USG CORP
Form 10-K
February 20, 2009

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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, 2008

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, as amended)	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, 2008 (the last business day of the registrant s most recently completed second fiscal quarter) was approximately $2,912,657,000.

The number of shares of the registrant s common stock outstanding as of January 31, 2009 was 99,178,828.

Documents Incorporated By Reference: Certain sections of USG Corporation s definitive Proxy Statement for use in connection with its 2009 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.

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. The housing market, a major source of demand for our businesses, continued to be very weak in 2008, and is expected to remain very weak throughout 2009. That weakness could extend into 2010, especially if the inventory of unsold homes remains at a historically high level and tight mortgage lending policies continue. The current economic recession is expected to contribute to further declines in residential repair and remodeling expenditures and non-residential construction activity in 2009.

Based on preliminary data issued by the U.S. Bureau of the Census, the rate of new home construction in the United States declined by approximately 33% in 2008 compared with 2007. This followed a 25% decrease in 2007 compared with 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. According to the National Association of Realtors, sales of existing homes in 2008 declined to an estimated 4.9 million units compared with 5.7 million units in 2007 and 6.5 million units in 2006, which contributed to a decrease in demand for our products from the residential repair and remodel market. Demand for our products from new nonresidential construction is determined by floor space for which contracts are signed. Installation of gypsum and ceilings products typically follows signing of construction contracts by about a year. According to McGraw-Hill Construction, total floor space for which contracts were signed declined 16% in 2008 compared with 2007 after increasing 2% in 2007 compared to 2006.

We have been scaling back our operations in response to market conditions since the downturn began in 2006. Since mid-2006, we have temporarily idled or permanently closed approximately 3.1 billion square feet of our highest cost wallboard manufacturing capacity. In 2008, we closed 54 distribution centers. In the second and fourth quarters of 2008, we implemented salaried workforce reductions that eliminated in total approximately 1,400 salaried positions. We are continuing to adjust our operations for the extended downturn in our markets. Our focus on costs and efficiencies, including capacity closures and overhead reductions, has helped to mitigate the effects of the downturn in all of our markets. If conditions continue to deteriorate in the broader economy, we will evaluate plans to further reduce costs, improve operational efficiency and maintain our liquidity.

The effects of these market conditions on our operations are discussed in this Item 1 and in Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

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 46%, 38% and 16%, respectively, of our 2008 consolidated net sales.

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North American Gypsum

BUSINESS

North American Gypsum manufactures and markets gypsum and related products in the United States, Canada and Mexico. It 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 29% of total domestic gypsum wallboard sales in 2008. 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. The SECUROCK® line of products includes glass mat sheathing used for building exteriors and gypsum fiber panels used as roof cover board. 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 brand 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. North American Gypsum s plants are located throughout the United States, Canada and Mexico.

Gypsum rock is mined or quarried at 15 company-owned locations in North America. In 2008, these locations provided approximately 67% of the gypsum used by our plants in North America. As of December 31, 2008, our geologists estimated that our recoverable rock reserves are sufficient for more than 26 years of operation based on our average annual production of crude gypsum during the past five years of 9.0 million tons. Proven reserves contain approximately 242 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 2008, outside purchases or acquisitions of synthetic gypsum and natural gypsum rock accounted for approximately 28% and 5%, 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. Twelve of our 23 gypsum wallboard plants in operation use synthetic gypsum for some or all of their needs.

We own eight paper mills located across the United States. Three of these paper mills have been idled due to the current market environment. 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. Approximately 1% of our paper supply was purchased from outside suppliers during 2008.

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 2008:

- Residential and nonresidential repair and remodel activity generated about 48% of volume demand for gypsum wallboard;
- New residential construction generated about 34% of volume demand;
- New nonresidential construction generated about 13% of volume demand; and
- Other activities such as exports and temporary construction generated the remaining 5% of volume demand.

COMPETITION

The Gypsum Association estimated that United States industry shipments of gypsum wallboard (including imports) in 2008 were 25.2 billion square feet. U.S. Gypsum shipped 7.2 billion square feet of wallboard in 2008, or approximately 29% of the total industry sales of gypsum wallboard in the United States.

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. and PABCO Gypsum. Our competitors in Canada include CertainTeed Corporation, Georgia-Pacific and Lafarge North America, Inc. 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 2008, L&W Supply distributed approximately 12% of all gypsum wallboard in the United States, including approximately 36% of U.S. Gypsum s wallboard production.

MARKETING AND DISTRIBUTION

L&W Supply 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 33% of its 2008 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.

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In the current market environment, L&W Supply s focus is on optimizing its asset utilization. In response to weak market conditions, L&W Supply closed 54 centers in 2008, while opening five new centers and continued to serve its customers from 198 centers in the United States as of December 31, 2008. L&W Supply operated 247 centers in the United States and Mexico as of December 31, 2007 and 220 centers in the United States as of December 31, 2006. L&W Supply also continues to consider opportunities to grow its specialty distribution business taking into account the current market environment.

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 principal competitors include ProBuild Holdings Inc., a national supplier of building materials, Gypsum Management Supply with locations in the southern, central and western United States, KCG, Inc. in the southwestern and central United 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 manufactures and markets interior systems products worldwide. It 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. Worldwide Ceilings had record net sales in 2008.

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 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 brand 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 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 20, 2009).

Other Information

RESEARCH AND DEVELOPMENT

To contribute to our high standards and our leadership 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. Research and development activities were scaled back in 2008 due to the current market environment. We charge research and development expenditures to earnings as incurred. These expenditures amounted to $19 million in 2008, $23 million in 2007 and $20 million in 2006.

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 10% of our consolidated net sales in 2008 and approximately 11% in each of 2007 and 2006.

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 our business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of any government.

As of December 31, 2008, we had approximately 12,800 employees worldwide.

See Note 17 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 Web site at www.usg.com and make available at this Web site 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

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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.

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 have been adversely affected by current economic conditions, including the worldwide financial crisis and restrictive lending practices, and are cyclical in nature. Prolonged periods of weak demand or excess supply may have a material adverse effect on 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 availability of credit, lending practices, the movement of interest rates, the unemployment rate and consumer confidence. Higher interest and unemployment rates and more restrictive lending practices could have a material adverse effect on our businesses, financial condition and results of operations. Our businesses are also affected by a variety of other factors beyond our control, including the inventory of unsold homes, which currently remains at a record level, housing affordability, office vacancy rates and foreign currency exchange rates.

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. Based on preliminary data issued by the U.S. Bureau of the Census, the rate of new home construction in the United States declined by approximately 33% in 2008 compared with 2007. This followed a 25% decrease in 2007 compared with 2006. Industry analysts forecasts for new home construction in the United States in 2009 are for a further decline of approximately 20% to 45% from the 2008 level.

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. According to the National Association of Realtors, sales of existing homes in the United States in 2008 declined to an estimated 4.9 million units compared with 5.7 million units in 2007 and 6.5 million units in 2006, which contributed to a decrease in demand for our products from the residential repair and remodel market. Industry analysts forecasts for residential repair and remodel activity in the United States in 2009 are for a further decline of approximately 5% to 10% from the 2008 level.

Demand for our products from new nonresidential construction is determined by floor space for which contracts are signed. Installation of gypsum and ceilings products typically follows signing of construction contracts by about a year. According to McGraw-Hill Construction, total floor space for which contracts were signed in the United States declined 16% in 2008 compared with 2007 after increasing 2% in 2007 compared to 2006. Industry analysts forecasts for commercial construction in the United States in 2009 are for a further decline of approximately 15% to 20% from the 2008 level.

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. Industry capacity in the United States was approximately 40 billion square feet in 2008. Industry shipments of wallboard in the United States (including imports) were an estimated 25.2 billion square feet in 2008, and we expect demand to decrease in 2009. We and other industry participants announced a number of closures near the end of 2008 that we

expect will reduce industry capacity in the United States by approximately 3 billion square feet in 2009. We do not expect any new industry capacity will be added in 2009. Prolonged continuation of weak demand or excess supply in any of our businesses may have a material adverse effect on our business, revenues, margins, financial condition and operating results.

We cannot predict the duration of the current market conditions, or the timing or strength of any future recovery of the North American housing and construction-based markets. We also cannot provide any assurances that those markets will not weaken further, or that the operational adjustments we have implemented to address the current market conditions will be successful. Continued weakness in these markets and the homebuilding industry may have a material adverse effect on our business, financial condition and operating results.

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.

Our customers and suppliers are exposed to risks associated with the current worldwide downturn and financial crisis which could adversely affect their ability to pay our invoices or continue to operate their businesses.

The businesses of many of our customers and suppliers are exposed to risks related to the current economic environment. A number of our customers and suppliers have been and may continue to be adversely affected by the worldwide financial crisis, disruptions to the capital and credit markets and decreased demand for their products and services. In the event that any of our large customers or suppliers, or a significant number of smaller customers and suppliers, are adversely affected by these risks, we may face disruptions in supply, further reductions in demand for our products and services, failure of customers to pay invoices when due and other adverse effects that may have a material adverse effect on our business, financial condition and operating results.

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 the current and potentially more severe adverse general economic and industry conditions; and
- limit our ability, or increase the cost, to refinance indebtedness.

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If we 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.

We are required to post letters of credit or cash as collateral primarily in connection with our hedging transactions, insurance programs and bonding activities. The amounts of collateral we are required to post may vary based on our financial position and credit ratings. Use of letters of credit as collateral reduces our borrowing availability under our revolving credit agreement and, therefore, like the use of cash as collateral, reduces our overall liquidity and our ability to fund other business activities.

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 further;
- reduce or delay planned capital expenditures, research and development or acquisitions;
- seek additional financing or restructure or refinance all or a portion of our indebtedness at 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 the agreements governing our indebtedness may limit our ability to pursue business activities or otherwise operate our business.

The agreements governing our indebtedness contain covenants that may 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 may 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 current 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 our credit agreement or indenture covenants or failure to maintain a required ratio or meet a required test 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 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.

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.

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, our ability to pass increased raw materials prices on to our customers has been limited. 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 adversely affect 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 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 or possible dislocations 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 historically has been 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.

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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.

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, 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.

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.

The U.S. Congress and several states are considering proposed legislation to reduce emission of greenhouse gases, including carbon dioxide and methane. Some states have already adopted greenhouse gas regulation or legislation. 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.

If the downturn in the markets for our businesses does not reverse or is significantly extended, we may incur material impairment charges.

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We have been scaling back our operations in response to market conditions since the downturn began in 2006. Since mid-2006, we have temporarily idled or permanently closed approximately 3.1 billion square feet of our highest-cost wallboard manufacturing capacity.

Historically, the housing and other construction markets that we serve have been deeply cyclical. Downturns in demand are typically steep and last several years, but they have typically been followed by periods of strong recovery. If this cycle is similar to past cycles in that regard, we believe we will generate significant cash flows when our markets recover. As a result, we currently expect to realize the carrying value of all facilities that are not permanently closed through future cash flows. We regularly monitor forecasts prepared by external economic forecasters and review our facilities and other assets to determine which of them, if any, are impaired under applicable accounting rules.

However, if the downturn in these markets does not reverse or the downturn is significantly extended, material write-downs or impairment charges may be required in the future. If these conditions materialize or worsen, or if there is a fundamental change in the housing market, which individually or collectively lead to a significantly extended downturn or permanent decrease in demand, material impairment charges may be necessary if we permanently close gypsum wallboard production facilities. The magnitude and timing of those charges would be dependent on the severity and duration of the downturn and cannot be determined at this time. Any material cash or non-cash impairment charges related to property, plant and equipment would have a material adverse effect on our financial condition and operating results.

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, 2009, we believe that six organizations collectively controlled over 50% of our common stock. Also, all of our 10% contingent convertible senior notes are currently held by two of our largest stockholders. At the current conversion price of $11.40 per share, the notes are convertible into approximately 35.1 million shares of our common stock, or approximately 25% of the shares that would be outstanding if all of the notes were converted at that price. Accordingly, a small number of our stockholders could affect matters requiring approval by stockholders, including the election of directors and the approval of potential business combination transactions.

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 may 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 and joint venture arrangements. As business conditions warrant and our financial resources permit, we may pursue opportunities to acquire businesses or technologies and to form joint ventures 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 or joint venture to achieve expected operational, profitability and investment return objectives; and

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.

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 impede or prevent the implementation of 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 limits our ability to pay a dividend or repurchase our stock unless specified borrowing availability and fixed charge coverage ratio tests are met, and it prohibits payment of a dividend 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.

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 2008, U.S. Gypsum s SHEETROCK® brand gypsum wallboard plants operated at 65% of capacity. However, the capacity utilization rate for our gypsum wallboard plants declined as the year progressed and was approximately 51% during the fourth quarter of 2008. USG Interiors AURATONE® brand ceiling tile plants operated at 64% of capacity in 2008. However, the capacity utilization rate for these ceiling tile plants also declined as the year progressed and was approximately 55% during the fourth quarter of 2008. The locations of our production properties in operation as of December 31, 2008, grouped by reportable segment, are as follows (plants are owned unless otherwise indicated):

North American Gypsum

GYPSUM WALLBOARD AND OTHER GYPSUM PRODUCTS

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

* Plants supplied fully or partially by synthetic gypsum

JOINT COMPOUND (SURFACE PREPARATION AND JOINT TREATMENT PRODUCTS)

Auburn, Wash.	Galena Park, Texas	Calgary, Alberta, Canada (leased)
Baltimore, Md.	Gypsum, Ohio	Hagersville, Ontario, Canada
Bridgeport, Ala.	Jacksonville, Fla.	Montreal, Quebec, Canada
Chamblee, Ga.	Phoenix (Glendale), Ariz. (leased)	Surrey, British Columbia, Canada
Dallas, Texas	Port Reading, N.J.	Monterrey, Nuevo Leon, Mexico
East Chicago, Ind.	Sigurd, Utah	Puebla, Puebla, Mexico
Fort Dodge, Iowa	Torrance, Calif.	

CEMENT BOARD

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

GYPSUM ROCK (MINES AND QUARRIES)

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

PAPER FOR GYPSUM WALLBOARD

Clark, N.J.	North Kansas City, Mo.	Otsego, Mich.
Galena Park, Texas	Oakfield, N.Y.	

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 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., and sealants and finishes at La Mirada, Calif.

