reasonable terms or at all.

Covenant restrictions under our credit agreement and the indenture governing our senior notes may limit our ability to pursue business activities or otherwise operate our business.

Our credit agreement and the indenture governing our senior notes contain covenants that limit our ability to finance future operations or capital needs or to engage in other business activities, including, among other things, our ability to:

- incur additional indebtedness;
- make guarantees;
- sell assets or make other fundamental changes;
- engage in mergers and acquisitions;
- make investments;
- enter into transactions with our affiliates;
- change our business purposes; and
- enter into sale and lease-back transactions.

In addition, we are subject to agreements that require us to meet and maintain certain financial ratios and tests, which may require that we take action to reduce our debt or to act in a manner contrary to our business objectives. General business and economic conditions may affect our ability to comply with these covenants or meet those financial ratios and tests.

A breach of any of the credit agreement or indenture covenants or failure to maintain the required ratios and meet the required tests may result in an event of default under those agreements. This may allow the counterparties to those agreements to declare all amounts outstanding thereunder, together with accrued interest, to be immediately due and payable. If this occurs, we may not be able to refinance the accelerated indebtedness on favorable terms, or at all, or repay the accelerated indebtedness.

The seasonal nature of our businesses may materially and adversely affect the trading prices of our securities.

A majority of our businesses are seasonal, with peak sales typically occurring from spring through the middle of autumn. Quarterly results have varied significantly in the past and are likely to vary significantly from quarter to quarter in the future. Those variations may materially and adversely affect our financial performance and the trading prices of our securities.

We are subject to environmental and safety regulations that may change and could cause us to make modifications to how we manufacture and price our products.

We are subject to federal, state, local and foreign laws and regulations governing the protection of the environment and occupational health and safety, including laws regulating air emissions, wastewater discharges, the management and disposal of hazardous materials and wastes, and the health and safety of our employees. We are also required to obtain permits from governmental authorities for certain operations. If we were to fail to comply with these laws, regulations or permits, we could incur fines, penalties or other sanctions. In addition, we could be held responsible for costs and damages arising from any contamination at our past or present facilities or at third-party waste disposal sites. We cannot completely eliminate the risk of contamination or injury resulting from hazardous materials.

Environmental laws tend to become more stringent over time, and we could incur material expenses relating to compliance with future environmental laws. In addition, the price and availability of certain of the raw materials that we use, including synthetic gypsum, may vary in the future as a result of environmental laws and regulations affecting our suppliers. An increase in the price of our raw materials, a decline in their availability or future costs relating to our compliance with environmental laws may materially and adversely affect our operating margins or result in reduced demand for our products.

Recent scientific studies have suggested that emissions of certain gases, commonly referred to as greenhouse gases and including carbon dioxide and methane, may be contributing to warming of the

Earth s atmosphere. In response to such studies, the U.S. Congress and several states are considering proposed climate control legislation. Some states have already taken legal measures to reduce emissions of greenhouse gases. Enactment of climate control legislation or other regulatory initiatives by Congress or various states, or the adoption of regulations by the U.S. Environmental Protection Agency and analogous state or foreign governmental agencies that restrict emissions of greenhouse gases in areas in which we conduct business, could have an adverse effect on our operations and demand for our services or products. Our manufacturing processes, particularly the manufacturing process for wallboard, use a significant amount of energy, especially natural gas. Increased regulation of energy use to address the possible emission of greenhouse gases and climate change could materially increase our manufacturing costs. Energy could also become more expensive, and we may not be able to pass these increased costs on to purchasers of our products. In addition, stricter regulation of emissions might require us to install emissions control equipment at some or all of our manufacturing facilities, requiring significant additional capital investments.

We depend on our senior management team for their expertise and leadership, and the unexpected loss of any member could adversely affect our operations.

Our success depends on the management and leadership skills of our senior management team. The unexpected loss of any of these individuals or an inability to attract and retain additional personnel could prevent us from implementing our business strategy. Although we have incentives for management to stay with us, we cannot assure that we will be able to retain all of our existing senior management personnel or attract additional qualified personnel when needed.

We do not expect to pay cash dividends on our common stock for the foreseeable future.

We have not paid a dividend on our common stock since the first quarter of 2001 and have no plans to do so in the foreseeable future. Further, our credit agreement prohibits us from paying a dividend on, or repurchasing, our stock if our earnings before interest, taxes, depreciation, amortization and other non-cash adjustments are below a specified level or if a default exists under the agreement. Because we do not expect to pay dividends on our common stock in the foreseeable future, investors will have to rely on stock appreciation for a return on their investment.

A small number of our stockholders could be able to significantly influence our business and affairs.

Based on filings made with the SEC and other information available to us, as of January 31, 2008, we believe that five organizations collectively controlled over 50% of our common stock. Accordingly, a small number of our stockholders could affect matters requiring approval by stockholders, including the election of directors and the approval of mergers or other business combination transactions.

Item 1B. UNRESOLVED STAFF COMMENTS

None

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Item 2. PROPERTIES

We operate plants, mines, quarries, transport ships and other facilities in North America, Europe and the Asia-Pacific region. In 2007, U.S. Gypsum s SHEETROCK® brand gypsum wallboard plants operated at 78% of capacity. USG Interiors AURATONE® brand ceiling tile plants operated at 67% of capacity. The locations of our production properties, grouped by reportable segment, are as follows (plants are owned unless otherwise indicated):

North American Gypsum

GYPSUM WALLBOARD AND OTHER GYPSUM PRODUCTS

Aliquippa, Pa.*
Baltimore, Md.*
Bridgeport, Ala.*
East Chicago, Ind.*
Empire, Nev.
Fort Dodge, Iowa
Galena Park, Texas*
Jacksonville, Fla.*
Norfolk, Va.
Plaster City, Calif.
Rainier, Ore.
Shoals, Ind.*
Sigurd, Utah
Southard, Okla.
Sperry, Iowa*
Stony Point, N.Y.
Sweetwater, Texas
Hagersville, Ontario, Canada*
Montreal, Quebec, Canada
Monterrey, Nuevo Leon, Mexico*
Puebla, Puebla, Mexico
Tecoman, Colima, Mexico

* Plants supplied fully or partially by synthetic gypsum

JOINT COMPOUND (SURFACE PREPARATION AND JOINT TREATMENT PRODUCTS)

Auburn, Wash.
Baltimore, Md.
Bridgeport, Ala.
Chamblee, Ga.
Dallas, Texas
East Chicago, Ind.
Fort Dodge, Iowa
Galena Park, Texas
Gypsum, Ohio
Jacksonville, Fla.
Phoenix (Glendale), Ariz. (leased)
Port Reading, N.J.
Sigurd, Utah
Torrance, Calif.

Calgary, Alberta, Canada (leased)
Hagersville, Ontario, Canada
Montreal, Quebec, Canada
Surrey, British Columbia, Canada
Monterrey, Nuevo Leon, Mexico
Puebla, Puebla, Mexico

CEMENT BOARD

Baltimore, Md.
Detroit (River Rouge), Mich.
New Orleans, La.
Santa Fe Springs, Calif.
Monterrey, Nuevo Leon, Mexico

GYPSUM ROCK (MINES AND QUARRIES)

Alabaster (Tawas City), Mich.
Empire, Nev.
Fort Dodge, Iowa
Plaster City, Calif.
Shoals, Ind.
Sigurd, Utah
Southard, Okla.
Sperry, Iowa
Sweetwater, Texas
Hagersville, Ontario, Canada
Little Narrows, Nova Scotia, Canada
Windsor, Nova Scotia, Canada
Monterrey, Nuevo Leon, Mexico
San Luis Potosi, San Luis Potosi, Mexico
Tecoman, Colima, Mexico

PAPER FOR GYPSUM WALLBOARD

Clark, N.J.
Galena Park, Texas
Gypsum, Ohio
North Kansas City, Mo.
Oakfield, N.Y.
Otsego, Mich.
South Gate, Calif.

OTHER PRODUCTS

We operate a mica-processing plant at Spruce Pine, N.C. We manufacture metal lath, plaster and drywall accessories and light gauge steel framing products at Monterrey, Nuevo Leon, Mexico and Puebla, Puebla, Mexico. We produce plaster products at Boston, Mass., Puebla, Puebla, Mexico, Saltillo, Coahuila, Mexico, and San Luis Potosi, San Luis Potosi, Mexico. We manufacture gypsum fiber panel products at Gypsum, Ohio, paper-faced metal corner bead at Auburn, Wash., and Weirton, W.Va., structural cementitious panels at Delavan, Wis. (leased), and sealants and finishes at La Mirada, Calif.

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FACILITY SHUTDOWNS

Gypsum wallboard lines were temporarily idled at Jacksonville, Fla., in January 2007, Detroit, Mich., in September 2007 and New Orleans, La., in December 2007. A paper mill at Jacksonville, Fla., was temporarily idled in December 2007. A gypsum wallboard line was permanently closed at Santa Fe Springs, Calif., in January 2007. A framing products plant at Tuscaloosa, Ala., was permanently closed in June 2007. A gypsum wallboard line at Boston (Charlestown), Mass., will be permanently closed in March 2008.

NEW FACILITIES

New facilities that began operation in 2007 include a low-cost wallboard line in Norfolk, Va., that replaced a high-cost, 50-year-old line at the same location, a joint compound facility in Baltimore, Md., and a gypsum wallboard manufacturing plant in Tecoman, Colima, Mexico.