FACILITY SHUTDOWNS

During 2008, we permanently closed our gypsum wallboard and plaster production facilities in Boston, Mass., and one of our gypsum wallboard production facilities in Stony Point, N.Y. We temporarily idled a gypsum wallboard production facility at each of our Plaster City, Calif., Jacksonville, Fla., Baltimore, Md., and Ft. Dodge, Iowa, plants. In addition, we temporarily idled our paper mills in South Gate, Calif., and Gypsum, Ohio, a cement board production facility in Santa Fe Springs, Calif., and a structural cement panel production facility in Delavan, Wis. During 2007, we temporarily idled a gypsum wallboard line at each of our Jacksonville, Fla., Detroit, Mich., and New Orleans, La., plants and a paper mill in Jacksonville, Fla.

NEW FACILITIES

In the fourth quarter of 2008, we began operating a new low-cost gypsum wallboard plant in Washingtonville, Pa., that is serving the Northeastern market, including customers of the Boston gypsum wallboard production facility that we closed in the first quarter of 2008. In the second quarter of 2008, we began operating a new high-quality, low-cost paper mill in Otsego, Mich., that will serve U.S. Gypsum s wallboard plants. Because of the current market environment, commencement of construction of a new, low-cost gypsum wallboard plant in Stockton, Calif., has been delayed until 2012, with production targeted to begin in 2014.

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 expect to take delivery of our new 40,000-ton self-unloading ship, which is expected to lower the delivered cost of gypsum rock to East Coast wallboard plants, by March 31, 2009.

Worldwide Ceilings

CEILING GRID

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

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 Dreux, France, Peterlee, England (leased), St. Petersburg, Russia (leased), Thessaloniki, Greece, Viersen, Germany, and Port Klang, Malaysia (leased) and gypsum wallboard and joint compound at Lima, Peru.

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.

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

None

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, 2009, there were 3,235 record holders of our common stock. We currently do not pay dividends on our common stock. Our credit agreement restricts our ability to pay cash dividends on, or repurchase, our common stock. See Part II, Item 8, Financial Statements and Supplementary Data, Note 10, Debt, for more information regarding these restrictions.

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 2008.

The high and low sales prices of our common stock in 2008 and 2007 were as follows:

	2008		2007	
	High	Low	High	Low
First quarter	$ 38.38	$ 29.71	$ 58.74	$ 46.22
Second quarter	40.25	29.48	52.75	45.43
Third quarter	35.00	23.12	50.13	35.42
Fourth quarter	26.39	5.50	40.54	34.69

Pursuant to our Stock Compensation Program for Non-Employee Directors, on December 31, 2008, our non-employee directors were entitled to receive an $80,000 annual grant, payable at their election in cash or common stock with an equivalent value. Pursuant to this program, on December 31, 2008, a total of 21,918 shares of common stock were issued to two non-employee directors based on the average of the high and low sales prices of a share of USG common stock on December 30, 2008. The issuance of these shares was effected through a private placement under Section 4(2) of the Securities Act of 1933, as amended, or the Securities Act, and was exempt from registration under Section 5 of the Securities Act.

Pursuant to our Deferred Compensation Program for Non-Employee Directors, four of our non-employee directors deferred their $80,000 annual grant, and three of our non-employee directors deferred their quarterly retainers for service as directors that were payable on December 31, 2008, into a total of approximately 49,579 deferred stock units. These units will increase or decrease in value in direct proportion to the market value of our common stock and will be paid in cash or shares of common stock, at each director s option, following termination of service as a director. The issuance of these deferred stock units was effected through a private placement under Section 4(2) of the Securities Act and was exempt from registration under Section 5 of the Securities Act.

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PERFORMANCE GRAPH

The following graph and table compare the cumulative total stockholder return on our common stock with the Standard and Poor s 500 Index, or S&P 500, and the Dow Jones U.S. Construction and Materials Index, or DJUSCN, in each case assuming an initial investment of $100 and full dividend reinvestment, for the five-year period ended December 31, 2008.

	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2007	Dec. 31, 2008
USG	$ 100	$ 243	$ 392	$ 331	$ 253	$ 57
S&P 500	$ 100	$ 111	$ 116	$ 135	$ 142	$ 90
DJUSCN	$ 100	$ 132	$ 147	$ 172	$ 212	$ 122

All amounts rounded to the nearest dollar.

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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,				
	2008	2007(a)	2006(a)	2005(a)	2004(a)
Statement of Operations Data:					
Net sales	$ 4,608	$ 5,202	$ 5,810	$ 5,139	$ 4,509
Cost of products sold	4,416	4,601	4,426	4,030	3,643
Gross profit	192	601	1,384	1,109	866
Selling and administrative expenses	380	408	419	352	317
Restructuring and long-lived asset impairment charges	98	26			
Goodwill and other intangible asset impairment charges (b)	226				
Asbestos claims provision (reversal)			(44)	3,100	
Chapter 11 reorganization expenses			10	4	12
Operating profit (loss)	(512)	167	999	(2,347)	537
Interest expense (c)	86	105	555	5	5
Interest income	(7)	(22)	(43)	(10)	(6)
Other income, net	(10)	(4)	(3)		
Income taxes (benefit)	(118)	11	193	(921)	208
Earnings (loss) before cumulative effect of accounting change	(463)	77	297	(1,421)	330
Cumulative effect of accounting change				(11)	
Net earnings (loss)	(463)	77	297	(1,432)	330
Net Earnings (Loss) Per Common Share (d):					
Cumulative effect of accounting change				(0.20)	
Basic	(4.67)	0.80	4.47	(25.42)	5.93
Diluted	(4.67)	0.79	4.46	(25.42)	5.93
Balance Sheet Data (as of the end of the year)**:**					
Working capital	$ 738	$ 717	$ 975	$ 1,602	$ 1,239
Current ratio	1.98	2.26	1.55	3.60	3.17
Cash and cash equivalents	471	297	565	936	756
Property, plant and equipment, net	2,562	2,596	2,210	1,946	1,853
Total assets	4,719	4,654	5,397	6,180	4,297
Long-term debt (e)	1,642	1,238	1,439		1
Liabilities subject to compromise (e)				5,340	2,242
Total stockholders equity (deficit)	1,550	2,226	1,566	(279)	1,043
Other Information:					
Capital expenditures	$ 238	$ 460	$ 393	$ 198	$ 138
Stock price per common share (f)	8.04	35.79	54.80	65.00	40.27
Average number of employees (g)	13,600	14,650	14,700	14,100	13,800

(a) Financial information for

2004 through 2007 has been retrospectively adjusted for our change in 2008 from the last-in, first-out method of inventory accounting to the average cost method. These adjustments reduced cost of products sold by $2 million in 2007, $14 million in 2006, $7 million in 2005 and $29 million in 2004. See Note 1 to the Consolidated Financial Statements.

(b) See Note 3 to the Consolidated Financial Statements for information regarding goodwill and other intangible asset impairment charges.

(c) 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 22 to the Consolidated Financial Statements.

(d) Net earnings (loss) per common share for 2005 and 2004 were adjusted to reflect the effect of a rights offering implemented in 2006. See Note 19 to the Consolidated Financial Statements.

(e) For 2004 and 2005, debt of $1.005 billion was included in liabilities subject to compromise in connection with USG s five-year reorganization proceeding. See Note 22 to the Consolidated Financial Statements.

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

(g) As a result of workforce reductions, we had approximately 12,800 employees

worldwide as of
December 31,
2008.

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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 manufactures and markets gypsum and related products in the United States, Canada and Mexico. It 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 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 manufactures and markets interior systems products worldwide. It 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. 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 ceiling tile and ceiling grid in the United States, Canada, Mexico, Europe, Latin America and the Asia-Pacific region. It also manufactures and markets joint compound in Europe, Latin America and the Asia-Pacific region and gypsum wallboard in Latin America.

Geographic Information: In 2008, approximately 81% of our net sales were attributable to the United States. Canada accounted for approximately 9% of our net sales and other foreign countries accounted for the remaining 10%.

FINANCIAL INFORMATION

Consolidated net sales in 2008 were $4.608 billion, down 11% from 2007. An operating loss of $512 million and a net loss of $463 million, or $4.67 per diluted share, were incurred in 2008. These results compared with operating profit of $167 million and net earnings of $77 million, or $0.79 per diluted share, in 2007. Results for 2008 included goodwill and other intangible asset impairment charges of $226 million pretax, restructuring and long-lived asset impairment charges of $98 million pretax and start-up costs for new manufacturing facilities totaling $26 million pretax. The net loss for 2008 also reflected an increase in the valuation allowance, primarily on certain state net operating loss and tax credit carryforwards, that had the impact of reducing our income tax benefit by $71 million, net of tax. Results for 2007 included restructuring and long-lived asset impairment charges of $26 million pretax. The restructuring and long-lived asset impairment charges in 2008 and 2007 primarily related to salaried workforce reductions, facility shutdowns and the closure of distribution locations.

As of December 31, 2008, we had $471 million of cash and cash equivalents compared with $297 million as of

December 31, 2007. The increase was primarily attributable to our issuance of $400 million of 10% contingent convertible senior notes in November 2008. Subsequent to December 31, 2008, we used $190 million of cash to repay all outstanding borrowings under our revolving credit facility in connection with its amendment and restatement, as discussed below under Liquidity and Capital Resources. The remaining proceeds from the issuance of the contingent convertible senior notes are being used for general corporate purposes.

In the fourth quarter of 2008, we recorded impairment charges of $226 million pretax associated with goodwill and other intangible assets. Based on impairment testing performed as of October 31, 2008, we determined that impairment existed for goodwill related to the L&W Supply reporting unit that comprises our Building Products Distribution segment, the Latin America reporting unit within our Worldwide Ceilings segment and the USG Mexico reporting unit within our North American Gypsum segment. These charges also include an impairment charge for the partial write-off of certain trade names related to L&W Supply.

Financial information for 2007 and 2006 has been retrospectively adjusted for our change in 2008 from the last-in, first-out method of inventory accounting to the average cost method. See Note 1 to the Consolidated Financial Statements for additional information regarding this change in accounting principle.

MARKET CONDITIONS AND OUTLOOK

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. Housing starts in the United States, which are a major source of demand for our products and services, continued to decline during 2008. Based on preliminary data issued by the U.S. Bureau of the Census, U.S. housing starts in 2008 were an estimated 904,300 units, compared with actual housing starts of 1.355 million units in 2007 and 1.801 million units in 2006. In December 2008, the annualized rate of housing starts was reported to have decreased to 550,000 units, the lowest level recorded in the last 50 years. Industry analysts forecasts for housing starts in the United States in 2009 are for a range from 500,000 to 700,000.

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. According to the National Association of Realtors, sales of existing homes in the United States in 2008 declined to an estimated 4.9 million units compared with 5.7 million units in 2007 and 6.5 million units in 2006, which contributed to a decrease in demand for our products from the residential repair and remodel market. Industry analysts forecasts for residential repair and remodel activity in the United States in 2009 are for a further decline of approximately 5% to 10% from the 2008 level.

Demand for our products from new nonresidential construction is determined by floor space for which contracts are signed. Installation of gypsum and ceilings products typically follows signing of construction contracts by about a year. According to McGraw-Hill Construction, total floor space for which contracts were signed in the United States declined 16% in 2008 compared with 2007 after increasing 2% in 2007 compared to 2006. Industry analysts forecasts for commercial construction in the United States in 2009 are for a further decline of approximately 15% to 20% from the 2008 level.

The markets that we serve, including in particular the housing and construction-based markets, are affected by the availability of credit, lending practices, the movement of interest rates, the unemployment rate and consumer confidence. Higher interest and unemployment rates and more restrictive lending practices could have a material adverse effect on our businesses, financial condition and results of operations. Our businesses are also affected by a variety of other factors beyond our control, including the inventory of unsold homes, which currently remains at a record level, housing affordability, office vacancy rates and foreign currency exchange rates. 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 businesses, financial condition and results of operations.

Our results of operations have been adversely affected by the economic downturn in North America, which recently has been exacerbated by substantial turmoil in the financial markets. In 2008, our North American Gypsum segment continued to be adversely affected by the sharp drop in the residential housing market and high raw material and energy costs. Our Building Products Distribution segment, which serves both the residential and commercial markets, has been adversely affected by lower product shipments and tighter margins. Our Worldwide Ceilings segment recorded year-over-year sales growth in 2008. However, the commercial market has begun to weaken and fourth quarter 2008 results for our Worldwide Ceilings segment were significantly below its results for the fourth quarter of 2007 and the third quarter of 2008.

Industry shipments of gypsum wallboard in the United States (including imports) were an estimated 25.2 billion square feet in 2008, down approximately 18% compared with 30.7 billion square feet in 2007, which was down approximately 15% from 36.2 billion square feet in 2006. U.S. Gypsum shipped 7.2 billion square feet of SHEETROCK® brand gypsum wallboard in 2008, a 20% decrease from 9.0 billion square feet in 2007, which was down 17% from 10.8 billion square feet in 2006. The percentage decline of U.S. Gypsum s wallboard shipments in each of 2008 and 2007 exceeded the declines for the industry primarily due to our decisions to maintain or increase our selling prices despite losing volume and market share and to reduce our sales efforts in geographic markets where we believed the gross margin was inadequate. Because the housing market continues to be very weak and is expected to remain very weak throughout 2009 and the economic recession is expected to contribute to further declines in residential repair and remodeling expenditures and nonresidential construction activity in 2009, we expect demand for gypsum wallboard to decline further in 2009 for USG and the industry as a whole. We estimate that the industry capacity utilization rate was approximately 62% during 2008 and approximately 54% in the fourth quarter of 2008. We expect that rate to remain below 60% in 2009. At such a low level of capacity utilization, we expect there to be continued pressure on wallboard gross margins. For the fourth quarter of 2008, our shipments of SHEETROCK® brand gypsum wallboard were 1.4 billion square feet, down 33% from 2.1 billion square feet in the fourth quarter of 2007.

Currently, there is significant excess wallboard production capacity industry-wide in the United States. Approximately 500 million square feet of additional capacity, net of closures, became operational in the United States in 2008. Industry capacity in the United States was approximately 40 billion square feet in 2008. We and other industry participants announced a number of closures near the end of 2008 that we expect will reduce industry capacity by approximately 3 billion square feet in 2009. We do not expect any new industry capacity will be added in 2009.