Under our capital expenditures program, we are building new gypsum wallboard plants in Washingtonville, Pa., which we expect to complete in the second half of 2008, and Stockton, Calif. Construction of the Stockton plant is scheduled to begin in the second half of 2009 and to be completed in 2011. In 2006, we acquired a paper mill in Otsego, Mich., and are converting it to manufacture high-quality, low-cost wallboard paper. We expect the paper mill to begin production in the first half of 2008.

OCEAN VESSELS

Gypsum Transportation Limited, our wholly owned subsidiary headquartered in Bermuda, owns and operates two self-unloading ocean vessels. Under a contract of affreightment, these vessels transport gypsum rock from Nova Scotia to our East Coast plants. We offer excess ship time, when available, for charter on the open market to back haul cargo such as coal. We sold one ship during 2007. A new 40,000-ton self-unloading ship, which is expected to lower the delivered cost of gypsum rock to East Coast wallboard plants, is expected to become operational in the second half of 2008.

Worldwide Ceilings

CEILING GRID

Cartersville, Ga.
Stockton, Calif.
Westlake, Ohio
Auckland, New Zealand (leased)
Dreux, France
Oakville, Ontario, Canada
Peterlee, England (leased)
Shenzhen, China (leased)
St. Petersburg, Russia (leased)
Viersen, Germany

A coil coater and slitter plant used in the production of ceiling grid is located in Westlake, Ohio. Slitter plants are located in Stockton, Calif. (leased), and Antwerp, Belgium (leased).

CEILING TILE

Cloquet, Minn.
Greenville, Miss.
Walworth, Wis.

OTHER PRODUCTS

We manufacture mineral fiber products at Red Wing, Minn., and Walworth, Wis., metal specialty systems at Oakville, Ontario, Canada, joint compound at Peterlee, England (leased), St. Petersburg, Russia (leased), Viersen, Germany, and Port Klang, Malaysia (leased), and gypsum wallboard and joint compound at Lima, Peru.

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Item 3. LEGAL PROCEEDINGS

See Part II, Item 8, Financial Statements and Supplementary Data Notes to Consolidated Financial Statements, Note 21, Litigation, for information on legal proceedings, which information is incorporated herein by reference.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable

PART II

Item 5. MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock trades on the New York Stock Exchange, or NYSE, and the Chicago Stock Exchange under the symbol USG. The NYSE is the principal market for our common stock. As of January 31, 2008, there were 2,792 record holders of our common stock. We currently do not pay dividends on our common stock.

See Part III, Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters, for information regarding common stock authorized for issuance under equity compensation plans.

We did not purchase any of our equity securities during the fourth quarter of 2007.

The high and low sales prices of our common stock in 2007 and 2006 were as follows:

	2007		2006	
	High	Low	High	Low
First quarter	$ 58.74	$ 46.22	$ 99.30	$ 64.05
Second quarter	52.75	45.43	121.70	65.33
Third quarter *	50.13	35.42	57.45	43.68
Fourth quarter	40.54	34.69	58.50	46.00

* During the third quarter of 2006, we completed a rights offering pursuant to which our stockholders of record on June 30, 2006 were issued transferable rights to purchase, at $40 per share, one new share of our common stock for each share owned. In connection with the rights offering, we

issued 44.92 million new shares of our common stock. The historical common stock prices shown above have not been adjusted to reflect the rights offering.

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Item 6. SELECTED FINANCIAL DATA
USG CORPORATION
FIVE-YEAR SUMMARY

(dollars in millions, except per-share data)	Years Ended December 31, 2007	2006	2005	2004	2003
Statement of Operations Data:					
Net sales	$ 5,202	$ 5,810	$ 5,139	$ 4,509	$ 3,666
Cost of products sold	4,603	4,440	4,037	3,672	3,121
Gross profit	599	1,370	1,102	837	545
Selling and administrative expenses	408	419	352	317	324
Restructuring and impairment charges	26				
Asbestos claims provision (reversal)		(44)	3,100		
Chapter 11 reorganization expenses		10	4	12	11
Operating profit (loss)	165	985	(2,354)	508	210
Interest expense (a)	105	555	5	5	6
Interest income	(22)	(43)	(10)	(6)	(4)
Other income, net	(4)	(3)			(9)
Income taxes (benefit)	10	188	(924)	197	79
Earnings (loss) before cumulative effect of accounting change	76	288	(1,425)	312	138
Cumulative effect of accounting change			(11)		(16)
Net earnings (loss)	76	288	(1,436)	312	122
Net Earnings (Loss) Per Common Share (b):					
Cumulative effect of accounting change			(0.20)		(0.29)
Basic	0.78	4.34	(25.49)	5.62	2.18
Diluted	0.78	4.33	(25.49)	5.62	2.18
Balance Sheet Data (as of the end of the year):					
Working capital	$ 684	$ 943	$ 1,579	$ 1,220	$ 1,084
Current ratio	2.21	1.53	3.63	3.14	3.62
Cash and cash equivalents	297	565	936	756	700
Property, plant and equipment, net	2,596	2,210	1,946	1,853	1,818
Total assets	4,621	5,365	6,142	4,278	3,799
Long-term debt (c) (d)	1,238	1,439		1	2
Liabilities subject to compromise (d)			5,340	2,242	2,243
Total stockholders equity (deficit)	2,193	1,534	(302)	1,024	689
Other Information:					
Capital expenditures	$ 460	$ 393	$ 198	$ 138	$ 111
Stock price per common share (e)	35.79	54.80	65.00	40.27	16.57
Average number of employees	14,650	14,700	14,100	13,800	13,900

(a) Interest expense for 2006 included

post-petition interest and fees of $528 million related to pre-petition obligations in connection with USG s five-year reorganization proceeding. See Note 19 to the Consolidated Financial Statements.

(b) Net earnings (loss) per common share for 2005, 2004 and 2003 were adjusted to reflect the effect of a rights offering implemented in 2006. See Note 18 to the Consolidated Financial Statements.

(c) Total debt as of December 31, 2006 was $2.504 billion. See Note 10 to the Consolidated Financial Statements.

(d) For 2003 through 2005, debt of $1.005 billion was included in liabilities subject to compromise in connection with USG s five-year reorganization proceeding. See Note 19 to the Consolidated Financial Statements.

(e) Stock price per common share reflects the final closing price of the year.

Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

SEGMENTS

Through our subsidiaries, we are a leading manufacturer and distributor of building materials, producing a wide range of products for use in new residential, new nonresidential, and repair and remodel construction as well as products used in certain industrial processes. Our operations are organized into three reportable segments: North American Gypsum, Building Products Distribution and Worldwide Ceilings.

North American Gypsum: North American Gypsum, which manufactures and markets gypsum and related products in the United States, Canada and Mexico, includes United States Gypsum Company, or U.S. Gypsum, in the United States, the gypsum business of CGC Inc., or CGC, in Canada, and USG Mexico, S.A. de C.V., or USG Mexico, in Mexico. North American Gypsum s products are used in a variety of building applications to finish the interior walls, ceilings and floors in residential, commercial and institutional construction and in certain industrial applications. Its major product lines include SHEETROCK® brand gypsum wallboard, a line of joint compounds used for finishing wallboard joints also sold under the SHEETROCK® brand name, DUROCK® brand cement board and FIBEROCK® brand gypsum fiber panels.

Building Products Distribution: Building Products Distribution consists of L&W Supply Corporation and its subsidiaries, or L&W Supply, the leading specialty building products distribution business in the United States. It is a service-oriented business that stocks a wide range of construction materials. It delivers less-than-truckload quantities of construction materials to job sites and places them in areas where work is being done, thereby reducing the need for handling by contractors.

Worldwide Ceilings: Worldwide Ceilings, which manufactures and markets interior systems products worldwide, includes USG Interiors, Inc., or USG Interiors, the international interior systems business managed as USG International, and the ceilings business of CGC. Worldwide Ceilings is a leading supplier of interior ceilings products used primarily in commercial applications. It manufactures ceiling tile in the United States and ceiling grid in the United States, Canada, Europe and the Asia-Pacific region. It markets both ceiling tile and ceiling grid in the United States, Canada, Mexico, Europe, Latin America and the Asia-Pacific region.

Geographic Information: Approximately 84% of our net sales are attributable to the United States. Canada accounts for approximately 8% of our net sales and other foreign countries account for the remaining 8%.

FINANCIAL INFORMATION

Consolidated net sales in 2007 were $5.202 billion, down 10% from 2006. Operating profit was $165 million, down from $985 million for the prior year. Net earnings were $76 million, or $0.78 per diluted share, for 2007 compared with net earnings of $288 million, or $4.33 per diluted share, for 2006.

In 2007, new housing construction in the United States dropped 25% compared with 2006 as the inventory of unsold homes continued to build and the availability of mortgage financing tightened. The residential repair and remodeling market declined as well. As expected, this has led to lower wallboard shipments and selling prices and has significantly reduced our sales and profits compared with 2006.

Shipments of U.S. Gypsum s SHEETROCK® brand gypsum wallboard in 2007 were down 17% compared with 2006. Capacity utilization rates for our gypsum wallboard plants were approximately 78% for 2007. These plants operated at 92% of capacity during 2006. The decrease in demand caused U.S. Gypsum s nationwide average realized selling price for SHEETROCK® brand gypsum wallboard to fall to $134.93 per thousand square feet for 2007 compared with $180.59 for 2006. Gypsum wallboard selling prices continued to decline during the fourth quarter, but at a slower rate of decline compared to earlier in the year. During 2007, manufacturing costs for SHEETROCK® brand gypsum wallboard were adversely affected by higher costs for wastepaper, other raw materials and natural gas compared with 2006.

As of December 31, 2007, we had $297 million of cash and cash equivalents compared with $565 million as of December 31, 2006. The decrease in cash was primarily attributable to lower earnings, increased capital expenditures and the repayment of a portion of our bank debt.

MARKET CONDITIONS AND OUTLOOK

Our businesses are cyclical in nature and sensitive to changes in general economic conditions, including, in particular, conditions in the housing and construction-based markets. Housing starts in the United States, which are a major source of demand for our products and services, continued to decline during 2007. Based on preliminary data issued by the U.S. Bureau of the Census, U.S. housing starts in 2007 were an estimated 1.354 million units, compared with actual housing starts of 1.801 million units in 2006 and 2.068 million units in 2005.

The downturn has caused both homebuilders and drywall dealers to reduce activity to keep inventories from expanding. As a result, industry shipments of gypsum wallboard in the United States were an estimated 30.7 billion square feet in 2007, a 15% decrease from 36.2 billion square feet in 2006.

The repair and remodel market, which includes renovation of both residential and nonresidential buildings, currently accounts for the largest portion of our sales, ahead of new housing construction. Many buyers begin to remodel an existing home within two years of purchase. Because sales of existing homes in 2007 dropped to an estimated 5.7 million units compared with 6.5 million units in 2006 and 7.1 million units in 2005, opportunity from the residential repair and remodel market has also decreased.

Demand for our products from new nonresidential construction is determined by floor space for which contracts are signed. Installation of gypsum and ceilings products follows signing of construction contracts by about a year. After a moderate increase in 2006, total floor space for which contracts were signed was flat in 2007, with increased investments in office construction offset by declines in store and educational construction.

The rate of new home construction in the United States dropped by 25% during 2007 compared to 2006, and current forecasts indicate a similar percentage decline in 2008 compared to 2007. Residential repair and remodeling expenditures also are expected to decline due to lower sales of existing homes and weakness in housing prices. We expect the nonresidential markets to be down modestly in 2008.

Demand for gypsum wallboard in the fourth quarter of 2007 was lower than in the fourth quarter of 2006. We anticipate that this trend will continue and that U.S. industry-wide demand for gypsum wallboard in 2008 will be down approximately 10% to 15% from 2007. Industry capacity utilization rates are expected to be below 70% for 2008. At this level of capacity utilization, we expect to see continued pressure on wallboard selling prices. This combination is expected to have a significant negative impact on North American Gypsum s profits.

We have responded to the lower level of demand for our products by making significant adjustments to our manufacturing capacity. We have idled or closed approximately 3.3 billion square feet of higher-cost wallboard capacity in the last 18 months. This figure includes wallboard capacity that was idled at the New Orleans plant during the fourth quarter of 2007. We have also eliminated about 1,250 hourly and salaried positions and closed or consolidated 12 L&W Supply locations. We will close our 80-year-old Boston gypsum wallboard line in March of 2008. We will continue adjusting our operations as conditions warrant.

See Part I, Item 1A, Risk Factors, for additional information on the cyclicality of our businesses and other risks and uncertainties that affect our businesses.

KEY OBJECTIVES

In order to perform as efficiently as possible during this challenging business cycle and to support our long-term growth objectives, we will focus on the following key objectives:

- extend our customer satisfaction leadership;
- achieve significant cost reductions;
- continue to invest in new, low-cost gypsum wallboard manufacturing capacity in order to maximize profits to support our long-term growth plan;
- keep the enterprise financially strong to act on selective acquisition opportunities that support our long-term vision; and

continue to enhance financial flexibility.

In line with our objectives to invest in new, low-cost manufacturing capacity and improve customer service, during the third quarter of 2007,

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U.S. Gypsum opened a new, low-cost wallboard line in Norfolk, Va., to replace a high-cost, 50-year-old line at the same location. U.S. Gypsum also opened a new joint compound facility in Baltimore, Md., in the third quarter of 2007. USG Mexico opened a new gypsum wallboard manufacturing plant in Tecoman, Colima, Mexico, in the third quarter of 2007 that is serving western Mexico and Latin America. We expect to begin production at our new paper mill in Otsego, Mich., in the first half of 2008. Construction of a new gypsum wallboard plant in Washingtonville, Pa., that will serve the northeastern United States is expected to be completed in the second half of 2008. The new, low-cost wallboard line in Washingtonville will serve the customers of the Boston facility that we are closing in March of 2008.

Consolidated Results of Operations

(dollars in millions, except per-share data)	2007	2006	2005	Increase (Decrease) 2007 vs. 2006	Increase 2006 vs. 2005
Net sales	$ 5,202	$ 5,810	$ 5,139	(10)%	13%
Cost of products sold	4,603	4,440	4,037	4%	10%
Gross profit	599	1,370	1,102	(56)%	24%
Selling and administrative expenses	408	419	352	(3)%	19%
Restructuring and impairment charges	26				
Asbestos claims provision (reversal)		(44)	3,100		
Chapter 11 reorganization expenses		10	4		150%
Operating profit (loss)	165	985	(2,354)	(83)%	
Interest expense	105	555	5	(81)%	
Interest income	(22)	(43)	(10)	(49)%	330%
Other income, net	(4)	(3)		33%	
Income taxes (benefit)	10	188	(924)	(95)%	
Cumulative effect of accounting change			(11)		
Net earnings (loss)	76	288	(1,436)	(74)%	
Diluted earnings (loss) per share	0.78	4.33	(25.49)	(82)%	

NET SALES

Net sales were $5.202 billion in 2007, $5.810 billion in 2006 and $5.139 billion in 2005.

Net sales for 2007 declined 10% from the record level of 2006. The steep downturn in United States residential construction since mid-2006 resulted in decreased demand for building products and lower selling prices for gypsum wallboard. Consequently, net sales in 2007 for North American Gypsum and Building Products Distribution decreased compared with 2006. However, net sales in 2007 for Worldwide Ceilings, which mainly serves the nonresidential construction market, improved compared with 2006 primarily due to higher volume and selling prices for ceiling grid and higher selling prices, partially offset by lower volume, for ceiling tile.

Net sales for 2006 were an all-time high and represented a 13% increase over 2005 primarily due to higher realized selling prices for all major product lines. Net sales increased for all three of our segments. Net sales were up for North American Gypsum and Building Products Distribution primarily due to higher selling prices, partially offset by lower volume, for gypsum wallboard. Net sales for Worldwide Ceilings increased primarily due to higher selling prices and volume for ceiling grid and higher selling prices, partially offset by lower volume, for ceiling tile.

COST OF PRODUCTS SOLD

Cost of products sold totaled $4.603 billion in 2007, $4.440 billion in 2006 and $4.037 billion in 2005.

Cost of products sold increased in 2007 compared with 2006 primarily reflecting higher costs for wastepaper, other raw materials and natural gas, partially offset by lower product volumes.

Cost of products sold increased in 2006 compared with 2005 primarily due to the effect of higher costs for natural gas and raw materials for all major product lines.

GROSS PROFIT

Gross profit was $599 million in 2007, $1.370 billion in 2006 and $1.102 billion in 2005. Gross margin (gross profit as a percentage of net sales) was 11.5% in 2007, 23.6% in 2006 and 21.4% in 2005.

Gross profit was down in 2007 compared with 2006 primarily due to lower demand for gypsum wallboard, lower gypsum wallboard selling prices and higher costs for wastepaper, other raw materials and natural gas.

Gross profit increased in 2006 compared with 2005 primarily due to higher selling prices for gypsum wallboard and for all other major product lines, partially offset by higher costs for natural gas and raw materials.

SELLING AND ADMINISTRATIVE EXPENSES

Selling and administrative expenses totaled $408 million in 2007, $419 million in 2006 and $352 million in 2005. As a percentage of net sales, these expenses were 7.8% in 2007, 7.2% in 2006 and 6.8% in 2005.

The decrease in selling and administrative expenses in 2007 compared with 2006 primarily reflected lower accruals for incentive compensation and a company-wide emphasis on reducing expenses, which more than offset a higher level of salaries and related benefits. Selling and administrative expenses as a percentage of net sales increased due to the lower level of net sales in 2007.

The increase in 2006 selling and administrative expenses versus 2005 primarily reflected increased expenses for salaries and related benefits, incentive compensation and funding for marketing and growth initiatives, as well as costs incurred in 2006 associated with our move to our new corporate offices in the first quarter of 2007.

RESTRUCTURING AND IMPAIRMENT CHARGES

In 2007, we recorded restructuring and impairment charges totaling $26 million pretax ($16 million after-tax, or $0.16 per diluted share) associated with salaried workforce reductions, shutdown costs for several manufacturing facilities and asset impairment charges. We implemented these actions in response to current market conditions. See Note 4 to the Consolidated Financial Statements for additional information related to these charges.