RESTRUCTURING AND OTHER INITIATIVES

We have been scaling back our operations in response to market conditions since the downturn began in 2006. During the fourth quarter of 2008, we permanently closed a gypsum wallboard production facility in Stony Point, N.Y., and a plaster production facility in Boston, Mass., and we temporarily idled a gypsum wallboard production facility at each of our Plaster City, Calif., Jacksonville, Fla., and Baltimore, Md., plants, a cement board production facility in Santa Fe Springs, Calif., and a structural cement panel production facility in Delavan, Wis. Earlier in 2008, we permanently closed our 80-year-old Boston gypsum wallboard production facility and temporarily idled the gypsum wallboard production facility in Ft. Dodge, Iowa and paper mills in South Gate, Calif., and Gypsum, Ohio. Since mid-2006, we have temporarily idled or permanently closed approximately 3.1 billion square feet of our highest-cost wallboard manufacturing capacity.

Historically, the housing and other construction markets that we serve have been deeply cyclical. Downturns in demand are typically steep and last several years, but they have typically been followed by periods of strong recovery. If this cycle is similar to past cycles in that regard, we believe we will generate significant cash flows when our markets recover. As a result, we currently expect to realize the carrying value of all facilities that are not permanently closed through future cash flows. We regularly monitor forecasts prepared by external economic forecasters and review our facilities and other assets to determine which of them, if any, are impaired under applicable accounting rules. Because we believe that a recovery in the housing and other construction markets we

serve will begin in the next two to three years, we determined that there have been no material impairments of our long-lived assets.

However, if the downturn in these markets does not reverse or the downturn is significantly extended, material write-downs or impairment charges may be required in the future. If these conditions were to materialize or worsen, or if there is a fundamental change in the housing market, which individually or collectively lead to a significantly extended downturn or permanent decrease in demand, material impairment charges may be necessary if we permanently close gypsum wallboard production facilities. The magnitude and timing of those charges would be dependent on the severity and duration of the downturn and cannot be determined at this time. Any material cash or noncash impairment charges related to property, plant and equipment would have a material adverse effect on our financial condition and results of operations, but material noncash impairment charges would have no effect on compliance with the financial covenant under our amended and restated secured credit facility or other terms of our outstanding indebtedness.

As part of L&W Supply s ongoing efforts to reduce its cost structure in light of market conditions, it closed 54 centers during 2008, 30 of which were closed during the fourth quarter. These closures have been widely dispersed throughout the markets L&W Supply serves. L&W Supply opened five new centers during 2008, but none was opened during the fourth quarter.

In the second and fourth quarters of 2008, we implemented salaried workforce reductions that eliminated in total approximately 1,400 salaried positions. We are continuing to adjust our operations for the extended downturn in our markets.

Our focus on costs and efficiencies, including capacity closures and overhead reductions, has helped to mitigate the effects of the downturn in all of our markets. If economic and market conditions continue to deteriorate, we will evaluate plans to further reduce costs, improve operational efficiency and maintain our liquidity.

Our new gypsum wallboard plant at Norfolk, Va., and new paper mill at Otsego, Mich., are operating at significantly lower costs than the operations they replaced. A new, low-cost gypsum wallboard plant in Washingtonville, Pa., that will serve the northeastern United States, began operating in the fourth quarter of 2008.

In the fourth quarter of 2008, we completed the sale of $400 million aggregate principal amount of 10% contingent convertible senior notes due 2018. Early in the first quarter of 2009, we amended and restated our unsecured credit facility to convert it into a secured credit facility that contains a single restrictive financial covenant that only applies if borrowing availability under the facility is below $75 million. Please refer to the discussion under Liquidity and Capital Resources below for information regarding our cash position and this credit facility.

See Part I, Item 1A, Risk Factors, for additional information regarding the conditions affecting our businesses and other risks and uncertainties that affect us.

KEY OBJECTIVES

In order to perform as efficiently as possible during this challenging business cycle, we are focusing on the following key objectives:

- extend our customer satisfaction leadership;
- achieve significant cost reductions; and
- maintain financial flexibility.

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Consolidated Results of Operations

(dollars in millions, except per-share data)	2008	2007(a)	2006(a)	Increase (Decrease) 2008 vs. 2007	Increase (Decrease) 2007 vs. 2006
Net sales	$ 4,608	$ 5,202	$ 5,810	(11)%	(10)%
Cost of products sold	4,416	4,601	4,426	(4)%	4%
Gross profit	192	601	1,384	(68)%	(57)%
Selling and administrative expenses	380	408	419	(7)%	(3)%
Restructuring and long-lived asset impairment charges	98	26		277%	
Goodwill and other intangible asset impairment charges	226				
Asbestos claims provision (reversal)			(44)		
Chapter 11 reorganization expenses			10		
Operating profit (loss)	(512)	167	999		(83)%
Interest expense	86	105	555	(18)%	(81)%
Interest income	(7)	(22)	(43)	(68)%	(49)%
Other income, net	(10)	(4)	(3)	150%	33%
Income taxes (benefit)	(118)	11	193		(94)%
Net earnings (loss)	(463)	77	297		(74)%
Diluted earnings (loss) per share	(4.67)	0.79	4.46		(82)%

(a) Information for 2007 and 2006 has been retrospectively adjusted for our change in 2008 from the last-in, first-out method of inventory accounting to the average cost method. See Note 1 to the Consolidated Financial Statements for information regarding this change in accounting principle.

NET SALES

Consolidated net sales were $4.608 billion in 2008, $5.202 billion in 2007 and $5.810 billion in 2006. Net sales declined for the second consecutive year in 2008 following the record level of 2006 primarily due to the steep downturn in United States residential construction that began in mid-2006. This downturn resulted in lower demand

and selling prices for gypsum wallboard, which had a significant adverse effect on our North American Gypsum and Building Products Distribution segments.

Consolidated net sales for 2008 were down $594 million, or 11%, compared with 2007. This decrease reflected a 17% decline in net sales for North American Gypsum and a 13% decline in net sales for Building Products Distribution. The lower level of net sales in 2008 for North American Gypsum was largely attributable to declines in U.S. Gypsum s SHEETROCK® brand gypsum wallboard volume (down 20%) and selling prices (down 18%) compared with 2007. Net sales for Building Products Distribution were down also due primarily to lower volume (down 23%) and selling prices (down 13%) for gypsum wallboard. Worldwide Ceilings continued its trend of year-over-year sales growth with a 4% increase compared with 2007, primarily reflecting USG Interiors higher selling prices for ceiling grid (up 9%) and ceiling tile (up 2%). However, demand from the commercial construction market that Worldwide Ceilings serves began to deteriorate in the second half of the year resulting in lower volume levels for USG Interiors ceiling grid (down 4%) and ceiling tile (down 1%) in 2008 compared with 2007.

Consolidated net sales for 2007 were down $608 million, or 10%, compared with 2006. This decrease reflected a 22% decline in net sales for North American Gypsum and an 8% decline in net sales for Building Products Distribution. The lower level of net sales in 2007 for North American Gypsum was largely attributable to declines in U.S. Gypsum s SHEETROCK® brand gypsum wallboard volume (down 17%) and selling prices (down 25%) compared with 2006. Net sales for Building Products Distribution were down also due primarily to lower volume (down 11%) and selling prices (down 16%) for gypsum wallboard. Worldwide Ceilings net sales increased 8% compared with 2006, primarily reflecting increased volume for USG Interiors ceiling grid (up 4%) and higher selling prices for its ceiling grid (up 2%) and ceiling tile (up 6%).

COST OF PRODUCTS SOLD

Cost of products sold totaled $4.416 billion in 2008, $4.601 billion in 2007 and $4.426 billion in 2006.

Cost of products sold decreased $185 million, or 4%, in 2008 compared with 2007 primarily reflecting the lower product volumes discussed above, partially offset by higher raw material and energy costs and higher fixed costs due to lower production volumes. For U.S. Gypsum s SHEETROCK® brand gypsum wallboard, higher per unit manufacturing costs reflected an 8% increase in raw material costs, a 10% increase in energy costs, and a 28% increase in fixed costs due to lower gypsum wallboard production volume. Cost of products sold in 2008 included charges totaling $26 million for start-up costs related to our new gypsum wallboard plants in Washingtonville, Pa., and Norfolk, Va., and our new paper mill in Otsego, Mich. For USG Interiors, manufacturing costs per unit increased 5% for ceiling tile primarily due to higher raw materials costs, but decreased 3% for ceiling grid primarily due to lower steel costs.

Cost of products sold increased $175 million, or 4%, in 2007 compared with 2006 primarily reflecting higher raw material and energy costs and higher fixed costs due to lower production volumes. For U.S. Gypsum s SHEETROCK® brand gypsum wallboard, higher per unit manufacturing costs reflected a 13% increase in raw material costs, a 4% increase in energy costs, and an 11% increase in fixed costs due to lower gypsum wallboard volume. Approximately half of the increase in raw materials costs was attributable to a 37% increase in wastepaper costs. For USG Interiors, manufacturing costs per unit increased 4% for ceiling tile primarily due to higher raw materials costs and 11% for ceiling grid primarily due to higher steel costs.

GROSS PROFIT

Gross profit was $192 million in 2008, $601 million in 2007 and $1.384 billion in 2006. Gross profit as a percentage of net sales was 4.2% in 2008, 11.6% in 2007 and 23.8% in 2006. Gross profit was down in 2008 and 2007 compared with each respective prior year primarily due to lower demand for gypsum wallboard, lower gypsum wallboard selling prices, higher costs for raw materials, energy and transportation and higher fixed costs due to lower production volumes, as discussed above.

SELLING AND ADMINISTRATIVE EXPENSES

Selling and administrative expenses totaled $380 million in 2008, $408 million in 2007 and $419 million in 2006. The decrease in selling and administrative expenses in 2008 compared with 2007 primarily reflected a company-wide emphasis on reducing expenses, including salaried workforce reductions. 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. As a percentage of net sales, selling and administrative expenses were 8.2% in 2008. 7.8% in 2007 and 7.2% in 2006. These expenses as a percentage of net sales increased for the second consecutive year in 2008 due to the declining levels of net sales.

RESTRUCTURING AND LONG-LIVED ASSET IMPAIRMENT CHARGES

In response to adverse market conditions, we implemented restructuring activities in 2008 and 2007. In 2008, we recorded restructuring and impairment charges totaling $98 million pretax ($61 million after-tax, or $0.62 per diluted share) primarily associated with salaried workforce reductions, the temporary idling or permanent closure of production facilities and the closure of 54 distribution centers. 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 and the temporary idling or permanent closure of production facilities. See Note 2 to the Consolidated Financial Statements for additional information related to these charges. Total cash payments charged against the restructuring reserve in 2008 amounted to $37 million. We expect future payments to be approximately $42 million in 2009, $6 million in 2010 and $2 million beyond 2010. All restructuring-related payments in 2008 were funded with cash from operations. We expect that the future payments also will be funded with cash from operations. Annual savings from the 2008 restructuring initiatives are estimated to be approximately $150 million beginning in 2009.

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GOODWILL AND OTHER INTANGIBLE ASSET IMPAIRMENT CHARGES

In the fourth quarter of 2008, we recorded impairment charges of $226 million pretax ($177 million after-tax, or $1.78 per diluted share) associated with goodwill and other intangible assets. Based on impairment testing performed as of October 31, 2008, we determined that impairment existed for goodwill related to the L&W Supply reporting unit that comprises our Building Products Distribution segment, the Latin America reporting unit within our Worldwide Ceilings segment and the USG Mexico reporting unit within our North American Gypsum segment. Of the total charge for goodwill impairment, $201 million related to Building Products Distribution, $12 million related to Worldwide Ceilings and $1 million related to North American Gypsum. We also recorded an impairment charge of $12 million pretax for the partial write-off of certain trade names related to L&W Supply. See Note 3 to the Consolidated Financial Statements for additional information related to these charges.

ASBESTOS CLAIMS REVERSAL

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. See Note 21 to the Consolidated Financial Statements.

INTEREST EXPENSE

Interest expense was $86 million in 2008, $105 million in 2007 and $555 million in 2006. 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.

INTEREST INCOME

Interest income was $7 million in 2008, $22 million in 2007 and $43 million in 2006. Interest income in 2008 and 2007 was generated primarily from money market investments. Interest income in 2006 was generated primarily from investments in marketable securities. The lower levels of interest income in 2007 and 2008 primarily reflect lower average levels of cash and cash equivalents during each year and lower interest rates.

OTHER INCOME, NET

Other income, net was $10 million in 2008 and included $11 million of income for a change in the fair value of an interest rate step-up derivative related to our contingent convertible senior notes. Other income, net was $4 million in 2007 and $3 million in 2006.

INCOME TAXES (BENEFIT)

Income tax benefit was $118 million in 2008. Income tax expense was $11 million in 2007 and $193 million in 2006. Our effective tax rates were 20.4% for 2008, 12.2% for 2007 and 39.4% for 2006. The 2008 tax benefit results from our anticipated carryforward of most of the 2008 net operating loss to offset U.S. federal and state income taxes in future years and reflects a reduction in tax benefit due to an increase in the valuation allowance, primarily on state net operating loss and tax credit carryforwards, in the amount of $71 million. The increase in the valuation allowance recognizes the difficulty in estimating when certain state net operating losses and tax credit carryforwards will be realized given the current challenging economic environment. The effective rate for 2008 also includes the tax impact of goodwill impairment charges. The difference in the 2008 and 2007 effective tax rates was primarily attributable to the favorable effect of items in the 2007 tax provision including, state and foreign tax law changes enacted, the reversal of valuation allowances on net operating loss and investment credit carryovers in our Worldwide Ceilings and Canadian businesses and the effect of a larger portion of our consolidated earnings arising in lower taxed foreign jurisdictions.

NET EARNINGS (LOSS)

A net loss of $463 million, or $4.67 per diluted share, was recorded in 2008. These amounts included the after-tax

charges of $177 million, or $1.78 per diluted share, for goodwill and intangible asset impairments and $61 million, or $0.62 per diluted share, for restructuring and long-lived asset impairments.

Net earnings in 2007 were $77 million, or $0.79 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.

Net earnings in 2006 were $297 million, or $4.46 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.

Core Business Results of Operations

	Net Sales			Operating Profit (Loss) (a)		
(millions)	2008	2007	2006	2008	2007 (b)	2006 (b)
North American Gypsum:						
United States Gypsum Company	$ 1,933	$ 2,417	$ 3,215	$ (261)	$ 30	$ 749
CGC Inc. (gypsum)	332	324	341	(8)	15	46
USG Mexico, S.A. de C.V.	201	193	177	20	26	31
Other subsidiaries (c)	74	83	89	8	13	17
Eliminations	(182)	(180)	(201)			
Total	2,358	2,837	3,621	(241)	84	843
Building Products Distribution:						
L&W Supply Corporation	1,993	2,291	2,477	(243)	91	205
Worldwide Ceilings:						
USG Interiors, Inc.	531	523	507	61	54	57
USG International	304	273	235	(4)	12	13
CGC Inc. (ceilings)	61	61	57	11	9	11
Eliminations	(50)	(44)	(43)			
Total	846	813	756	68	75	81
Corporate				(97)	(110)	(117)
Eliminations	(589)	(739)	(1,044)	1	27	(3)
Chapter 11 reorganization expenses						(10)
Total USG Corporation	$ 4,608	$ 5,202	$ 5,810	$ (512)	$ 167	$ 999

(a) Consolidated operating loss in 2008 included restructuring and long-lived asset impairment charges of $98 million pretax. On a segment basis,

$48 million of the total amount related to North American Gypsum, $34 million related to Building Products Distribution, $5 million related to Worldwide Ceilings and $11 million related to Corporate.

Consolidated operating loss in 2008 also included goodwill and other intangible asset impairment charges of $226 million pretax. On a segment basis, $213 million of the total amount related to Building Products Distribution, $12 million related to Worldwide Ceilings and $1 million related to North American Gypsum.

Consolidated operating profit in 2007 included restructuring and long-lived asset

impairment charges of $26 million pretax. On a segment basis, $18 million of the total amount related to North American Gypsum, $1 million related to Building Products Distribution, $2 million related to Worldwide Ceilings 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.

(b) Information for 2007 and 2006 has been retrospectively adjusted for our change in 2008 from the last-in, first-out method of inventory accounting to the average cost

method. See Note 1 to the Consolidated Financial Statements for information regarding this change in accounting principle.

(c) Includes a shipping company in Bermuda and a mining operation in Nova Scotia, Canada.

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NORTH AMERICAN GYPSUM

Net sales for North American Gypsum were $2.358 billion in 2008, $2.837 billion in 2007 and $3.621 billion in 2006. Net sales in 2008 were down 17% from 2007 following a decline of 22% in 2007 compared with 2006. An operating loss of $241 million was incurred in 2008. This loss included restructuring and long-lived asset impairment charges of $48 million. Operating profit of $84 million in 2007 included restructuring and long-lived asset impairment charges of $18 million. Operating profit of $843 million in 2006 included a $44 million reversal of our reserve for asbestos-related liabilities.

United States Gypsum Company 2008 Compared With 2007: Net sales in 2008 declined $484 million, or 20%, from 2007. Approximately $253 million of the decrease in net sales was attributable to a 20% decrease in SHEETROCK® brand gypsum wallboard volume and $170 million was attributable to an 18% decrease in average gypsum wallboard selling prices. Net sales for SHEETROCK® brand joint treatment products declined $67 million and net sales of other products increased $6 million compared with 2007.

An operating loss of $261 million was recorded in 2008 compared with operating profit of $30 million in 2007. The $291 million decline in operating profit was primarily attributable to a 95% decrease in gypsum wallboard gross margin, which lowered operating profit by $248 million, and the decline in gypsum wallboard volume, which lowered operating profit by $68 million. Gross profit for SHEETROCK® brand joint treatment products declined $34 million. Restructuring and long-lived asset impairment charges of $43 million pretax were recorded in 2008 compared with charges of $15 million pretax in 2007. The factors that contributed to the lower level of operating profit in 2008 were partially offset by a net gross profit increase for other product lines, lower information technology, promotional and other expenditures and lower selling and administrative expenses, which aggregated $87 million in operating profit improvement.

New housing construction was very weak throughout 2008 resulting in reduced demand for gypsum wallboard, as discussed above, and lower selling prices. U.S. Gypsum shipped 7.2 billion square feet of SHEETROCK® brand gypsum wallboard in 2008, a 20% decrease from 9.0 billion square feet in 2007. We estimate that industry capacity utilization rates were approximately 62%, while U.S. Gypsum s capacity utilization rate averaged 65%, during 2008. For the fourth quarter of 2008, we estimate that the industry operated at 54% of capacity, while U.S. Gypsum s wallboard plants operated at approximately 51% of capacity.

In 2008, our nationwide average realized selling price for SHEETROCK® brand gypsum wallboard was $111.15 per thousand square feet, down 18% from $134.93 in 2007. During the fourth quarter of 2008, our average realized selling price for SHEETROCK® brand gypsum wallboard was $118.98 per thousand square feet, up 4% from the third quarter of 2008 and 8% compared with the fourth quarter of 2007.

Manufacturing costs for U.S. Gypsum increased 11% in 2008 compared with 2007 primarily due to an 8% increase in raw materials costs, a 10% increase in energy costs and a 28% increase in fixed costs due to lower gypsum wallboard production volume. Raw materials costs increased in 2008 despite a 4% decrease in wastepaper costs.

Net sales and gross profit for SHEETROCK® brand joint treatment products declined by $67 million and $34 million, respectively, in 2008 compared with 2007 primarily due to lower joint compound volume (down 17%), partially offset by higher average realized selling prices (up 4%). Gross profit for joint compound products also was adversely affected by higher manufacturing costs (up 11%). Net sales for DUROCK® brand cement board were down in 2008 compared with 2007 primarily due to a 17% decrease in volume. Gross profit for cement board was adversely affected by higher manufacturing costs (up 3%). Net sales and gross profit for FIBEROCK® brand gypsum fiber panels improved in 2008 compared with 2007 reflecting higher selling prices (up 5%) and slightly lower manufacturing costs (down 1%), while volume was down 2%.

United States Gypsum Company 2007 Compared With 2006: Net sales in 2007 decreased $798 million, or 25%, from 2006. Approximately $412 million of the decrease in net sales was attributable to a 25% decrease in average

gypsum wallboard selling prices and $328 million was attributable to a 17% decrease in gypsum wallboard volume. Net sales for joint treatment products declined by $61 million. Net sales of other products increased $3 million compared with 2007.

Operating profit for 2007 decreased $719 million, or 96%, compared with 2006. A 60% decline in gypsum wallboard gross margin lowered operating profit by $489 million and the decline in gypsum wallboard shipments lowered operating profit by $164 million. Operating profit for 2007 also reflected restructuring and long-lived asset impairment charges of $15 million pretax. Operating profit for other products combined with other costs and selling and administrative expenses accounted for an additional decrease of $7 million. 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, lower 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 the United States (including imports) were an estimated 30.7 billion square feet in 2007, which was down approximately 15% from 36.2 billion square feet in 2006. U.S. Gypsum shipped 9.0 billion square feet of SHEETROCK® brand gypsum wallboard in 2007, which was down 17% from 10.8 billion square feet in 2006. The percentage decline of U.S. Gypsum s wallboard shipments in 2007 exceeded the decline for the industry primarily due to our decisions to maintain or increase our selling prices despite losing volume and market share and to reduce our sales efforts in geographic markets where we believed the gross margin was inadequate. U.S. Gypsum s capacity utilization for gypsum wallboard averaged 78% in 2007, down from 92% in 2006.

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.

Manufacturing costs for U.S. Gypsum increased 9% in 2007 compared with 2006 primarily due to a 13% increase in raw materials costs, a 4% increase in energy costs and an 11% increase in fixed costs due to lower gypsum wallboard production volume. Approximately half of the increase in raw materials costs in 2007 was attributable to a 37% increase in wastepaper costs.

Net sales and gross profit for SHEETROCK® brand joint treatment products declined by $61 million and $20 million, respectively, in 2007 compared with 2006 primarily due to lower joint compound volume (down 12%), partially offset by higher average realized selling prices (up 2%). Gross profit for joint compound products also was adversely affected by higher manufacturing costs (up 4%). Net sales for DUROCK® brand cement board were down in 2007 compared with 2006 primarily due to lower volume (down 6%). However, gross profit for cement board improved due to higher average realized selling prices (up 5%) and lower manufacturing costs (down 5%). Net sales and gross profit for FIBEROCK® brand gypsum fiber panels improved versus 2006 due to higher selling prices (up 6%) and lower manufacturing costs (down 3%), while volume was down 1%.

CGC Inc.: Net sales increased $8 million, or 2%, in 2008 compared with 2007 primarily due to increased sales of joint treatment and other nonwallboard products, increased sales for CGC s distribution subsidiary, higher outbound freight and the favorable effects of currency translation (together up $13 million), partially offset by a $5 million decrease in sales of SHEETROCK® brand gypsum wallboard due to a 12% decline in selling prices, partially offset by a 10% increase in volume. An operating loss of $8 million was recorded in 2008 compared with operating profit of $15 million in 2007. This $23 million decline in operating profit primarily reflected a $19 million decrease in gross profit for gypsum wallboard. Operating profit also was adversely affected by a higher cost of imported gypsum products (up $10 million) due to the decline of the Canadian dollar versus the U.S. dollar in the fourth quarter of 2008. Restructuring charges related to salaried workforce reductions totaled $4 million in 2008 compared with $3 million in 2007. Gross profit for joint treatment and other products increased $5 million and selling and administrative expenses decreased $2 million in 2008 compared with 2007.

Comparing 2007 with 2006, net sales declined $17 million, or 5%. This decrease reflected lower net sales for SHEETROCK® brand gypsum wallboard, which declined $36 million due to an 8% decrease in average selling prices and a 9% decrease in volume. This decline was partially offset by the favorable effects of currency translation, increased sales of joint treatment and lower outbound freight (together up $19 million). Operating profit declined $31 million, or 67%, primarily due to a $35 million decrease in gross profit for gypsum wallboard due to the lower average selling prices and volume and a 9% increase in manufacturing costs that primarily reflected higher costs for wastepaper and other raw materials. In addition, operating profit for 2007 included a restructuring charge of $3 million. These negative factors were partially offset by a $6 million increase in gross profit for joint treatment and other products and a $1 million decrease in selling and administrative expenses in 2007 compared with 2006.

USG Mexico, S.A. de C.V.: Net sales in 2008 for our Mexico-based subsidiary were up $8 million, or 4%, compared with 2007 largely due to increased sales of drywall steel (up $6 million), DUROCK® brand cement board (up $2 million) and other products (up $3 million), partially offset by lower sales of gypsum wallboard (down $3 million). However, operating profit declined $6 million, or 23%, compared with 2007 principally due to a 24% decrease in gross profit for gypsum wallboard as a result of lower selling prices and higher manufacturing costs. Gross profit for other product lines also were adversely affected by higher manufacturing costs. A restructuring charge of $1 million related to salaried workforce reductions was recorded in 2008. A goodwill impairment charge of $1 million also was recorded in 2008.

Comparing 2007 with 2006, net sales increased $16 million, or 9%, principally due to increased sales of construction plasters (up $6 million), drywall steel (up $4 million), DUROCK® brand cement board (up $3 million) and other products (up $4 million), partially offset by lower sales of gypsum wallboard (down $1 million). However, operating profit was down $5 million, or 16%, compared with 2006 principally due to a 16% decrease in gross profit for gypsum wallboard as a result of higher manufacturing costs. Gross profit for other product lines also was adversely affected by higher manufacturing costs.

BUILDING PRODUCTS DISTRIBUTION

L&W Supply s net sales in 2008 were $1.993 billion, down $298 million, or 13%, compared with 2007. This decline was primarily attributable to a 23% decrease in gypsum wallboard shipments and a 13% decline in average gypsum wallboard selling prices as a result of the weak residential construction market. The lower shipments adversely affected net sales by $225 million and the lower selling prices adversely affected net sales by $101 million. Net sales of construction metal products increased $90 million, or 21%, and net sales of ceilings products increased $27 million, or 10%. However, net sales of all other nonwallboard products fell $89 million, or 14%. As a result of lower product volumes and gypsum wallboard selling prices, same-location net sales for 2008 were down 18% compared with 2007.

An operating loss of $243 million was incurred in 2008 compared with operating profit of $91 million in 2007. The $334 million decline in operating profit reflected goodwill and other intangible asset impairment charges of $213 million pretax and restructuring and long-lived asset impairment charges of $34 million pretax primarily related to the closure of 54 distribution centers and salaried workforce reductions. In addition, the decline in gypsum wallboard shipments adversely affected operating profit by $63 million and a 24% decline in gypsum wallboard gross margin and the impact of rebates adversely affected operating profit by $59 million. Gross profit from other product lines increased $4 million and center overhead and delivery expense decreased $31 million. L&W Supply s gypsum wallboard price and volume trends in the fourth quarter of 2008 were similar to those for our North American Gypsum segment due to the weakened conditions in the United States construction markets.

Comparing 2007 with 2006, L&W Supply s net sales were $2.291 billion in 2007, down $186 million, or 8%, compared with 2006. This decline was primarily attributable to an 11% decrease in gypsum wallboard shipments and a 16% decrease in average gypsum wallboard selling prices as a result of the weak residential construction market. Lower shipments adversely affected net sales by $152 million and lower selling prices adversely affected net sales by $193 million. The benefit of acquisitions and increased sales related to nonresidential construction activity partially offset those negative factors. Sales of ceilings products increased $73 million, or 41%, and sales of other products

increased $86 million, or 9%. Wallboard shipments and sales of nonwallboard products were favorably affected by the acquisitions of California Wholesale Material Supply, Inc., or CALPLY, in late March 2007, and All Interiors Supply, in the fourth quarter of 2006. These acquired businesses contributed $460 million to 2007 net sales. As a result of lower product volumes and gypsum wallboard prices, same-location net sales for 2007 decreased 26% compared with 2006.

Operating profit in 2007 was $91 million, a decrease of $114 million, or 56%, compared with 2006. The decline in operating profit was primarily attributable to the decrease in gypsum wallboard shipments, which lowered operating profit by $38 million, and a 7% decline in the gross margin for gypsum wallboard and the impact of rebates, which lowered operating profit by $41 million. Center overhead and delivery expense increased $47 million in 2007, principally due to the acquisition of CALPLY. Amortization expense related to intangible assets associated with recent acquisitions was $6 million in 2007, while amortization expense for 2006 was immaterial. L&W Supply s operating profit for 2007 included a restructuring charge of $1 million related to salaried workforce reductions. These unfavorable factors were partially offset by a $19 million increase in gross profit for other product lines in 2007.

In response to weak market conditions, L&W Supply closed 54 centers in 2008, while opening five new centers and continued to serve its customers from 198 centers in the United States as of December 31, 2008. L&W Supply operated 247 centers in the United States and Mexico as of December 31, 2007 and 220 centers in the United States as of December 31, 2006.