ASBESTOS CLAIMS PROVISION (REVERSAL)

In the fourth quarter of 2005, in connection with our evaluation of the cost of resolving our asbestos-related liabilities, we recorded a pretax charge of $3.1 billion ($1.935 billion after-tax, or $34.34 per share), increasing our reserve for all asbestos claims to $4.161 billion. In increasing our reserve, we included the anticipated cost of funding the bankruptcy-related asbestos trust created in connection with our plan of reorganization (see Notes 19 and 21 to the Consolidated Financial Statements). We also included the estimated cost of resolving asbestos property damage claims, other asbestos-related claims and associated legal expenses.

In 2006, we reversed $44 million pretax ($27 million after-tax, or $0.41 per diluted share) of our reserve for asbestos-related liabilities. This included pretax reversals of $27 million in the second quarter and an additional $17 million in the third quarter. These reversals, which are reflected as income in the consolidated statement of operations, were based on our evaluation in each quarter of the settlements of asbestos property damage claims.

CHAPTER 11 REORGANIZATION EXPENSES

Chapter 11 reorganization expenses amounted to $10 million in 2006 and $4 million in 2005. These expenses consisted of legal and financial advisory fees partially offset by bankruptcy-related interest income.

INTEREST EXPENSE

Interest expense was $105 million in 2007, $555 million in 2006 and $5 million in 2005.

Interest expense in 2007 included charges totaling $14 million pretax ($9 million after-tax, or $0.09 per diluted share) to write off deferred financing fees primarily due to the first-quarter repayment of our tax bridge loan and the third-quarter repayment of our bank term loan.

Interest expense in 2006 included charges totaling $528 million pretax ($325 million after-tax, or $4.88 per diluted share) for post-petition interest and fees related to pre-petition obligations.

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INTEREST INCOME

Interest income was $22 million in 2007, $43 million in 2006 and $10 million in 2005. Interest income in 2007 was generated primarily from money market investments. Interest income in 2006 was generated primarily from investments in marketable securities.

OTHER INCOME, NET

Other income, net was $4 million in 2007, $3 million in 2006 and zero in 2005.

INCOME TAXES (BENEFIT)

Income tax expense was $10 million in 2007 and $188 million in 2006. An income tax benefit of $924 million was recorded in 2005 as a result of the provision for asbestos claims. Our effective tax rates were 12.2% for 2007, 39.5% for 2006 and 39.3% for 2005.

The difference in the 2007 and 2006 effective tax rates was primarily attributable to a larger portion of our consolidated operating earnings arising in lower taxed foreign jurisdictions, the favorable effects of state and foreign tax law changes enacted in 2007, the reversal of valuation allowances on net operating loss and investment credit carryovers in our Worldwide Ceilings and Canadian businesses and a tax expense of $4 million related to post-petition interest on pre-petition tax obligations that was recorded in 2006.

The effective tax rate for 2005 reflected a $25 million reduction in our third quarter 2005 income tax provision in connection with the Internal Revenue Service s completion of its audit of our federal income tax returns for the years 2000 through 2002. Due to the results of the audit, a portion of our recorded income tax contingency reserves became unnecessary and were eliminated. In the fourth quarter of 2005, this reduction was offset by an increase of $41 million ($28 million net of federal benefit) in the valuation allowance relating to our reserve for asbestos claims.

CUMULATIVE EFFECT OF ACCOUNTING CHANGE

In December 2005, we adopted Financial Accounting Standards Board Interpretation No. 47, or FIN 47. A noncash, after-tax charge of $11 million, or $0.20 per share ($18 million pretax), was reflected in the consolidated statement of operations as a cumulative effect of a change in accounting principle as of December 31, 2005.

See Note 8 to the Consolidated Financial Statements for additional information related to the adoption of FIN 47.

NET EARNINGS (LOSS)

2007: Net earnings in 2007 were $76 million, or $0.78 per diluted share. These amounts included the after-tax charge of $16 million, or $0.16 per diluted share, for restructuring and impairment charges. Net earnings and earnings per share for 2007 also included the after-tax charge of $9 million, or $0.09 per diluted share, for the write-off of deferred financing fees.

2006: Net earnings in 2006 were $288 million, or $4.33 per diluted share. These amounts included the after-tax charge of $325 million, or $4.88 per diluted share, for post-petition interest and fees related to pre-petition obligations. Net earnings and earnings per share for 2006 also included after-tax income of $27 million, or $0.41 per diluted share, as a result of the reversal of the reserve for asbestos-related claims.

2005: We incurred a net loss of $1.436 billion, or $25.49 per share, in 2005. This loss included the after-tax provision of $1.935 billion, or $34.34 per share, for asbestos claims and the after-tax charge of $11 million, or $0.20 per share, for the cumulative effect of an accounting change related to the adoption of FIN 47.

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Core Business Results of Operations

(millions)	Net Sales			Operating Profit (Loss) **		
	2007	2006	2005	2007	2006	2005
North American Gypsum:						
United States Gypsum Company	$ 2,417	$ 3,215	$ 2,881	$ 23	$ 742	$ (2,557)
CGC Inc. (gypsum)	324	341	323	15	46	53
USG Mexico, S.A. de C.V.	193	177	136	26	31	21
Other subsidiaries*	83	89	88	13	17	17
Eliminations	(180)	(201)	(206)			
Total	$ 2,837	$ 3,621	$ 3,222	$ 77	$ 836	$ (2,466)
Building Products Distribution:						
L&W Supply Corporation	$ 2,291	$ 2,477	$ 2,048	$ 116	$ 203	$ 149
Worldwide Ceilings:						
USG Interiors, Inc.	$ 523	$ 507	$ 489	$ 56	$ 53	$ 43
USG International	273	235	210	12	13	9
CGC Inc. (ceilings)	61	57	55	9	11	10
Eliminations	(44)	(43)	(47)			
Total	$ 813	$ 756	$ 707	$ 77	$ 77	$ 62
Corporate				(110)	(117)	(90)
Eliminations	(739)	(1,044)	(838)	5	(4)	(5)
Chapter 11 reorganization expenses					(10)	(4)
Total USG Corporation	$ 5,202	$ 5,810	$ 5,139	$ 165	$ 985	$ (2,354)

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

Nova Scotia, Canada.

** Consolidated operating profit in 2007 included restructuring and impairment charges of $26 million pretax. On a segment basis, $18 million of the total amount related to North American Gypsum, $2 million related to Worldwide Ceilings, $1 million related to Building Products Distribution, and $5 million related to Corporate. Operating profit in 2006 for North American Gypsum included a reversal of our reserve for asbestos-related liabilities. This reversal increased operating profit for North American Gypsum by $44 million. An operating loss in 2005 of $2.466 billion for North American Gypsum resulted from a $3.1 billion charge for asbestos claims recorded in the fourth quarter of 2005.

NORTH AMERICAN GYPSUM

Net sales in 2007 for North American Gypsum were $2.837 billion, down 22% from 2006. Net sales in 2006 were $3.621 billion, up 12% from 2005.

Operating profit of $77 million in 2007 included restructuring and impairment charges of $18 million. Operating profit of $836 million in 2006 included a $44 million reversal of our reserve for asbestos-related liabilities. An operating loss of $2.466 billion in 2005 resulted primarily from a $3.1 billion charge for asbestos-related claims associated with our then-proposed plan of reorganization.

United States Gypsum Company *2007 Compared With 2006*: Net sales in 2007 decreased $798 million, or 25%, from 2006. Operating profit decreased $719 million, or 97%. Operating profit for 2007 included restructuring and impairment charges of $15 million pretax. Operating profit for 2006 included the reversal of $44 million of our reserve for asbestos-related liabilities. Operating results in 2007 were adversely affected by lower average selling prices and volume and higher manufacturing costs for SHEETROCK® brand gypsum wallboard. New housing construction was weak throughout 2007 resulting in reduced demand for gypsum wallboard and lower selling prices. Industry shipments of gypsum wallboard in 2007 were down approximately 15% from 2006. U.S. Gypsum shipped 9.0 billion square feet of SHEETROCK® brand gypsum wallboard in 2007, a 17% decrease from 10.8 billion square feet in 2006. U.S. Gypsum s capacity utilization for gypsum wallboard averaged 78% in 2007, down from 92% in 2006.

For the fourth quarter of 2007, our shipments of SHEETROCK® brand gypsum wallboard were 2.1 billion square feet, down 9% from 2.3 billion square feet in the fourth quarter of 2006. Capacity utilization was 73% in the fourth quarter of 2007 compared with 79% in the fourth quarter of 2006. We estimate that the industry operated at 68% of capacity in the fourth quarter of 2007.

In 2007, our nationwide average realized selling price for SHEETROCK® brand gypsum wallboard was $134.93 per thousand square feet, down 25% from $180.59 in 2006. During the fourth quarter of 2007, our average realized selling price for SHEETROCK® brand gypsum wallboard was $110.29 per thousand square feet, down 10% from the third quarter of 2007 and 39% compared with the fourth quarter of 2006.

Manufacturing costs for U.S. Gypsum increased 9% in 2007 primarily due to higher costs for wastepaper, other raw materials and natural gas.

Net sales and gross profit for SHEETROCK® brand joint compound products declined in 2007 compared with 2006 primarily due to lower volume, partially offset by higher average realized selling prices. Gross profit for joint compound products also was adversely affected by higher manufacturing costs. Net sales for DUROCK® brand cement board were down in 2007 compared with 2006 primarily due to lower volume. However, gross profit for cement board improved due to higher average realized selling prices and lower manufacturing costs. Net sales and gross profit for FIBEROCK® brand gypsum fiber panels improved versus 2006 due to higher selling prices and lower manufacturing costs, while volume was down slightly.