WORLDWIDE CEILINGS

Worldwide Ceilings had record net sales of $846 million in 2008 which represented an increase of $33 million, or 4%, compared with 2007. Operating profit in 2008 was $68 million, a decrease of $7 million, or 9%, compared with 2007. Operating profit in 2008 was adversely affected by goodwill and other intangible asset impairment charges of $12 million and restructuring charges of $5 million related to salaried workforce reductions. Net sales in 2007 of $813 million increased 8% compared with 2006, while operating profit of $75 million, which included restructuring charges of $2 million related to salaried workforce reductions, was down $6 million.

USG Interiors, Inc.: Net sales in 2008 for our domestic ceilings business rose to $531 million, an increase of $8 million, or 2%, compared with 2007. Operating profit increased to $61 million, an increase of $7 million, or 13%, compared with 2007. These results primarily reflected higher selling prices for ceiling grid and tile in 2008. However, demand from the commercial construction market that USG Interiors serves began to deteriorate in the second half of the year, resulting in lower volume levels for ceiling grid and ceiling tile in 2008 compared with 2007.

Net sales in 2008 increased $8 million for ceiling grid and $1 million for AURATONE® brand ceiling tile while sales of other products declined $1 million compared with 2007. Net sales for ceiling grid benefited from higher selling prices (up 9%) that contributed a $14 million increase in sales and more than offset a 4% decrease in volume, which adversely affected sales by $6 million. Net sales for AURATONE® brand ceiling tile benefited from higher selling prices (up 2%) that contributed a $3 million increase in sales and more than offset a 1% decrease in volume, which adversely affected sales by $2 million.

A 37% increase in gross margin for ceiling grid in 2008 increased gross profit by $17 million, reflecting the higher selling prices and lower manufacturing costs (down 3%) compared with 2007. The decrease in costs primarily reflected lower steel costs. This increase in gross profit for ceiling grid more than offset a $2 million decline as a result of the lower volume. An 11% decrease in gross margin for ceiling tile in 2008 decreased gross profit by $5 million, reflecting higher manufacturing costs (up 5%), partially offset by the higher selling prices compared with 2007. The increase in ceiling tile costs primarily reflected higher raw material costs. Gross profit for other products were down $2 million in 2008. Restructuring charges of $2 million were recorded in 2008 compared with $1 million in 2007.

Net sales in 2007 for USG Interiors rose to $523 million, an increase of $16 million, or 3%, compared with

2006. However, operating profit of $54 million was down $3 million, or 5%, compared with 2006. Net sales for ceiling grid increased $9 million compared with 2006. Sales of ceiling grid benefited from higher volume (up 4%) that contributed $6 million in increased sales and higher selling prices (up 2%) that contributed a $3 million increase in sales. Net sales for AURATONE® brand ceiling tile increased $7 million, reflecting higher selling prices (up 6%) that contributed a $10 million increase in sales and more than offset a 1% decrease in volume, which adversely affected sales by $3 million.

A 16% decrease in gross margin for ceiling grid in 2007 compared with 2006 adversely affected gross profit by $9 million, reflecting higher manufacturing costs (up 11%) primarily due to higher steel costs, which more than offset the higher selling prices. The decrease in the gross profit for ceiling grid more than offset a $2 million increase as a result of the higher volume. A 13% increase in gross margin for ceiling tile in 2007 compared with 2006 contributed $4 million to gross profit, reflecting the higher selling prices that more than offset higher manufacturing costs (up 4%). The increase in costs primarily reflected higher raw material costs.

USG International: Net sales in 2008 for USG International increased $31 million, or 11%, compared with 2007. However, an operating loss of $4 million was recorded in 2008 compared with operating profit of $12 million in 2007. The improvement in net sales primarily reflected increased demand for ceiling grid and joint treatment in Europe and ceiling tile in the Asia-Pacific region as well as the favorable effects of currency translation. However, demand for ceiling grid and joint treatment in Europe decreased in the fourth quarter of 2008 compared with prior 2008 quarters and the fourth quarter of 2007. Operating profit fell in 2008 largely due to goodwill and other intangible asset impairment charges of $12 million and restructuring charges of $3 million related to salaried workforce reductions.

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.

CGC Inc.: Net sales in 2008 of $61 million were unchanged from 2007. However, operating profit increased $2 million to $11 million primarily due to higher selling prices for ceiling grid and ceiling tile.

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.

Liquidity and Capital Resources

LIQUIDITY

As of December 31, 2008, we had cash and cash equivalents of $471 million. Subsequent to December 31, 2008, $190 million of cash was used to repay borrowings under our revolving credit facility in connection with its amendment and restatement, as discussed below.

Since the beginning of the fourth quarter of 2008, we have implemented several financing arrangements to improve our financial flexibility and liquidity. In November 2008, we sold $400 million of 10% contingent convertible senior notes due 2018. The notes bear interest at a rate of 10% per annum and are convertible into shares of our common stock at an initial conversion ratio of 87.7193 shares per $1,000 principal amount of notes, which is equivalent to an initial conversion price of $11.40 per share. During the fourth quarter of 2008, we also finalized a ship mortgage facility under which we borrowed $29 million in the fourth quarter and expect to borrow an additional $25 million to $35 million in the first quarter of 2009.

In January 2009, we amended and restated our unsecured revolving credit facility. The amended and restated facility, which is guaranteed by, and secured by trade receivables and inventory of, our significant domestic

subsidiaries, matures in 2012 and provides for revolving loans of up to $500 million based upon a borrowing base determined by reference to the levels of trade receivables and inventory securing the facility. The amended and restated facility has a single financial covenant that will only apply if borrowing availability under the facility is less than $75 million. Availability under the credit facility will increase or decrease depending on changes to the borrowing base over time. In conjunction with the amendment and restatement of the revolving credit facility, our separate $170 million secured credit agreement was terminated.

Upon completion of the revolving credit facility amendment, we had about $550 million of available borrowing capacity and cash to fund operations, including approximately $250 million of borrowing capacity under the revolving credit facility, taking into account the borrowing base, outstanding letters of credit and the $75 million availability requirement for the minimum fixed charge coverage ratio not to apply. We do not satisfy the fixed charge coverage ratio as of the date of this report. As of the most recent borrowing base report delivered under the credit facility, which reflects trade receivables and inventory as of December 31, 2008, our borrowing availability under the revolving credit facility had declined by about $60 million since completion of the facility amendment. Inventories and trade receivables are typically at their lowest levels at year end.

We have taken significant actions to reduce the cash needed to operate our businesses. We expect operating cash inflows to improve in 2009 from 2008 levels as a result of the approximately $150 million of cost savings from our 2008 restructuring actions. These operating cash inflows are expected to largely fund our cash requirements. Any shortfall is expected to be funded by cash on hand, borrowings under our revolving credit facility and ship mortgage facility, other potential borrowings and potential sales of surplus property. We expect to lower our level of capital expenditures to approximately $50 million in 2009, reflecting the substantial completion of a number of strategic investments. Interest payments will increase to $137 million in 2009 due to the higher level of debt outstanding, but we have no term debt maturities until 2016, other than approximately $4 million of annual debt amortization under our ship mortgage facility, which will increase to approximately $9 million annually following the additional borrowing under that facility expected to occur in the first quarter of 2009. Due to significant tax loss carryforwards, our income tax payments are expected to be very low for the next several years.

We believe that cash on hand, cash available from future operations and the sources of funding described above will provide sufficient liquidity to fund our operations for the next 12 months. However, operating cash flows are expected to continue to be negative and reduce our liquidity in the near term. Cash requirements include, among other things, capital expenditures, working capital needs, interest, pension funding and other contractual obligations.

Notwithstanding the above, if a significantly extended downturn or further significant decrease in demand materializes, there will exist a material uncertainty as to whether we will have sufficient cash flows to be able to weather such a downturn or decrease in demand. As discussed above, during 2008 we took actions to reduce costs, increase our liquidity and improve our operations. We will continue our efforts to increase financial flexibility during the recession. There can be no assurance that the efforts taken to date and future actions will be sufficient to withstand the impact of any economic downturn that extends deeper or longer than we currently anticipate. Under these conditions, our operations and other sources of funds may not be sufficient to fund our operations, and we may be required to seek alternative sources of funding. There is no assurance, however, that we will be able to obtain financing on acceptable terms, or at all, especially in light of the ongoing turmoil in the financial markets discussed under Risk Factors above.

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CASH FLOWS

The following table presents a summary of our cash flows:

(millions)	2008	2007	2006
Net cash provided by (used for):			
Operating activities	$ (165)	$ 1,307	$ (3,703)
Investing activities	(252)	(730)	119
Financing activities	608	(853)	3,212
Effect of exchange rate changes on cash	(17)	8	1
Net increase (decrease) in cash and cash equivalents	$ 174	$ (268)	$ (371)

Operating Activities: The variation between 2008 and 2007 primarily reflects our 2007 receipt of a federal tax refund of $1.057 billion and a $463 million net loss in 2008 compared with net earnings of $77 million in 2007. The net loss for 2008 includes noncash goodwill and other intangible asset impairment charges of $177 million after-tax.
Investing Activities: The variation between 2008 and 2007 primarily reflects lower spending in 2008 for acquisitions (down $278 million) and capital projects (down $222 million), partially offset by a $12 million joint venture investment in 2008. The lower level of spending on capital projects in 2008 primarily reflected the completion of investments that we made in our operations over the past several years and the current market environment. The joint venture investment in 2008 related to a joint venture arrangement entered into in 2007 with a Chinese building materials company to manufacture a line of acoustical ceiling tile and grid systems in China.
Financing Activities: The variation between 2008 and 2007 primarily reflects the following transactions. In 2008, we increased debt by $598 million. 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 2007.

CAPITAL EXPENDITURES

Capital spending amounted to $238 million in 2008 compared with $460 million in 2007. Because of the high level of investment that we made in our operations over the past several years and the current market environment, our capital spending in 2008 was down $222 million compared with 2007. We plan to limit our capital spending in 2009 to approximately $50 million. Approved capital expenditures for the replacement, modernization and expansion of operations totaled $263 million as of December 31, 2008, compared with $302 million as of December 31, 2007. Approved expenditures as of December 31, 2008 included $211 million for construction of a new, low-cost gypsum wallboard plant in Stockton, Calif. Because of the current market environment, commencement of construction of this plant has been delayed until 2012, with production targeted to begin in 2014. 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.

WORKING CAPITAL

As of December 31, 2008, working capital (current assets less current liabilities) amounted to $738 million, and the ratio of current assets to current liabilities was 1.98-to-1. As of December 31, 2007, working capital amounted to $717 million, and the ratio of current assets to current liabilities was 2.26-to-1.
Cash and Cash Equivalents: As of December 31, 2008, we had cash and cash equivalents of $471 million compared with $297 million as of December 31, 2007. The increase was primarily attributable to our issuance of $400 million of 10% contingent convertible senior notes in November 2008. Subsequent to December 31, 2008, we used $190 million of cash to repay all outstanding borrowings under our revolving credit facility in connection with its amendment and restatement.

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Receivables: As of December 31, 2008, receivables were $467 million, up $37 million, or 9%, from $430 million as of December 31, 2007. This increase primarily reflected (1) our requirement to provide $43 million of collateral to our derivative counterparties as a result of changes in the market value of our derivatives and our credit rating and (2) an $11 million increase related to cross-currency swaps, partially offset by a $25 million decrease in customer receivables primarily due to a 13% decrease in consolidated net sales in December 2008 compared with December 2007.

Inventories: As of December 31, 2008, inventories were $404 million, down $27 million, or 6%, from $431 million as of December 31, 2007. The lower level of inventories primarily reflected a $35 million decrease in U.S. Gypsum s inventories principally resulting from the idling of production facilities due to the lower level of demand, as discussed above, partially offset by a $10 million increase in USG International s inventories. The increase in USG International s inventories primarily reflected a 30% increase in steel costs in Europe in December 2008 compared with December 2007 combined with our fixed contracts with vendors to purchase steel and the downturn in demand for ceiling grid products in Europe in the fourth quarter.

Accounts Payable: As of December 31, 2008, accounts payable were $220 million, down $108 million, or 33%, from $328 million as of December 31, 2007. The lower level of accounts payable largely reflected (1) a $32 million decrease related to capital spending as a result of the substantial completion of several strategic investments, including our new, low-cost wallboard plants and a paper mill combined with reduced capital spending subsequent to the completion of those projects, (2) a $32 million decrease in plant accruals largely reflecting the idling of production facilities due to the lower level of demand and (3) a $23 million decrease in non-plant year-end accruals due to the lower level of business and a company-wide emphasis on reducing expenses.

Accrued Expenses: As of December 31, 2008, accrued expenses were $338 million, up $104 million, or 44%, from $234 million as of December 31, 2007. The higher level of accrued expenses primarily reflected (1) a $43 million increase in restructuring-related accruals, (2) a $38 million increase in the fair value of outstanding hedge contracts and (3) a $15 million increase in accrued interest.

DEBT

Total debt, consisting of senior notes, contingent convertible senior notes, industrial revenue bonds, a ship mortgage credit facility and outstanding borrowings under our revolving credit facility, amounted to $1.836 billion as of December 31, 2008. Subsequent to December 31, 2008, $190 million of cash was used to repay borrowings under our revolving credit facility in connection with its amendment and restatement discussed above. Total debt, consisting of senior notes and industrial revenue bonds, amounted to $1.238 billion as of December 31, 2007. 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, 2008 included a gross deferred tax asset of $577 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, or NOL, and tax credit carryforwards. The NOL and tax credit carryforwards are a result of the amounts paid to the asbestos trust in 2006, as well as additional losses incurred in 2007 and 2008. We have concluded, based on the weight of available evidence, that all but $166 million of these tax benefits are more likely than not to be realized in the future.

In arriving at this conclusion, we evaluated all available evidence, including our past operating results, the existence of cumulative losses in the most recent fiscal years and our forecast of future taxable income. In determining future taxable income, assumptions were utilized, including the amount of pre-tax operating income in particular jurisdictions, reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. The assumptions utilized in forecasting pre-tax operating income are consistent with the plans and estimates used to determine the fair value of our reporting units for purposes of testing for impairment of goodwill and intangible assets. In projecting pre-tax income, we have relied upon historical data and forecasted

business cycles. Historically, the housing and other construction markets that we serve are deeply cyclical. Downturns in demand are typically steep and last several years, but are typically followed by periods of strong recovery. We believe this trend will occur again and that we will generate significant pre-tax profits when our markets recover. We also assumed that any deferred tax liabilities relied upon will reverse in the same period and jurisdiction and are of the same character as the temporary differences giving rise to the deferred tax asset related to the NOL and tax credit carryforwards.

As of December 31, 2008, we had deferred tax assets related to federal NOL and tax credit carryforwards of $336 million. We have federal NOLs of approximately $781 million that are available to offset federal taxable income and will expire in the years 2026 2028. In addition, we have federal alternative minimum tax credit carryforwards of approximately $69 million that are available to reduce future regular federal income taxes over an indefinite period. In order to fully realize the U.S. federal net deferred tax assets, taxable income of approximately $979 million would need to be generated during the period before their expiration. We currently anticipate that taxable income during that period will be in excess of the amount required in order to realize the U.S. deferred tax assets. As a result, management has concluded that it is more likely than not that these U.S. federal net deferred tax assets will be realized. In addition, we have federal foreign tax credit carryforwards of $6 million that will expire in 2015. Based on projections of future foreign tax credit usage, we concluded that, at December 31, 2008, a valuation allowance against the federal foreign tax credit carryforwards in the amount of $3 million was required.

In contrast to the results under the Internal Revenue Code, many U.S. states do not allow the carryback of an NOL in any significant amount. As a result, in these states our NOL carryforwards are significantly higher than our federal NOL carryforward. As of December 31, 2008, we had a gross deferred tax asset related to our state NOLs and tax credit carryforwards of $233 million, of which $12 million expires in years 2009-2011, $12 million expires in 2012-2014, $30 million expires in 2015-2017, $14 million expires in 2018-2020, $43 million expires in 2021-2023, $86 million expires in 2026, $7 million expires in 2027, $11 million expires in 2028 and $18 million does not expire. 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 in the states in which we conduct business operations and the loss carryforward periods allowed by current state laws (generally 5 to 20 years), we concluded that, at December 31, 2008, a valuation allowance in the amount of $163 million is required.

We also had deferred tax assets related to NOL and tax credit carryforwards in various foreign jurisdictions in the amount of $7 million at December 31, 2008, against a portion of which we had historically maintained a valuation allowance. During 2007, we reversed the entire $8 million valuation allowance on our Worldwide Ceilings business due to a change in judgment regarding the continued profitability of that business. Our profitability in that business in recent years, and our projections of future taxable income, have increased significantly due to cost-reduction activities and the introduction of new products, which has resulted in our concluding that it was more likely than not that we would be able to realize the deferred tax assets related to the NOLs in our Worldwide Ceilings business. During 2007, we reversed all $2 million of a valuation allowance on our Canadian businesses due to a planned amalgamation of entities, which as a combined entity is a historically profitable business. As a result, we believe it is more likely than not that we will be able to realize the deferred tax asset related to the NOLs and tax credit carryforwards in our Canadian businesses.

Section 382 of the Internal Revenue Code, or Section 382, imposes limitations on a corporation s ability to utilize NOLs if it experiences an ownership change. In general terms, an ownership change may result from transactions increasing the ownership of certain stockholders in the stock of a corporation by more than 50 percentage points over a three year period. If we were to experience an ownership change, utilization of our NOLs would be subject to an annual limitation under Section 382 determined by multiplying the market value of our outstanding shares of stock at the time of the ownership change by the applicable long-term tax-exempt rate (which was 5.4% for December 2008). Any unused annual limitation may be carried over to later years within the allowed NOL carryforward period. The amount of the limitation may, under certain circumstances, be increased or decreased by built-in gains or losses held by us at the time of the change that are recognized in the five-year period after the

change. Based on information available as of December 31, 2008, we estimate our current ownership change to be between 39% and 41%. If an ownership change had occurred as of December 31, 2008, our annual NOL utilization would have been limited to approximately $43 million per year.

During the fourth quarter of 2008, we amended our shareholder rights plan to reduce, until September 30, 2009, the threshold at which a person or group becomes an Acquiring Person under the rights plan from 15% to 4.99% of our outstanding common stock. The rights plan, as amended, exempts certain stockholders as long as they do not acquire additional shares of our common stock, except as otherwise provided by existing agreements. Common shares that otherwise would be deemed beneficially owned under the rights plan by reason of ownership of our 10% contingent convertible senior notes are exempted during the period in which the threshold is reduced to 4.99%. The amendment to the rights plan is intended to maximize the value of our NOL carryforwards and related tax benefits. The amendment does not, however, ensure that use of NOLs will not be limited by an ownership change, and there can be no assurance that an ownership change will not occur.

Contractual Obligations and Other Commitments

CONTRACTUAL OBLIGATIONS

As of December 31, 2008, our contractual obligations and commitments were as follows:

	Payments Due by Period				
(millions)	Total	2009	2010-2011	2012-2013	There-after
Debt obligations (a)	$ 1,858	$ 194	$ 8	$ 6	$ 1,650
Other long-term liabilities (b)	593	18	14	16	545
Interest payments (c)	1,416	137	268	262	749
Purchase obligations (d)	532	77	73	91	291
Capital expenditures (e)	263	37	35	182	9
Operating leases	428	91	136	77	124
Unrecognized tax benefits (f)	47	3	10	34	
Total	$ 5,137	$ 557	$ 544	$ 668	$ 3,368

(a) Excludes debt discount of $22 million. Debt obligations for 2009 include $190 million that was due in 2012, but was paid in January 2009 in connection with the amendment and restatement of our revolving credit facility.

(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, 2008.

(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 approved prior to December 31, 2008 but were not completed by that date.

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

For 2009, our defined benefit pension plans have no minimum funding requirements under the Employee Retirement Income Security Act of 1974, or ERISA. We are evaluating our level of funding for pension plans and currently estimate that we will contribute approximately $34 million to $46 million of cash to our pension plans in 2009.

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 2008 was $19 million. See Note 14 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.

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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

We are named as defendants in litigation arising from our operations, including claims and lawsuits arising from the operation of our vehicles, product warranties, personal injury and commercial disputes. Two of those cases, which were recently filed in Florida, were brought against L&W Supply seeking unspecified damages for certain drywall L&W Supply sold in Florida in 2006 that was manufactured in China by Knauf Plasterboard (Tianjin) Co. Ltd., also named as a defendant. In those two cases, the plaintiffs allege that the drywall is defective and emits excessive sulfur compounds which have caused, among other things, property damage to the homes in which the drywall was installed.

We have also been notified by state and federal environmental protection agencies of possible involvement as one of numerous potentially responsible parties in a number of Superfund sites in the United States. As a potentially responsible party, we may be responsible to pay for some part of the cleanup of hazardous waste at those sites. In most of these sites, our involvement is expected to be minimal. In addition, we are involved in environmental cleanups of other property that we own or owned.

We believe that appropriate reserves have been established for our potential liability in connection with these matters, taking into account the probability of liability, whether our exposure can be reasonably estimated and, if so, our estimate of our liability or the range of our liability. However, we continue to review these accruals as additional information becomes available and revise them as appropriate. We do not expect the environmental matters or any other litigation matters involving USG to have a material adverse effect upon our results of operations, financial position or cash flows. See Note 21 to the Consolidated Financial Statements for additional information regarding litigation matters.

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.

GOODWILL, OTHER INTANGIBLE ASSETS AND PROPERTY, PLANT AND EQUIPMENT

Goodwill: In the fourth quarter of 2008, we recorded goodwill impairment charges of $214 million which were included in goodwill and other intangible asset impairment charges in the 2008 consolidated statement of operations. These charges left a remaining balance of goodwill of $12 million at December 31, 2008, as described in Note 3 to the Consolidated Financial Statements. As a result, we no longer believe that accounting for goodwill impairment represents a critical accounting policy for us.

Other Intangible Assets: We have both indefinite and definite lived other intangible assets. 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. The impairment test consists of a comparison of the fair value of an intangible asset with its carrying amount. If the carrying amount of an intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. An income approach is used for valuing trade names. Assumptions used in the income approach include projected revenues and assumed royalty, long-term growth and discount rates.

In 2008, our impairment tests for trade names resulted in $13 million of impairment charges, of which $12 million were included in goodwill and other intangible asset impairment charges in the 2008 consolidated statement of operations. These charges related to our Building Products Distribution segment. The pretax royalty rate of 1.25% was used based on comparable royalty agreements. The long-term growth rate that was applied was 2.5% based on our historical revenue growth. If the long-term growth rate decreased by 0.5%, the fair value of our trade names would have been $1.0 million lower. If the long-term growth rate increased by 0.5%, the fair value of our trade names would have been $1.0 million higher. We applied a discount rate of 15.5% based on our current cost of capital of 14.0% plus an adjustment of 1.5% for risk related to trade name valuation. If the discount rate decreased by 0.5%, the fair value of our trade names would have been $2.2 million higher. If the discount rate increased by 0.5%, the fair value of our trade names would have been $2.1 million lower.

We recorded $3 million of impairment charges related to trade names in 2007.

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 the assets 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 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. Customer relationships are currently being amortized over 10 years using annualized attrition rates. We periodically compare the current attrition rate of existing customers with the attrition rates assumed in the initial determination of the useful life to ensure that the useful life is still appropriate. At December 31, 2008, we determined that no impairment of customer relationships existed nor was a revision to the remaining useful life necessary.

Property, Plant and Equipment: We assess our property, plant and equipment for possible impairment in accordance with Statement of Financial Accounting Standards, or 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 and competitive conditions, 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 on a market appraisal.

Determination as to whether and how much an asset is impaired involves significant management judgment involving highly uncertain matters, including estimating the future success of product lines, future sales volumes, future 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 take into account our business plans and long-term investment decisions.

We regularly evaluate the recoverability of assets idled or at risk of being idled. In most cases, the idled assets are relatively older and higher-cost production plants or lines, which we refer to as facilities, that have relatively low carrying values. The last downturn during which we idled production facilities occurred in 1981 and 1982. At that time, we idled three facilities, all of which were restarted during the subsequent recovery. We consider idled facilities to be unimpaired because we plan to reopen them to meet future demand and the estimated future undiscounted cash flows exceed the carrying values of those facilities. We record impairment charges for facilities that we permanently close. Because we believe that a recovery in the housing and other construction markets that we serve will begin in the next two to three years and result in significantly higher demand than today s conditions, it is our current intention to restart all facilities that are currently idled. As a result, estimated future undiscounted cash

flows for the idled facilities significantly exceed their carrying values.

In 2008, we permanently closed two gypsum wallboard production facilities and one plaster production facility and we temporarily idled four gypsum wallboard production facilities, two paper production facilities and two facilities that produced other products. U.S. Gypsum recorded impairment charges totaling $9 million in 2008 related to the permanent closing of one gypsum wallboard production facility, one plaster production facility and a plant site. The impairment charge for one of the gypsum wallboard production facilities closed in 2008 was recorded in 2007. As of December 31, 2008, the aggregate carrying value of the production facilities permanently closed and temporarily idled in 2008 was $58 million after impairment charges. L&W Supply recorded an impairment charge of $2 million in 2008 related to the closing of 54 distribution centers, most of which were leased properties.

In 2007, we permanently closed one framing products facility and temporarily idled four gypsum wallboard production facilities and one paper production facility. U.S. Gypsum recorded impairment charges totaling $6 million in 2007 related to one gypsum wallboard production facility that was permanently closed in the first quarter of 2008 and the framing products facility. As of December 31, 2008, the aggregate carrying value of the production facilities permanently closed and temporarily idled in 2007 was $22 million after impairment charges.

On a segment basis, most of the closed and idled facilities and impairment charges relate to U.S. Gypsum within the North American Gypsum segment, and U.S. Gypsum s business is currently generating negative cash flows. As of December 31, 2008, the total carrying value of U.S. Gypsum s net property, plant and equipment was $1.902 billion.

Our gypsum wallboard business is 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. This business is also 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 declined by approximately 33% in 2008 compared with 2007. This followed a 25% decrease in 2007 compared with 2006.

Currently, there is significant excess wallboard production capacity industry-wide in the United States. Approximately 500 million square feet of additional capacity, net of closures, became operational in the United States in 2008. Industry capacity in the United States was approximately 40 billion square feet in 2008. We and other industry participants announced a number of closures near the end of 2008 that we expect will reduce industry capacity by approximately 3 billion square feet in 2009. We do not expect any new industry capacity will be added in 2009.

The markets that we serve, including in particular the housing and construction-based markets, are affected by the availability of credit, lending practices, the movement of interest rates, the unemployment rate and consumer confidence. Higher interest and unemployment rates and more restrictive lending practices could have a material adverse effect on our businesses, financial condition and results of operations. Our businesses are also affected by a variety of other factors beyond our control, including the inventory of unsold homes, which currently remains at a record level, housing affordability, office vacancy rates and foreign currency exchange rates. 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 businesses, financial condition and results of operations.

If the downturn in these markets does not reverse or the downturn is significantly extended, material write-downs or impairment charges may be required. If these conditions were to materialize or worsen, or if there is a fundamental change in the housing market, which individually or collectively lead to a significantly extended downturn or permanent decrease in demand, material impairment charges may be necessary if we permanently close gypsum wallboard production facilities. The magnitude and timing of those charges would be dependent on the severity and duration of the downturn and cannot be determined at this time. Any material cash or noncash impairment charges related to property, plant and equipment would have a material adverse effect on our financial

condition and results of operations, but material noncash impairment charges would have no effect on compliance with the financial covenant under our amended and restated secured credit facility or other terms of our outstanding indebtedness.

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 15 to the Consolidated Financial Statements for additional information.

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. We consider the underlying types of bonds and our projected cash flows of the plans in evaluating the yield curve selected. 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):

		Increase (Decrease) in	
Assumptions	Percentage Change	2009 Net Annual Benefit Cost	2008 Projected Benefit Obligation
Pension Benefits:			
Discount rate	0.5% increase	$ (2)	$ (53)
Discount rate	0.5% decrease	4	58
Asset return	0.5% increase	(5)	

Asset return	0.5% decrease		5		
Postretirement Benefits:					
Discount rate	0.5% increase	$	(1)	$	(23)
Discount rate	0.5% decrease		1		26

Compensation increase rates are based on historical experience and anticipated future management actions.

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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 2008. Economic factors and conditions could affect multiple assumptions simultaneously, and the effects of changes in assumptions are not necessarily linear.