United States Gypsum Company 2006 Compared With 2005: Net sales in 2006 increased $334 million, or 12%, from 2005. Operating profit in 2006 was $742 million and included the above-mentioned reversal of $44 million of our reserve for asbestos-related liabilities. An operating loss of $2.557 billion in 2005 included the above-mentioned $3.1 billion charge for asbestos claims. Operating results benefited in 2006 primarily from higher average selling prices for SHEETROCK® brand gypsum wallboard, SHEETROCK® brand joint compound products and FIBEROCK® brand gypsum fiber panels. However, the higher levels of average selling prices were partially offset by lower shipments of gypsum wallboard and higher manufacturing costs.

New housing construction was strong in the first half of 2006 resulting in strong demand for gypsum wallboard. However, housing starts fell considerably during the second half of the year causing demand for gypsum wallboard to decrease. As a result, industry shipments of gypsum wallboard in 2006 were down approximately 3% from 2005. U.S. Gypsum shipped 10.8 billion square feet of SHEETROCK® brand gypsum wallboard in 2006, a 4% decrease from the previous record of 11.3 billion square feet in 2005. For the fourth quarter of 2006, our shipments of SHEETROCK® brand gypsum wallboard were 2.3 billion square feet, down 18% from 2.8 billion square feet in the fourth quarter of 2005. U.S. Gypsum s capacity utilization for gypsum wallboard averaged 92% in 2006, down from 96% in 2005.

Our nationwide average realized selling price for SHEETROCK® brand gypsum wallboard of $180.59 per thousand square feet in 2006 was up 25% from $143.93 in 2005. U.S. Gypsum s average realized selling price for SHEETROCK® brand gypsum wallboard was $181.75 per thousand square feet during the fourth quarter of 2006.

Manufacturing costs for U.S. Gypsum increased in 2006 primarily due to higher costs for energy and raw materials.

CGC Inc.: Net sales decreased $17 million, or 5%, and operating profit decreased $31 million, or 67%, in 2007 versus 2006. The decline in net sales was largely attributable to lower selling prices for SHEETROCK® 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 2007 also included a restructuring charge of $3 million related to our salaried workforce reductions.

Comparing 2006 with 2005, net sales increased 6%, while operating profit decreased 13%. The decline in operating profit was primarily due to lower volume and higher manufacturing costs, partially offset by higher selling prices for CGC s

SHEETROCK® brand gypsum wallboard and the favorable effects of currency translation.

USG Mexico, S.A. de C.V.: Net sales in 2007 for our Mexico-based subsidiary were up $16 million, or 9%, compared with 2006 largely due to increased sales of complementary products such as construction plasters and DUROCK® brand cement board. However, operating profit was down $5 million, or 16%, compared with 2006 largely due to higher energy and raw material costs.

Comparing 2006 with 2005, net sales increased 30% and operating profit increased 48%. These results primarily reflected increased volume and higher selling prices for gypsum wallboard.

BUILDING PRODUCTS DISTRIBUTION

L&W Supply s net sales in 2007 were $2.291 billion, down $186 million, or 8%, compared with 2006. This decline was primarily attributable to lower gypsum wallboard shipments and selling prices as a result of the weak residential construction market. The benefit of recent acquisitions and increased sales related to nonresidential construction activity partially offset those negative factors.

L&W Supply s gypsum wallboard shipments declined 11% compared with 2006, while sales of other products increased 14%, including a 36% increase in sales of ceilings products. Wallboard shipments and sales of nonwallboard products were favorably affected by the impact of recently acquired businesses. California Wholesale Material Supply, Inc., or CALPLY, which was acquired in late March 2007, and All Interiors Supply, which was acquired in the fourth quarter of 2006, contributed $460 million to 2007 net sales. Driven by lower product volumes and gypsum wallboard prices, same-location net sales for 2007 decreased 26% compared with 2006.

Operating profit in 2007 was $116 million, down $87 million, or 43%, compared with 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 operating profit. Profit margins for most other product lines experienced only modest declines. Amortization expense related to intangible assets associated with recent acquisitions was $6 million in 2007 and further reduced operating profit. Amortization expense in 2006 was immaterial. L&W Supply s operating profit for 2007 included a restructuring charge of $1 million related to salaried workforce reductions.

L&W Supply s gypsum wallboard price and volume trends in the fourth quarter of 2007 were similar to those for our North American Gypsum segment due to the weakened conditions in the United States residential construction market.

During 2007, L&W Supply closed or consolidated 12 locations in response to weak market conditions, but it continues to serve its customers in these markets from other locations.

Net sales and operating profit in 2006 for L&W Supply were the highest for any year in its history. Net sales of $2.477 billion represented a 21% increase compared with 2005, while operating profit rose 36% to $203 million. These results were primarily attributable to a 26% increase in selling prices for gypsum wallboard and record shipments of gypsum wallboard, which were up 3% from 2005. Record sales of complementary building products such as drywall metal, ceiling products and joint compound also contributed to the improved results in 2006.

L&W Supply operated 247 locations in the United States and Mexico as of December 31, 2007 compared with 220 locations in the United States as of December 31, 2006 and 192 locations in the United States as of December 31, 2005.

WORLDWIDE CEILINGS

Net sales in 2007 of $813 million increased 8% compared with 2006, while operating profit of $77 million, which included a restructuring charge of $2 million related to salaried workforce reductions, was unchanged. Net sales in 2006 of $756 million increased 7% and operating profit in 2006 of $77 million increased 24% compared with 2005.

USG Interiors, Inc.: Net sales in 2007 for our domestic ceilings business rose to $523 million, an increase of $16 million, or 3%, compared with 2006. Operating profit of $56 million increased 6% compared with 2006. These favorable results primarily reflected higher volume and selling prices for ceiling grid and higher selling prices, partially offset by lower volume, for ceiling tile. The improved profitability was tempered by higher manufacturing costs for both product lines.

Net sales in 2006 for our domestic ceilings business were $507 million, an $18 million increase compared with 2005. Operating profit of $53 million increased 23% compared with 2005. Results for

ceiling grid improved in 2006 due to increased shipments and higher selling prices, partially offset by higher manufacturing costs. Results for ceiling tile improved due to higher selling prices, partially offset by lower shipments and higher manufacturing costs.

USG International: Net sales in 2007 for USG International increased $38 million, or 16%, while operating profit of $12 million was down $1 million compared with 2006. The improvement in net sales primarily reflected increased demand for USG 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.

Comparing 2006 with 2005, net sales were up 12%, and operating profit increased 44%. These increases primarily reflected increased demand for USG ceiling grid in Europe and increased exports to Latin America.

CGC Inc.: Net sales in 2007 increased $4 million, or 7%, compared with 2006 primarily due to improved pricing for ceiling grid, partially offset by lower selling prices for ceiling tile. However, operating profit of $9 million was down $2 million primarily due to higher grid manufacturing costs.

Comparing 2006 with 2005, net sales increased $2 million and operating profit increased $1 million. These results primarily reflected the favorable effects of currency translation and improved pricing for ceiling tile.

Liquidity and Capital Resources

LIQUIDITY

As of December 31, 2007, we had cash and cash equivalents of $297 million compared with $565 million as of December 31, 2006. We believe that cash on hand, cash available from future 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 asset dispositions. Transactions of these types may result in material cash expenditures or proceeds.

We have a credit agreement with a syndicate of banks that includes a $650 million revolving credit facility with a $250 million sublimit for letters of credit. As of December 31, 2007, we had not drawn upon the revolving credit facility except for approximately $78 million of outstanding letters of credit. See Note 10 to the Consolidated Financial Statements for information regarding the credit agreement.

We expect to be able 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)	2007	2006	2005
Net cash provided by (used for):			
Operating activities	$ 1,307	$ (3,703)	$ 506
Investing activities	(730)	119	(372)
Financing activities	(853)	3,212	44
Effect of exchange rate changes on cash	8	1	2
Net (decrease) increase in cash and cash equivalents	$ (268)	$ (371)	$ 180

Operating Activities: The variation between 2007 and 2006 primarily reflects our first-quarter 2007 receipt of a federal tax refund of $1.057 billion, our payments in 2006 to fund our obligations under our plan of reorganization, which included a $3.95 billion payment to the asbestos personal injury trust established under the plan, $499 million for interest on pre-petition debt and $166 million for pre-petition trade claims and related interest. We also made other asbestos-related payments in 2007 and 2006. In 2007, we paid approximately $40 million for asbestos property damage settlements. In 2006, we paid approximately $99 million for asbestos property damage settlements and $19 million for the settlement of other asbestos-related claims.

Investing Activities: The variation between 2007 and 2006 primarily reflects increased spending in 2007 for acquisitions (up $151 million) and capital projects (up $67 million), while in 2006 we had a cash inflow of $565 million from net sales of marketable securities. This cash was used in 2006 to fund a portion of our obligations under the plan of reorganization. Also in 2006, restricted cash of $72 million was returned to us primarily due to the termination of a credit agreement with LaSalle Bank National Association.

Financing Activities: The variation between 2007 and 2006 primarily reflects the following transactions. In 2007, we repaid a $1.065 billion borrowing under our tax bridge facility and a $700 million borrowing under our term loan facility. These repayments were partially offset by the issuance of $499 million of 7.75% senior unsecured 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. In 2006, we borrowed $1.065 billion under the tax bridge facility and $700 million under the term loan facility and issued $500 million of 6.3% senior unsecured notes. We received net proceeds of approximately $1.7 billion in connection with our rights offering discussed in Note 18 to the Consolidated Financial Statements. These cash inflows were used in 2006 to fund a portion of our obligations under the plan of reorganization and were partially offset by the payment of $766 million related to pre-petition debt principal.

CAPITAL EXPENDITURES

Capital spending amounted to $460 million in 2007 compared with $393 million in 2006. As of December 31, 2007, capital expenditure commitments for the replacement, modernization and expansion of operations amounted to $302 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 December 31, 2007 include the following with the estimated total costs indicated:

approximately $129 million to acquire a paper mill in Otsego, Mich., in 2006 and to convert it to manufacture high-quality, low-cost paper for U.S. Gypsum s wallboard plants. The plant is expected to begin production in the first half of 2008;

approximately $225 million for a new low-cost gypsum wallboard plant in Washingtonville, Pa., that will serve the northeastern United States. Construction of this plant began in late 2006 and is expected to be completed in the second half of 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 the second half of 2008; and

approximately $220 million for a new, low-cost gypsum wallboard plant in Stockton, Calif., that will serve Northern California. Construction of this plant is scheduled to begin in the second half of 2009 and to be completed in 2011.

WORKING CAPITAL

As of December 31, 2007, working capital (current assets less current liabilities) amounted to $684 million, and the ratio of current assets to current liabilities was 2.21-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. The decrease in working capital largely reflected a lower level of cash in 2007, primarily as a result of lower earnings, increased capital expenditures and the repayment of a portion of our bank debt.

Receivables decreased to $430 million as of December 31, 2007 from $448 million as of December 31, 2006. During the same period, inventories increased to $377 million from $348 million, and accounts payable increased to $328 million from $303 million. The increases in inventories and payables were attributable in part to the acquisitions of CALPLY and Grupo Supremo, a Mexican plaster company, in 2007. The lower level of receivables primarily reflected a 10% decrease in net sales for the month of December 2007 compared with December 2006. Accrued expenses decreased to $234 million as of December 31, 2007 from $358

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million as of December 31, 2006 largely due to payments made in 2007 for asbestos property damage settlements and a lower level of accrued employee incentive compensation in 2007.

DEBT

Total debt amounted to $1.238 billion as of December 31, 2007 compared with $2.504 billion as of December 31, 2006. During 2007:

- we repaid the $1.065 billion borrowing under our bank credit agreement s tax bridge facility using a $1.057 billion federal tax refund and cash on hand. We received the tax refund as a result of tax deductions generated by our payments in 2006 to the asbestos personal injury trust;

- we repaid $700 million of outstanding borrowings under our bank credit agreement s term loan facility; and

- we sold $500 million of 7.75% senior unsecured notes due January 2018 in an underwritten public offering. We recorded the notes on the consolidated balance sheet at $499 million, which is net of debt discount of $1 million.

See Note 10 to the Consolidated Financial Statements for additional information about our debt.

Realization of Deferred Tax Asset

Our consolidated balance sheet as of December 31, 2007 includes a gross deferred tax asset of $455 million relating to U.S. federal, state and foreign income tax benefits available for use in future periods with respect to various net operating loss and tax credit carryforwards arising in 2007 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 $63 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 $226 million of federal income tax benefits relating to our federal net operating loss and tax credit carryforwards.

In contrast to the results under the Internal Revenue Code, many U.S. states do not allow the carryback of a net operating loss in any significant amount. As a result, in these states our net operating loss carryforwards are significantly higher than our federal net operating loss carryforward. To the extent that we do not generate sufficient state taxable income within the statutory carryforward periods to utilize the loss carryforwards in these states, the loss carryforwards will expire unused. Based on projections of future taxable income (consistent with historical results and anticipated future trends) in the 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 $62 million of the $216 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, based on taxable income projected to be realized in those jurisdictions in future years, we expect to utilize in full.

During 2007, we decreased our valuation allowance for deferred tax assets by a net total of $10 million due to a change in our judgment about the realizability of the deferred tax assets relating to net operating loss and investment credit carryforwards in our Worldwide Ceilings and Canadian businesses.

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Contractual Obligations and Other Commitments

CONTRACTUAL OBLIGATIONS

As of December 31, 2007, our contractual obligations and commitments were as follows:

		Payments Due by Period			
(millions)	Total	2008	2009-2010	2011-2012	There-after
Debt obligations (a)	$ 1,239	$	$	$	$ 1,239
Other long-term liabilities (b)	563	5	9	13	536
Interest payments (c)	1,017	76	168	168	605
Purchase obligations (d)	482	125	110	75	172
Commitments for capital expenditures (e)	302	104	198		
Operating leases	496	103	156	85	152
Unrecognized tax benefits (f)	56	4	10	38	4
Total	$ 4,155	$ 417	$ 651	$ 379	$ 2,708

(a) Excludes debt discount of $1 million.

(b) Other long-term liabilities primarily consist of asset retirement obligations that principally extend over a 50-year period. The majority of associated payments are due toward the latter part of that period.

(c) Reflects estimated interest payments on debt obligations as of December 31, 2007.

(d) Purchase obligations primarily consist of contracts to purchase energy and certain raw materials.

(e) Reflects estimates of future spending on capital projects that were committed to prior to December 31, 2007 but were not completed by that date.

(f) Reflects estimated payments (if required) of gross unrecognized tax benefits.

Our defined benefit pension plans have no minimum funding requirements under the Employee Retirement Income Security Act of 1974, or ERISA. In accordance with our funding policy, we currently plan to voluntarily contribute approximately $52 million of cash to our pension plans in 2008.

The above table excludes liabilities related to postretirement benefits (retiree health care and life insurance). We voluntarily provide postretirement benefits for eligible employees and retirees. The portion of benefit claim payments we made in 2007 was $17 million. See Note 12 to the Consolidated Financial Statements for additional information on future expected cash payments for pension and other postretirement benefits.

OFF-BALANCE-SHEET ARRANGEMENTS

With the exception of letters of credit, it is not our business practice to use off-balance-sheet arrangements, such as third-party special-purpose entities.

GUARANTEES

USG is party to a variety of agreements under which it may be obligated to indemnify a third party with respect to certain matters. We do not consider the maximum potential amount of future payments that we could be required to make under these agreements to be material.

Legal Contingencies

USG and certain of its subsidiaries 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. See Note 21 to the Consolidated Financial Statements for additional information on environmental litigation and for information concerning asbestos and related litigation. We do not expect the environmental, asbestos-related or any other litigation matters involving USG to have a material adverse effect upon our results of operations, financial position or cash flows.

Critical Accounting Policies

Our consolidated financial statements are prepared in conformity with accounting policies generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses during the periods presented. The following is a summary of the accounting policies we believe are the most important to aid in understanding our financial results.

IMPAIRMENT OF GOODWILL, OTHER INTANGIBLE ASSETS AND PROPERTY PLANT AND EQUIPMENT

Goodwill and Other Intangible Assets: In accordance with Statement of Financial Accounting Standards, or SFAS, No. 142, Goodwill and Other Intangible Assets, we complete the impairment testing of

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goodwill each year, or more frequently if events or circumstances indicate it might be impaired. When the carrying amount of goodwill exceeds its fair value, a goodwill impairment loss is recognized. Determining fair value requires us to make significant estimates and assumptions. Our judgments are based upon historical experience, current market trends, and other information.

Other intangible assets determined to have indefinite useful lives, primarily comprised of trade names, are not amortized. We perform impairment tests for intangible assets with indefinite useful lives annually, or more frequently if events or circumstances indicate they might be impaired. An income approach is used for valuing trade names. A market approach is used for valuing other intangible assets. Assumptions used in the income approach include projected revenues estimated by management and an appropriate discount rate.

Other intangible assets with definite lives, primarily comprised of customer relationships, are amortized over their useful lives. Judgment is used in assessing whether the carrying amount is not expected to be recoverable over their estimated remaining useful lives and whether conditions exist to warrant a revision to the remaining periods of amortization. An asset impairment would be indicated if the sum of the expected future net pretax cash flows from the use of the asset (undiscounted and without interest charges) is less than the carrying amount of the asset. An impairment loss would be measured based on the difference between the fair value of the asset and its carrying value.

While we believe that the estimates and assumptions underlying the valuation methodologies are reasonable, different estimates and assumptions could result in different outcomes.

Property, Plant and Equipment: We assess our property plant and equipment for possible impairment in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable or a revision of remaining useful lives is necessary. Such indicators may include economic conditions, competition, changes in our business plans or management s intentions regarding future utilization of the assets, or changes in our commodity prices. An asset impairment would be indicated if the sum of the expected future net pretax cash flows from the use of an asset (undiscounted and without interest charges) is less than the carrying amount of the asset. An impairment loss would be measured based on the difference between the fair value of the asset and its carrying value. The determination of fair value is based on an expected present value technique in which multiple cash flow scenarios that reflect a range of possible outcomes and a risk free rate of interest are used to estimate fair value or a market appraisal.

Determination as to whether and how much an asset is impaired involves significant management judgment on highly uncertain matters including estimating the future success of product lines, future sales volumes, growth rates for selling prices and costs, alternative uses for the assets, and estimated proceeds from disposal of the assets. However, the impairment reviews and calculations are based on estimates and assumptions that are consistent with our business plans and long-term investment decisions. Impairment testing is conducted at the lowest level where cash flows can be measured and are independent of cash of other assets.