See Note 14 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. 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 of December 31, 2008, we have recorded valuation allowances totaling $166 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 16 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. Our adoption of this statement effective January 1, 2008 had an immaterial impact on our financial statements and we have complied with the disclosure provisions of this statement. We also adopted the deferral provisions of FASB Staff Position, or FSP, SFAS No. 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS No. 157 for all nonrecurring fair value measurements of non-financial assets and liabilities until fiscal years beginning after November 15, 2008. We also adopted FSP SFAS No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active. This FSP, which provides guidance on measuring the fair value of a financial asset in an inactive market, had no impact on our financial statements (see Note 12 to the Consolidated Financial Statements).

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is effective as of the beginning of the first fiscal year beginning after November 15, 2007. Upon our adoption of this statement effective January 1, 2008, we elected not to fair value financial instruments and certain other items under SFAS No. 159. Therefore, this statement had 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 and for deferred tax adjustments for acquisitions completed before 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 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.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, which amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 161 requires companies with derivative instruments to disclose information that should enable financial statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133, and how derivative instruments and related hedged items affect a company s financial position, financial performance, and cash flows. The required disclosures include the fair value of derivative instruments and their gains or losses in tabular format, information about credit risk related contingent features in derivative agreements, counterparty credit risk, and a company s strategies and objectives for using derivative instruments. The Statement expands the current disclosure framework in SFAS No. 133. SFAS No. 161 is effective prospectively for periods beginning on or after November 15, 2008. We will comply with the disclosure provisions of this statement after its effective date.

In December 2008, the FASB issued FASB Staff Position, or FSP, No. 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets. This FSP amends SFAS 132(R), Employer s Disclosures about Pensions and Other Postretirement Benefits, to require additional disclosures about assets held in an employer s defined benefit pension or other postretirement plan. This FSP replaces the requirement to disclose the percentage of the fair value of total plan assets for each major category of plan assets, such as equity securities, debt securities, real estate and all other assets, with the fair value of each major asset category as of each annual reporting date for which a financial statement is presented. It also amends SFAS No. 132(R) to require disclosure of the level within the fair value hierarchy in which each major category of plan assets falls, using the guidance in SFAS No. 157, Fair Value Measurements. This FSP is applicable to employers that are subject to the disclosure requirements of SFAS No. 132(R) and is generally effective for fiscal years ending after December 15, 2009. We will comply with the disclosure provisions of this FSP after its effective date.

In December 2008, the Emerging Issues Task Force, or EITF, of the FASB issued EITF No. 07-5, Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock. Under this pronouncement, companies must evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own stock using a two-step approach. Step 1 requires an evaluation of the instrument s contingent exercise provisions. Step 2 requires the evaluation of the instrument s settlement provisions. This pronouncement is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. We will comply with this pronouncement upon the effective date.

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, construction and other financing, mortgage and other interest rates, housing affordability and supply, currency exchange rates and consumer confidence;
- capital markets conditions, the availability of borrowings under our credit agreement or other financings;
- competitive conditions, such as price, service and product competition;
- shortages in raw materials;
- changes in raw material, energy, transportation and employee benefit costs;
- the loss of one or more major customers and our customers ability to meet their financial obligations to us;
- capacity utilization rates;
- 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

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acts of God.

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

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 the results of this analysis, which may differ from actual results, the potential change in the fair value of our natural gas swap contracts is $15 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 $55 million, and all contracts mature by December 23, 2009. As of December 31, 2008, the fair value of these hedges was a $10 million pretax gain 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 $18 million, and all contracts mature by June 8, 2012. As of December 31, 2008, the fair value of these hedges, which was a gain of $2 million, was recorded to accumulated other comprehensive income, or AOCI.

INTEREST RATE RISK

As of December 31, 2008, most of our outstanding debt was fixed-rate debt. A sensitivity analysis was prepared to estimate the potential change in interest expense assuming a hypothetical 100 basis-point increase in interest rates. Based on results of this analysis, which may differ from actual results, the potential change in interest expense would be approximately $2 million.

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

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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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,		
	2008	2007	2006
Net sales	$ 4,608	$ 5,202	$ 5,810
Cost of products sold	4,416	4,601	4,426
Gross profit	192	601	1,384
Selling and administrative expenses	380	408	419
Restructuring and long-lived asset impairment charges	98	26	
Goodwill and other intangible asset impairment charges	226		
Asbestos claims provision (reversal)			(44)
Chapter 11 reorganization expenses			10
Operating profit (loss)	(512)	167	999
Interest expense	86	105	555
Interest income	(7)	(22)	(43)
Other income, net	(10)	(4)	(3)
Earnings (loss) before income taxes	(581)	88	490
Income taxes (benefit)	(118)	11	193
Net earnings (loss)	$ (463)	$ 77	$ 297
Earnings (Loss) Per Common Share:			
Basic	$ (4.67)	$ 0.80	$ 4.47
Diluted	$ (4.67)	$ 0.79	$ 4.46

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, 2008	2007
Assets		
Current Assets:		
Cash and cash equivalents	$ 471	$ 297
Restricted cash	1	
Receivables (net of reserves: 2008 $15; 2007 $17)	467	430
Inventories	404	431
Income taxes receivable	15	37
Deferred income taxes	68	32
Other current assets	68	57
Total current assets	1,494	1,284
Property, plant and equipment, net	2,562	2,596
Deferred income taxes	374	228
Goodwill	12	226
Other assets	277	320
Total assets	$ 4,719	$ 4,654
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$ 220	$ 328
Accrued expenses	338	234
Short-term debt	190	
Current portion of long-term debt	4	
Income taxes payable	4	5
Total current liabilities	756	567
Long-term debt	1,642	1,238
Deferred income taxes	7	10
Other liabilities	764	613
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: 2008 103,972 shares; 2007 103,972 shares	10	10
Treasury stock at cost (000) 2008 4,793 shares; 2007 4,921 shares	(199)	(204)

Capital received in excess of par value	2,625	2,607
Accumulated other comprehensive (loss) income	(227)	9
Retained earnings (deficit)	(659)	(196)
Total stockholders equity	1,550	2,226
Total liabilities and stockholders equity	$ 4,719	$ 4,654

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, 2008	2007	2006
Operating Activities			
Net earnings (loss)	$ (463)	$ 77	$ 297
Adjustments to Reconcile Net Earnings (Loss) to Net Cash:			
Goodwill and other intangible asset impairment charges	226		
Asbestos claims provision (reversal)			(44)
Depreciation, depletion and amortization	182	176	138
Share-based compensation expense	24	20	17
Deferred income taxes	(111)	5	1,203
Other, net	(10)		
(Increase) Decrease in Working Capital (net of acquisitions):			
Receivables	(37)	91	(12)
Income taxes receivable	22	1,063	(1,096)
Inventories	27	5	(32)
Payables	(78)	(60)	38
Accrued expenses	49	(59)	(24)
Increase in other assets	(23)	(29)	(33)
Increase in other liabilities	25	33	40
Reorganization distribution other		(40)	(783)
Payment to Section 524(g) asbestos trust			(3,950)
Increase in liabilities subject to compromise			521
Other, net	2	25	17
Net cash (used for) provided by operating activities	(165)	1,307	(3,703)
Investing Activities			
Capital expenditures	(238)	(460)	(393)
Investment in joint venture	(12)		
Acquisitions of businesses, net of cash acquired	(1)	(279)	(128)
Return (deposit) of restricted cash	(1)	6	72
Net proceeds from asset dispositions		3	3
Purchases of marketable securities			(112)
Sales or maturities of marketable securities			677
Net cash (used for) provided by investing activities	(252)	(730)	119
Financing Activities			
Issuance of debt	1,950	499	2,265
Repayment of debt	(1,331)	(1,765)	
Payment of debt issuance fees	(10)	(4)	(26)
Excess tax benefits from share-based compensation	(1)	(5)	5
Proceeds from equity offering, net of fees		422	

Proceeds from the exercise of stock options			14
Proceeds from rights offering, net of fees			1,720
Reorganization distribution debt principal			(766)
Net cash provided by (used for) financing activities	608	(853)	3,212
Effect of exchange rate changes on cash	(17)	8	1
Net increase (decrease) in cash and cash equivalents	174	(268)	(371)
Cash and cash equivalents at beginning of period	297	565	936
Cash and cash equivalents at end of period	$ 471	$ 297	$ 565
Supplemental Cash Flow Disclosures:			
Interest paid	$ 83	$ 90	$ 548
Income taxes (refunded) paid, net	(21)	(1,046)	108

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, 2006, as previously stated	49,985	(5,348)	$ 5	$ (219)	$ 435	$ (595)	$ 72	$ (302)
Impact of adopting change in accounting related to inventory						23		23
Balance at January 1, 2006, as restated	49,985	(5,348)	$ 5	$ (219)	$ 435	$ (572)	$ 72	$ (279)
Net earnings						297		297
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								210
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	$ (275)	$ (136)	$ 1,566
Net earnings						77		77
Foreign currency translation, net of tax benefit of $1							53	53
Change in fair value of derivatives, net of tax of $15							21	21

Change in pension and postretirement benefit plans, net of tax of $48							72	72
Unrealized loss on marketable securities, net of tax benefit of $0.1							(1)	(1)
Total comprehensive income								222
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	$ (196)	$ 9	$ 2,226
Net loss						(463)		(463)
Foreign currency translation, net of tax benefit of $1							(100)	(100)
Change in fair value of derivatives, net of tax benefit of $20							(30)	(30)
Change in pension and postretirement benefit plans, net of tax benefit of $49							(107)	(107)
Unrealized loss on marketable securities, net of tax of $0.1							1	1
Total comprehensive income (loss)								(699)
Share-based compensation					24			24
Stock issuances		128		5	(5)			
Other					(1)			(1)
Balance at December 31, 2008	103,972	(4,793)	$ 10	$ (199)	$ 2,625	$ (659)	$ (227)	$ 1,550

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 $23 million in 2008, $30 million in 2007 and $29 million in 2006.

RESEARCH AND DEVELOPMENT

We charge research and development expenditures to earnings as incurred. These expenditures amounted to $19 million in 2008, $23 million in 2007 and $20 million in 2006.

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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 and for net operating loss carryforwards. 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 estimates of amounts that are currently payable, plus changes in deferred tax assets and liabilities.

INVENTORY VALUATION

All of our inventories are stated at the lower of cost or market. Virtually all of our inventories are valued under the average cost method with the remainder valued under the first-in, first-out cost method. Inventories include material, labor and applicable factory overhead costs. Depreciation associated with manufacturing assets is excluded from inventory cost, but is included in cost of products sold.

Prior to the fourth quarter of 2008, we valued our inventories in the United States under the last-in, first-out (LIFO) cost method. As of October 1, 2008, we changed our method of accounting for these inventories from the LIFO method to the average cost method. As of September 30, 2008, the inventories in the United States for which the LIFO method of accounting was applied represented approximately 79% of total gross inventories. We believe that this change is to a preferable method which better reflects the current cost of inventory on our consolidated balance sheets. Additionally, this change conforms virtually all of our worldwide inventories to a consistent inventory costing method and provides better comparability to our peers. We applied this change in accounting principle retrospectively to all prior periods presented herein in accordance with Statement of Financial Accounting Standards, or SFAS, No. 154, Accounting Changes and Error Corrections. As a result of this accounting change, our retained earnings (deficit) as of January 1, 2006 decreased to $(572) million using the average cost method from $(595) million as originally reported using the LIFO method for inventories in the United States. The following table summarizes the effect of the accounting change on our consolidated financial statements.

	2008			2007			2006		
(millions, except per share data)	Computed under Prior Method	Effect of Change	As Reported	Originally Reported	Effect of Change	As Adjusted	Originally Reported	Effect of Change	As Adjusted
Statement of Operations for the year ended December 31:									
Cost of products sold	$ 4,443	$ (27)	$ 4,416	$ 4,603	$ (2)	$ 4,601	$ 4,440	$ (14)	$ 4,426
Income taxes (benefit)	(128)	10	(118)	10	1	11	188	5	193
Net earnings (loss)	(480)	17	(463)	76	1	77	288	9	297
Per common share:									
Basic earnings (loss)	(4.84)	0.17	(4.67)	0.78	0.02	0.80	4.34	0.13	4.47
Diluted earnings (loss)	(4.84)	0.17	(4.67)	0.78	0.01	0.79	4.33	0.13	4.46
Balance Sheet as of December 31:									
Inventories	323	81	404	377	54	431			
Deferred income taxes	99	(31)	68	53	(21)	32			
Retained earnings (deficit)	(709)	50	(659)	(229)	33	(196)			
Statement of Cash Flows for the year ended December 31:									
Net earnings (loss)	(480)	17	(463)	76	1	77	288	9	297

Deferred income taxes	(121)	10	(111)	4	1	5	1,198	5	1,203
Inventory working capital change	54	(27)	27	7	(2)	5	(18)	(14)	(32)
Net cash (used for) provided by operating activities	(165)		(165)	1,307		1,307	(3,703)		(3,703)