SHARE-BASED COMPENSATION

We account for share-based compensation in accordance with SFAS No. 123(R), Share-Based Payment. Under the fair value recognition provisions of this statement, we measure share-based compensation cost at the grant date based on the value of the award, which is recognized as expense over the vesting period. We use the Black-Scholes option valuation model to determine the fair value of USG stock options and stock appreciation rights and a Monte Carlo simulation to determine the fair value of performance shares. Determining the fair value of share-based awards at the grant date requires several assumptions, and a change in these assumptions could impact our share-based compensation expense and our results of operations. These assumptions include the expected volatility of our common stock, the risk-free interest rate, the expected dividend yield on our common stock, the expected option and performance share grant terms and the amount of share-based awards that are expected to be forfeited. If we use different assumptions to value share-based awards granted in future periods, share-based compensation expense and our results of operations could be impacted in future periods. See Note 13 to the Consolidated Financial Statements for additional information.

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EMPLOYEE RETIREMENT PLANS

We maintain defined benefit pension plans for most of our employees. Most of these plans require employee contributions in order to accrue benefits. We also maintain plans that provide postretirement benefits (retiree health care and life insurance) for eligible employees. For accounting purposes, these plans depend on assumptions made by management, which are used by actuaries we engage to calculate the projected and accumulated benefit obligations and the annual expense recognized for these plans. The assumptions used in developing the required estimates primarily include discount rates, expected return on plan assets for the funded plans, compensation increase rates, retirement rates, mortality rates and, for postretirement benefits, health-care-cost trend rates.

We determined the assumed discount rate based on a hypothetical AA yield curve represented by a series of annualized individual discount rates. Each underlying bond issue is required to have a credit rating of Aa or better by Moody s Investor Service, Inc. or a credit rating of AA or better by Standard & Poor s Ratings Services. The use of a different discount rate would impact net pension and postretirement benefit costs and benefit obligations. In determining the expected return on plan assets, we use a building block approach, which incorporates historical experience, our pension plan investment guidelines and expectations for long-term rates of return. The use of a different rate of return would impact net pension costs. A one-half-percentage-point change in the assumed discount rate and return-on-plan-asset rate would have the following effects (dollars in millions):

Assumptions	Percentage Change	Increase (Decrease) in 2008 Net Annual Benefit Cost	Increase (Decrease) in 2007 Projected Benefit Obligation
Pension Benefits:			
Discount rate	0.5% increase	$ (5)	$ (85)
Discount rate	0.5% decrease	9	93
Asset return	0.5% increase	(6)	
Asset return	0.5% decrease	6	
Postretirement Benefits:			
Discount rate	0.5% increase	$ (3)	$ (29)
Discount rate	0.5% decrease	4	33

Compensation increase rates are based on historical experience and anticipated future management actions. Retirement rates are based primarily on actual plan experience, while standard actuarial tables are used to estimate mortality rates. We developed health-care-cost trend rate assumptions based on historical cost data and an assessment of likely long-term trends.

Results that differ from these assumptions are accumulated and amortized over future periods and, therefore, generally affect the net benefit cost of future periods. The sensitivity of assumptions reflects the impact of changing one assumption at a time and is specific to conditions at the end of 2007. Economic factors and conditions could affect multiple assumptions simultaneously, and the effects of changes in assumptions are not necessarily linear.

See Note 12 to the Consolidated Financial Statements for additional information regarding costs, plan obligations, plan assets and assumptions including the health-care-cost trend rate.

SELF-INSURANCE RESERVES

We purchase insurance from third parties for workers compensation, automobile, product and general liability claims that exceed certain levels. However, we are responsible for the payment of claims up to those levels. In estimating the obligation associated with incurred and incurred-but-not-reported losses, we use our historical data to project the future development of losses and take into account the impact of claims that were stayed during our five-year Chapter 11 proceedings. These claims will impact the analysis until all pre-petition claims are closed. We monitor and review all estimates and related assumptions for reasonableness. Loss estimates are adjusted based upon actual claims settlements and reported claims.

INCOME TAXES

We reduce the recorded amount of our deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. We evaluate all available evidence to determine whether, based on the weight of that evidence, a valuation allowance is needed. Information about our current financial position and our results of operations for the current and preceding years is taken into account, supplemented by all currently available information about future years. As

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of December 31,2007, we have recorded valuation allowances totaling $63 million with respect to various U.S. federal and state net operating loss and tax credit carryforwards, the substantial majority of which arose from the funding of the asbestos trust in 2006. Under Realization of Deferred Tax Asset above, we describe the amount and nature of these carryforwards and our conclusions regarding the need for valuation allowances on the related deferred tax assets. Our conclusions are based in large part on our best available projections of future taxable income. If the estimates and assumptions on which these projections are based change in the future or actual results differ from our projections, we may be required to adjust our valuation allowances. This could result in a charge to, or an increase in, income in the period such determination is made.

In addition, we operate within multiple taxing jurisdictions and are subject to audit in these jurisdictions. We record accruals for the estimated outcomes of these audits, and these accruals may change in the future due to new developments in each matter. In each of the prior two years, we have experienced adjustments to our accruals for the settlement of tax audits as described in Note 15 to the Consolidated Financial Statements. Such adjustments could result in a charge to, or an increase in, income in the period such determination is made.

On January 1, 2007, we adopted Financial Accounting Standards Board, or FASB, Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of Financial Accounting Standards Board Statement No. 109. Under this interpretation, we recognize the tax benefits of an uncertain tax position only if those benefits have a greater than 50% likelihood of being sustained upon examination by the relevant taxing authorities. Unrecognized tax benefits are subsequently recognized at the time the more-likely-than-not recognition threshold is met, the tax matter is effectively settled or the statute of limitations for the relevant taxing authority to examine and challenge the tax position has expired, whichever is earlier.

Recent Accounting Pronouncements

In September 2006, the FASB issued 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. The adoption of this statement will have an immaterial impact on our financial statements, and we will comply with the disclosure provisions of this statement when applicable.

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. Upon adoption, this statement will have no impact on our financial statements.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations. The objective of this statement is to improve the relevance and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS No. 141(R) presents several significant changes from current accounting practices for business combinations, most notably the following: revised definition of a business; a shift from the purchase method to the acquisition method; expensing of acquisition-related transaction costs; recognition of contingent consideration and contingent assets and liabilities at fair value; and capitalization of acquired in-process research and development. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We will adopt this statement for acquisitions consummated after its effective date.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements. The objective of this statement is to improve the relevance, comparability and transparency of the financial information that a

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reporting entity provides in its consolidated financial statements. Under the new standard, noncontrolling interests are to be treated as a separate component of stockholders equity, not as a liability or other item outside of stockholders equity. The practice of classifying minority interests within the mezzanine section of the balance sheet will be eliminated and the current practice of reporting minority interest expense also will change. The new standard also requires that increases and decreases in the noncontrolling ownership amount be accounted for as equity transactions. This statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We are currently reviewing this pronouncement to determine the impact, if any, that it may have on our financial statements.

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.

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Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We use derivative instruments from time to time to manage selected commodity price and foreign currency exposures. We do not use derivative instruments for speculative trading purposes. In addition, we use financial instruments, including fixed and variable rate debt, to finance our operations in the normal course of business.

COMMODITY PRICE RISK

We use swap contracts to manage our exposure to fluctuations in commodity prices associated with anticipated purchases of natural gas. Generally, we have a majority of our anticipated purchases of natural gas over the next 12 months hedged; however, we review our positions regularly and make adjustments as market and business conditions warrant. A sensitivity analysis was prepared to estimate the potential change in the fair value of our natural gas swap contracts assuming a hypothetical 10% change in market prices. Based on results of this analysis, which may differ from actual results, the potential change in the fair value of our natural gas swap contracts is $18 million. This analysis does not consider the underlying exposure.

FOREIGN CURRENCY EXCHANGE RISK

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 $61 million, and all contracts mature by December 29, 2009. As of December 31, 2007, the fair value of these hedges was a $0.5 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 December 31, 2007, the fair value of these hedges, which was a loss of $1 million, was recorded to accumulated other comprehensive income, or AOCI.

INTEREST RATE RISK

As of December 31, 2007, all of our outstanding debt was fixed-rate debt. Consequently, changes in floating interest rates will have no impact on our interest expense.

See Notes 1 and 11 to the Consolidated Financial Statements for additional information on our financial exposures.

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Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

All other schedules have been omitted because they are not required or applicable or the information is included in the consolidated financial statements or notes thereto.

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USG CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

(millions, except per-share data)	Years Ended December 31,		
	2007	2006	2005
Net sales	$ 5,202	$ 5,810	$ 5,139
Cost of products sold	4,603	4,440	4,037
Gross profit	599	1,370	1,102
Selling and administrative expenses	408	419	352
Restructuring and impairment charges	26		
Asbestos claims provision (reversal)		(44)	3,100
Chapter 11 reorganization expenses		10	4
Operating profit (loss)	165	985	(2,354)
Interest expense	105	555	5
Interest income	(22)	(43)	(10)
Other income, net	(4)	(3)	
Earnings (loss) before income taxes and cumulative effect of accounting change	86	476	(2,349)
Income taxes (benefit)	10	188	(924)
Earnings (loss) before cumulative effect of accounting change	76	288	(1,425)
Cumulative effect of accounting change			(11)
Net earnings (loss)	$ 76	$ 288	$ (1,436)
Basic Earnings (Loss) Per Common Share:			
Before cumulative effect of accounting change	$ 0.78	$ 4.34	$ (25.29)
Cumulative effect of accounting change			(0.20)
Basic earnings (loss) per common share	$ 0.78	$ 4.34	$ (25.49)
Diluted Earnings (Loss) Per Common Share:			
Before cumulative effect of accounting change	$ 0.78	$ 4.33	$ (25.29)
Cumulative effect of accounting change			(0.20)
Diluted earnings (loss) per common share	$ 0.78	$ 4.33	$ (25.49)

The notes to consolidated financial statements are an integral part of these statements.

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USG CORPORATION
CONSOLIDATED BALANCE SHEETS

(millions, except share data)	As of December 31,	
	2007	2006
Assets		
Current Assets:		
Cash and cash equivalents	$ 297	$ 565
Restricted cash		6
Receivables (net of reserves: 2007 $17; 2006 $16)	430	448
Inventories	377	348
Income taxes receivable	37	1,102
Deferred income taxes	53	169
Other assets	57	69
Total current assets	1,251	2,707
Property, plant and equipment, net	2,596	2,210
Deferred income taxes	228	187
Goodwill	226	154
Other assets	320	107
Total assets	$ 4,621	$ 5,365
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$ 328	$ 303
Accrued expenses	234	358
Income taxes payable	5	38
Short-term debt		1,065
Total current liabilities	567	1,764
Long-term debt	1,238	1,439
Deferred income taxes	10	11
Other liabilities	613	617
Commitments and contingencies		
Stockholders Equity:		
Preferred stock (000) $1 par value, $1.80 convertible preferred stock (initial series); authorized 36,000 shares; outstanding none		
Common stock (000) $0.10 par value; authorized 200,000 shares; issued: 2007 103,972 shares; 2006 94,908 shares	10	9
Treasury stock at cost (000) 2007 4,921 shares; 2006 5,043 shares	(204)	(208)

Capital received in excess of par value	2,607	2,176
Accumulated other comprehensive income (loss)	9	(136)
Retained earnings (deficit)	(229)	(307)
Total stockholders equity	2,193	1,534
Total liabilities and stockholders equity	$ 4,621	$ 5,365

The notes to consolidated financial statements are an integral part of these statements.

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USG CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(millions)	Years Ended December 31,		
	2007	2006	2005
Operating Activities			
Net earnings (loss)	$ 76	$ 288	$ (1,436)
Adjustments to Reconcile Net Earnings (Loss) to Net Cash:			
Asbestos claims provision (reversal)		(44)	3,100
Cumulative effect of accounting change			11
Depreciation, depletion and amortization	176	138	125
Share-based compensation expense	20	17	
Deferred income taxes	4	1,198	(1,261)
Gain on asset dispositions			(5)
(Increase) Decrease in Working Capital (net of acquisitions):			
Receivables	91	(12)	(31)
Income taxes receivable	1,063	(1,096)	19
Inventories	7	(18)	27
Payables	(60)	38	(30)
Accrued expenses	(59)	(24)	41
Increase in other assets	(29)	(33)	(43)
Increase in other liabilities	33	40	20
Reorganization distribution other	(40)	(783)	
Payment to Section 524(g) asbestos trust		(3,950)	
Increase (decrease) in liabilities subject to compromise		521	(2)
Other, net	25	17	(29)
Net cash provided by (used for) operating activities	1,307	(3,703)	506
Investing Activities			
Capital expenditures	(460)	(393)	(198)
Acquisitions of businesses, net of cash acquired	(279)	(128)	(29)
Return (deposit) of restricted cash	6	72	(35)
Net proceeds from asset dispositions	3	3	5
Purchases of marketable securities		(112)	(648)
Sales or maturities of marketable securities		677	533
Net cash (used for) provided by investing activities	(730)	119	(372)
Financing Activities			
Repayment of debt	(1,765)		(1)
Issuance of debt, net of discount	499	2,265	
Proceeds from equity offering, net of fees	422		
Payment of debt issuance fees	(4)	(26)	
Excess tax benefits from share-based compensation	(5)	5	

Proceeds from the exercise of stock options		14	45
Proceeds from rights offering, net of fees		1,720	
Reorganization distribution debt principal		(766)	
Net cash (used for) provided by financing activities	(853)	3,212	44
Effect of exchange rate changes on cash	8	1	2
Net (decrease) increase in cash and cash equivalents	(268)	(371)	180
Cash and cash equivalents at beginning of period	565	936	756
Cash and cash equivalents at end of period	$ 297	$ 565	$ 936
Supplemental Cash Flow Disclosures:			
Interest paid	$ 90	$ 548	$ 2
Income taxes (refunded) paid, net	(1,046)	108	341

The notes to consolidated financial statements are an integral part of these statements.

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USG CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(millions, except share data)	Common Shares Issued (000)	Treasury Shares (000)	Common Stock	Treasury Stock	Capital Received in Excess of Par Value	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
Balance at January 1, 2005	49,985	(6,676)	$ 5	$ (256)	$ 417	$ 841	$ 17	$ 1,024
Net loss						(1,436)		(1,436)
Foreign currency translation							6	6
Change in fair value of derivatives, net of tax of $34							54	54
Minimum pension liability, net of tax benefit of $3							(5)	(5)
Total comprehensive loss								(1,381)
Stock issuances		1,330		37	8			45
Other		(2)			10			10
Balance at December 31, 2005	49,985	(5,348)	5	(219)	435	(595)	72	(302)
Net earnings						288		288
Foreign currency translation							3	3
Change in fair value of derivatives, net of tax benefit of $56							(86)	(86)
Gain on marketable securities, net of tax of $1							1	1
Minimum pension liability, net of tax benefit of $10							(5)	(5)
Total comprehensive income								201
Adjustment to initially apply SFAS No. 158, net of tax benefit of $97							(121)	(121)
Proceeds from exercise of stock options		309		11	3			14
Rights offering	44,923		4		1,716			1,720
Share-based compensation					17			17
Other		(4)			5			5
Balance at December 31, 2006	94,908	(5,043)	9	(208)	2,176	(307)	(136)	1,534

Net earnings						76		76
Foreign currency translation, net of tax of $1							53	53
Change in fair value of derivatives, net of tax of $15 million							21	21
Change in pension and postretirement benefit plans, net of tax of $48 million							72	72
Unrealized loss on marketable securities, net of tax benefit of $0.1 million							(1)	(1)
Total comprehensive income								221
Adoption of new accounting pronouncements, net of tax of $2						2		2
Equity offering	9,064		1		421			422
Share-based compensation					20			20
Stock issuances		122		4	(4)			
Other					(6)			(6)
Balance at December 31, 2007	103,972	(4,921)	$ 10	$ (204)	$ 2,607	$ (229)	$ 9	$ 2,193

The notes to consolidated financial statements are an integral part of these statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In the following Notes to 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. Significant Accounting Policies

NATURE OF OPERATIONS

USG, through its subsidiaries, is a leading manufacturer and distributor of building materials, producing a wide range of products for use in new residential, new nonresidential, and repair and remodel construction as well as products used in certain industrial processes. Our operations are organized into three reportable segments: North American Gypsum, which manufactures SHEETROCK® brand gypsum wallboard and related products in the United States, Canada and Mexico; Building Products Distribution, which distributes gypsum wallboard, drywall metal, ceilings products, joint compound and other building products throughout the United States; and Worldwide Ceilings, which manufactures ceiling tile in the United States and ceiling grid in the United States, Canada, Europe and the Asia-Pacific region. Our products also are distributed through building materials dealers, home improvement centers and other retailers, specialty wallboard distributors, and contractors.

CONSOLIDATION

Our consolidated financial statements include the accounts of USG Corporation and its majority-owned subsidiaries. Entities in which we have more than a 20% but not more than 50% ownership interest are accounted for on the equity basis of accounting and are not material to consolidated operations. All intercompany balances and transactions are eliminated in consolidation.

USE OF ESTIMATES

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from these estimates.

REVENUE RECOGNITION

With the exception of our Building Products Distribution segment, we recognize revenue upon the shipment of products to customers, which is when title and risk of loss are transferred to customers. For Building Products Distribution, revenue is recognized and title and risk of loss are transferred when customers receive products, either through delivery by company trucks or customer pickup. We record provisions for discounts to customers based on the terms of sale in the same period in which the related sales are recorded. We record estimated reductions to revenue for customer programs and incentive offerings, including promotions and other volume-based incentives. With the exception of Building Products Distribution, our products are generally shipped free on board, commonly called FOB, shipping point.

SHIPPING AND HANDLING COSTS

Shipping and handling costs are included in cost of products sold.

ADVERTISING

Advertising expenses consist of media advertising and related production costs and sponsorships. We charge advertising expenses to earnings as incurred. These expenses amounted to $20 million in 2007, $20 million in 2006 and $16 million in 2005.

RESEARCH AND DEVELOPMENT

We charge research and development expenditures to earnings as incurred. These expenditures amounted to $23 million in 2007, $20 million in 2006 and $17 million in 2005.

INCOME TAXES

We account for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred tax assets are evaluated for realizability and a valuation allowance is established if it is more likely than not that some portion or all of the deferred tax assets will not be realized. Tax provisions include

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