EARNINGS PER SHARE
Basic earnings per share are based on the weighted average number of common shares outstanding. Diluted earnings per share are based on the weighted average number of common shares outstanding, the dilutive effect, if any, of restricted stock units, or RSUs, and performance shares and the potential exercise of outstanding stock options and the potential conversion of our 10% contingent convertible senior notes. Average common shares and average diluted common shares outstanding are calculated in accordance with SFAS No. 128, Earnings Per Share, and reflect the effect of the rights offering described in Note 19.
CASH AND CASH EQUIVALENTS
Cash and cash equivalents consist of highly liquid investments with maturities of three months or less at the time of purchase.
PROPERTY, PLANT AND EQUIPMENT
Property, plant and equipment is recorded at cost. We determine provisions for depreciation of property, plant and equipment on a straight-line basis over the expected average useful lives of composite asset groups. We determine estimated useful lives to be 50 years for buildings and improvements, a range of 10 to 25 years for machinery and equipment, and five years for computer software and systems development costs. Leasehold improvements are capitalized and amortized over the shorter of the remaining lease term or remaining economic useful life. We capitalize interest during the active construction period of major capital projects. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful lives of the assets. Facility start-up costs that cannot be capitalized are expensed as incurred and are recorded in cost of products sold. We compute depletion on a basis calculated to spread the cost of gypsum and other applicable resources over the estimated quantities of material recoverable. We review property, plant and equipment for impairment when indicators of a potential impairment are present by comparing the carrying value of the assets with their estimated future undiscounted cash flows or fair value, as appropriate. If we determine an impairment exists, the asset is written down to estimated fair value.
GOODWILL AND OTHER INTANGIBLE ASSETS
We review goodwill and other indefinite lived intangible assets annually for impairment or when indicators of a potential impairment are present by comparing asset carrying values to fair values. Historically, we performed our annual impairment test as of May 31 of each year. In the first quarter of 2008, we decided to change our annual impairment testing date from May 31 to October 31 of each year to coincide with the timing of our annual forecasting process and thus allow for the use of more current information in the goodwill and other intangible assets impairment testing. We believe this change in the method of applying an accounting principle is preferable. This change did not result in the delay, acceleration or avoidance of recording an impairment (see Note 3), and we determined that this change did not result in any adjustment to our prior-period consolidated financial statements when applied retroactively. For 2008, so that no more than 12 months would elapse between testing dates, we performed the impairment testing as of May 31 and updated it as of October 31. The impairment testing performed as of May 31, 2008 indicated that no impairment existed as of that date. However, the impairment testing performed as of October 31, 2008 indicated the existence of impairment that resulted in impairment charges in the fourth quarter of 2008. See Note 3 for additional information on the October 31, 2008 impairment testing and impairment charges.
SHARE-BASED COMPENSATION
Effective January 1, 2006, we adopted SFAS No. 123(R), Share-Based Payment, which requires companies to recognize in the income statement the grant-date fair value of stock options and other equity-based compensation issued to employees.
DERIVATIVE INSTRUMENTS
We use derivative instruments to manage selected commodity price and foreign currency exposures. We do not use derivative instruments for speculative trading purposes. All derivative instruments must be recorded on the balance sheet at fair value. For derivatives

designated as fair value hedges, the changes in the fair values of both the derivative instrument and the hedged item are recognized in earnings in the current period. For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is recorded to accumulated other comprehensive income, or AOCI, and is reclassified to earnings when the underlying transaction has an impact on earnings. The ineffective portion of changes in the fair value of the derivative is reported in cost of products sold. For derivatives designated as net investment hedges, we record changes in value to AOCI. For derivatives not classified as fair value, cash flow or net investment hedges, all changes in market value are recorded to earnings.

Commodity Derivative Instruments: Currently, we are using swap contracts to hedge a major portion of our anticipated purchases of natural gas to be used in our manufacturing operations. Generally, we have a substantial 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. The current contracts, all of which mature by December 31, 2012, are designated as cash flow hedges.

Foreign Exchange Derivative Instruments: We have operations in a number of countries and use forward contracts and cross-currency swaps from time to time to hedge selected risk of changes in cash flows resulting from forecasted intercompany and third-party sales or purchases, as well as intercompany loans, denominated in non-U.S. currencies, or to hedge selected risk of changes in our net investment in foreign subsidiaries. These contracts are designated as either cash flow hedges or hedges of net investment or are not designated as hedges.

EMBEDDED DERIVATIVES

We issued $400 million of 10% contingent convertible senior notes due 2018 in the fourth quarter of 2008. We determined that the notes contained multiple embedded derivatives that were required to be analyzed under SFAS No. 133 and related accounting standards. Except for the embedded derivative described in Note 11, the other embedded derivatives that were identified either were immaterial or did not need to be bifurcated and valued separately. These derivatives are recorded on the consolidated balance sheet at fair value with changes in market value recorded to earnings.

FOREIGN CURRENCY TRANSLATION

We translate foreign-currency-denominated assets and liabilities into U.S. dollars at the exchange rates existing as of the respective balance sheet dates. We record translation adjustments resulting from fluctuations in exchange rates to AOCI on our consolidated balance sheets. We translate income and expense items at the average exchange rates during the respective periods. The total transaction (gain) loss was $8 million in 2008, less than $1 million in 2007 and $(2) million in 2006.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board, or 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. Our adoption of this statement effective January 1, 2008 had an immaterial impact on our financial statements and we have complied with the disclosure provisions of this statement. We also adopted the deferral provisions of FASB Staff Position, or FSP, SFAS No. 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS No. 157 for all nonrecurring fair value measurements of non-financial assets and liabilities until fiscal years beginning after November 15, 2008. We also adopted FSP SFAS No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active. This FSP, which provides guidance on measuring the fair value of a financial asset in an inactive market, had no impact on our financial statements (see Note 12 to the Consolidated Financial Statements).

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is effective as of the beginning of the first fiscal year beginning after November 15, 2007. Upon our adoption of this statement effective

January 1, 2008, we elected not to fair value financial instruments and certain other items under SFAS No. 159. Therefore, this statement had 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 and for deferred tax adjustments for acquisitions completed before 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 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.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, which amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 161 requires a company with derivative instruments to disclose information that should enable financial statement users to understand how and why the company uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133, and how derivative instruments and related hedged items affect the company s financial position, financial performance, and cash flows. The required disclosures include the fair value of derivative instruments and their gains or losses in tabular format, information about credit risk related contingent features in derivative agreements, counterparty credit risk, and a company s strategies and objectives for using derivative instruments. The Statement expands the current disclosure framework in SFAS No. 133. SFAS No. 161 is effective prospectively for periods beginning on or after November 15, 2008. We will comply with the disclosure provisions of this statement after its effective date.

In December 2008, the FASB issued FASB Staff Position, or FSP, No. 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets. This FSP amends SFAS 132(R), Employer s Disclosures about Pensions and Other Postretirement Benefits, to require additional disclosures about assets held in an employer s defined benefit pension or other postretirement plan. This FSP replaces the requirement to disclose the percentage of the fair value of total plan assets for each major category of plan assets, such as equity securities, debt securities, real estate and all other assets, with the fair value of each major asset category as of each annual reporting date for which a financial statement is presented. It also amends SFAS No. 132(R) to require disclosure of the level within the fair value hierarchy in which each major category of plan assets falls, using the guidance in SFAS No. 157, Fair Value Measurements. This FSP is applicable to employers that are subject to the disclosure requirements of SFAS No. 132(R) and is generally effective for fiscal years ending after December 15, 2009. We will comply with the disclosure provisions of this FSP after its effective date.

In December 2008, the Emerging Issues Task Force, or EITF, of the FASB issued EITF No. 07-5, Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock. Under this pronouncement, companies must evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own

stock using a two-step approach. Step 1 requires an evaluation of the instrument s contingent exercise provisions. Step 2 requires the evaluation of the instrument s settlement provisions. This pronouncement is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. We will comply with this pronouncement upon the effective date.

2. Restructuring and Long-Lived Asset Impairment Charges

In response to adverse market conditions in 2008 and 2007, we implemented restructuring activities that resulted in the restructuring and long-lived asset impairment charges described below in 2008 and 2007.

2008 RESTRUCTURING AND LONG-LIVED ASSET IMPAIRMENT CHARGES

In 2008, we recorded restructuring and impairment charges totaling $98 million pretax primarily associated with salaried workforce reductions, the temporary idling or permanent closure of production facilities and the closure of 54 distribution centers. Permanent closures included our gypsum wallboard and plaster production facilities in Boston, Mass., and a gypsum wallboard production facility at Stony Point, N.Y. Temporary idlings included a gypsum wallboard production facility at each of our Plaster City, Calif., Jacksonville, Fla., Baltimore, Md., and Ft. Dodge, Iowa, plants, paper mills in South Gate, Calif., and Gypsum, Ohio, a cement board production facility in Santa Fe Springs, Calif., and a structural cement panel production facility in Delavan, Wis. On a segment basis, $48 million of the total related to North American Gypsum, $34 million to Building Products Distribution, $5 million to Worldwide Ceilings and $11 million to Corporate.

The total charge for severance was $50 million. This charge included $39 million for salaried workforce reductions and $11 million for severance associated with the closure or idling of production facilities and distribution centers. The number of salaried employees terminated and open positions eliminated was approximately 1,400. The number of hourly employees terminated and open positions eliminated was approximately 1,000. Payments totaling $23 million for severance, related benefits and outplacement services were made in 2008. Most of the remaining payments are expected to be made in 2009.

The total charge for lease terminations was $24 million. This charge related to the closure or idling of production facilities, closure of distribution centers and excess leased office space to be sublet. Most of the payments associated with these charges are expected to be made in 2009.

The total charge for asset impairments was $18 million. This charge reflected the write-down of the value of machinery and equipment of the plaster production facility in Boston, Mass., and the gypsum wallboard production facility at Stony Point, N.Y., that were permanently closed. It also included the write-down of leasehold improvements and write-off of receivables and inventory at the closed distribution centers. An impairment charge related to the gypsum wallboard production facility in Boston, Mass., that was permanently closed in the first quarter of 2008 was recorded in 2007, as discussed below.

The total charge for other exit costs related to 2008 restructuring activities was $4 million. This charge primarily related to the clean-up of closed or idled production facilities, cross-training for retained employees and other exit activities. Additional expenses of $2 million were incurred in 2008 for production facilities that were closed in 2007. All payments for these activities were made in 2008.

2007 RESTRUCTURING AND LONG-LIVED ASSET IMPAIRMENT CHARGES

In 2007, we recorded restructuring and long-lived asset impairment charges totaling $26 million pretax. These charges included $18 million for salaried workforce reductions and $2 million for severance and other exit costs related to the permanent closure of our framing products plant in Tuscaloosa, Ala., and the temporary idling of the gypsum wallboard production facility at our New Orleans, La., plant and the paper mill at our Jacksonville, Fla., plant. The 2007 charges also included $6 million for long-lived asset impairments. The number of employees terminated and open positions eliminated during 2007 as a result of our salaried workforce reductions was approximately 500. The exit costs primarily reflected severance for approximately 130 employees at the closed or

idled production facilities and lease-termination costs for the Tuscaloosa plant. The impairment charges reflected the write-down of the value of machinery and equipment at the Tuscaloosa plant and at our Boston, Mass., gypsum wallboard production facility that we closed in the first quarter of 2008.

On a segment basis, $18 million of the total amount related to North American Gypsum, $2 million to Worldwide Ceilings, $1 million to Building Products Distribution, and $5 million to Corporate. All payments associated with 2007 restructuring activities not made in 2007 were made in 2008.

RESTRUCTURING RESERVE

A restructuring reserve of $50 million was included in accrued expenses on the consolidated balance sheet as of December 31, 2008. We expect future payments to be approximately $42 million in 2009, $6 million in 2010 and $2 million after 2010. All restructuring-related payments in 2008 were funded with cash from operations. We expect that the future payments also will be funded with cash from operations. The restructuring reserve is summarized as follows:

	Balance		2008 Activity		Balance
(millions)	as of 1/1/08	Charges	Cash Payments	Asset Impairment	as of 12/31/08
2008 Restructuring Activities:					
Severance	$	$ 50	$ (23)	$	$ 27
Lease terminations		24	(1)		23
Asset impairments		18		(18)	
Other exit costs		4	(4)		
Subtotal		96	(28)	(18)	50
2007 Restructuring Activities:					
Salaried workforce reductions	6		(6)		
Facility shutdowns	1	2	(3)		
Subtotal	7	2	(9)		
Total	$ 7	$ 98	$ (37)	$ (18)	$ 50

3. Goodwill and Other Intangible Assets

In the fourth quarter of 2008, we recorded impairment charges of $226 million pre-tax associated with goodwill and other intangible assets related to L&W Supply Corporation and its subsidiaries, or L&W Supply, the reporting unit that comprises our Building Products Distribution segment, the Latin America reporting unit within our Worldwide Ceilings segment and the USG Mexico S.A de C.V. reporting unit within our North American Gypsum segment. As noted in the goodwill table below, most of the goodwill relates to the Building Products Distribution segment. This charge was measured and recognized following the guidance in SFAS No. 142, Goodwill and Other Intangible Assets, or SFAS No. 142, which requires that the carrying value of goodwill and indefinite lived other intangible assets be tested annually for impairment or when indicators of a potential impairment are present.

As part of our annual impairment testing, we identified that an impairment existed. The conditions that contributed to the impairment included our sustained low stock price and reduced market capitalization relative to the book value of our equity, which was adversely affected by generally weak economic conditions, macroeconomic factors impacting industry business conditions, recent and forecasted segment operating performance, the increased competitive environment, and continued tightening of the credit markets, along with other factors, such as a significant decline in housing starts.

Under SFAS No. 142, the measurement of impairment of goodwill consists of two steps. In the first step, we compare the fair value of each reporting unit to its carrying value. As part of our impairment analysis, we determined the fair value of each of our reporting units with goodwill using a combination of the income approach and the

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market approach. The income approach uses a discounted cash flow methodology to determine fair value. This methodology recognizes value based on the expected receipt of future economic benefits. Key assumptions in the income approach include a free cash flow projection, an estimated discount rate, a long-term growth rate and a terminal value. These assumptions are based upon our historical experience, current market trends and future expectations. The market approach uses the guideline public company methodology to determine fair value. This methodology recognizes value by applying valuation multiples of similar companies trailing 12-month revenue and earnings before interest, taxes, depreciation and amortization, or EBITDA, adjusted for various performance metrics. Our assessment also considered indicators of potential impairment that have occurred in our business, including declining U.S. residential housing starts, declining gross margins, curtailment of gypsum wallboard operations and closing of distribution centers. Based on this evaluation, we determined that the fair value of each reporting unit was less than its carrying value. Following this assessment, SFAS No. 142 required us to perform a second step in order to determine the implied fair value of goodwill in each reporting unit and to compare it to its carrying value. The activities in the second step included hypothetically valuing all of the tangible and intangible assets of the impaired reporting unit as if the reporting unit had been acquired in a business combination.

We have both indefinite and definite lived other intangible assets. 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. The impairment test consists of a comparison of the fair value of an intangible asset with its carrying amount. If the carrying amount of an intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. An income approach is used for valuing trade names. Assumptions used in the income approach include projected revenues and assumed royalty, long-term growth and discount rates.

As a result of these assessments, we recorded noncash charges of $226 million to goodwill and other intangible asset impairment charges in the consolidated statement of operations. The components of these noncash impairment charges consisted of $214 of goodwill and $12 million related to trade names. The portion of the charges related to goodwill is shown in the table below by segment. A portion of the charges related to goodwill was not deductible for tax purposes, resulting in a tax benefit of $49 million, or approximately 22% of the pre-tax charges amount.

GOODWILL

Changes in the carrying amount of goodwill by segment during 2008 and 2007 were as follows:

	North American	Building Products	Worldwide