USG CORP
Form 10-Q
October 28, 2008

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 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 West Adams Street, Chicago, Illinois	60661-3676
(Address of principal executive offices)	(Zip code)

Registrant s telephone number, including area code (312) 436-4000

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

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 (Do not check if a smaller reporting company)	Smaller reporting company o

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

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 o 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 number of shares of the registrant s common stock outstanding as of September 30, 2008 was 99,153,616.

Table of Contents

Table of Contents

PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months ended September 30,		Nine Months ended September 30,	
(millions, except per-share and share data)	2008	2007	2008	2007
Net sales	$ 1,211	$ 1,335	$ 3,627	$ 4,002
Cost of products sold	1,155	1,217	3,459	3,470
Gross profit	56	118	168	532
Selling and administrative expenses	91	90	287	306
Restructuring and impairment charges	5	3	30	18
Operating profit (loss)	(40)	25	(149)	208
Interest expense	21	22	59	85
Interest income	(2)	(5)	(5)	(18)
Other expense (income), net	3	(2)	2	(4)
Earnings (loss) before income taxes	(62)	10	(205)	145
Income tax expense (benefit)	(22)	3	(80)	41
Net earnings (loss)	(40)	7	(125)	104
Earnings (loss) per common share:				
Basic	$ (0.40)	$ 0.07	$ (1.26)	$ 1.07
Diluted	$ (0.40)	$ 0.07	$ (1.26)	$ 1.07
Average common shares	99,114,947	98,998,334	99,081,335	96,435,985
Average diluted common shares	99,114,947	99,214,635	99,081,335	96,721,553

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

USG CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(millions)		As of September 30, 2008		As of December 31, 2007
Assets				
Current Assets:				
Cash and cash equivalents	$	159	$	297
Receivables (net of reserves $15 and $17)		531		430
Inventories		419		377
Income taxes receivable		6		37
Deferred income taxes		60		53
Other current assets		78		57
Total current assets		1,253		1,251
Property, plant and equipment (net of accumulated depreciation and depletion $1,357 and $1,249)		2,643		2,596
Deferred income taxes		316		228
Goodwill		227		226
Other assets		329		320
Total Assets	$	4,768	$	4,621
Liabilities and Stockholders Equity				
Current Liabilities:				
Accounts payable	$	333	$	328
Accrued expenses		268		234
Income taxes payable		6		5
Total current liabilities		607		567
Long-term debt		1,464		1,238
Deferred income taxes		11		10
Other liabilities		636		613
Commitments and contingencies				
Stockholders Equity:				
Preferred stock				
Common stock		10		10
Treasury stock		(200)		(204)
Capital received in excess of par value		2,622		2,607

Accumulated other comprehensive (loss) income		(28)		9
Retained earnings (deficit)		(354)		(229)
Total stockholders equity		2,050		2,193
Total Liabilities and Stockholders Equity	$	4,768	$	4,621

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(millions)	Nine Months Ended September 30, 2008	2007
Operating Activities		
Net earnings (loss)	$ (125)	$ 104
Adjustments to reconcile net earnings (loss) to net cash:		
Depreciation, depletion and amortization	132	133
Share-based compensation expense	21	18
Deferred income taxes	(87)	26
(Increase) decrease in working capital (net of acquisitions):		
Receivables	(101)	(24)
Income taxes receivable	31	1,065
Inventories	(42)	5
Payables	28	(2)
Accrued expenses	15	(41)
Increase in other assets	(28)	(43)
Increase in other liabilities	17	28
Reorganization distribution other		(40)
Other, net	(4)	19
Net cash (used for) provided by operating activities	(143)	1,248
Investing Activities		
Capital expenditures	(209)	(341)
Acquisitions of businesses, net of cash acquired	(1)	(280)
Return of restricted cash		6
Net proceeds from asset disposition		1
Net cash used for investing activities	(210)	(614)
Financing Activities		
Issuance of debt, net of discount	940	499
Repayment of debt	(714)	(1,765)
Payment of debt issuance fees	(7)	(3)
Tax benefit of share-based payments	(1)	(6)
Proceeds from equity offering, net of fees		422
Net cash provided by (used for) financing activities	218	(853)
Effect of exchange rate changes on cash	(3)	7

Net decrease in cash and cash equivalents		(138)		(212)
Cash and cash equivalents at beginning of period		297		565
Cash and cash equivalents at end of period	$	159	$	353
Supplemental Cash Flow Disclosures:				
Interest paid	$	61	$	70
Income taxes refunded, net		(26)		(1,046)

See accompanying Notes to Condensed Consolidated Financial Statements.

USG CORPORATION
Notes to Condensed Consolidated Financial Statements
(Unaudited)

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

1. PREPARATION OF FINANCIAL STATEMENTS

We prepared the accompanying unaudited condensed consolidated financial statements of USG Corporation in accordance with applicable United States Securities and Exchange Commission guidelines pertaining to interim financial information. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates. In the opinion of our management, the financial statements reflect all adjustments, which are of a normal recurring nature, necessary for a fair presentation of our financial results for the interim periods. These financial statements and notes are to be read in conjunction with the financial statements and notes included in USG s Annual Report on Form 10-K for the fiscal year ended December 31, 2007, which we filed with the Securities and Exchange Commission on February 15, 2008.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 157, Fair Value Measurements. This statement defines fair value in generally accepted accounting principles and expands disclosures about fair value measurements that are required or permitted under other accounting pronouncements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. 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 11).

Table of Contents

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.

3. RESTRUCTURING AND IMPAIRMENT CHARGES

In response to adverse market conditions, we implemented the restructuring activities described below in 2008 and 2007.

2008 Restructuring Charges

During the first nine months of 2008, we recorded restructuring charges totaling $30 million pretax. Of this amount, we recorded $5 million in the third quarter, $21 million in the second quarter and $4 million in the first quarter.

The third quarter restructuring charges of $5 million primarily related to severance and other expenses associated with the suspension of operations at our paper mill at South Gate, California, expenses related to the closure of several distribution locations and additional expenses associated with manufacturing facilities that were shut down in the first quarter of 2008.

The second quarter restructuring charges of $21 million included $15 million for salaried workforce reductions. The number of employees terminated and open positions eliminated during the second quarter as a result of these reductions was approximately 450. Charges of $5 million related to the closure of distribution locations and additional expenses associated with manufacturing facilities that were shut down in the first quarter of 2008. The remaining $1 million primarily related to expenses associated with the closing of facilities in 2007.

The first quarter restructuring charges of $4 million included $3 million primarily for severance related to the closure of our gypsum wallboard line in Boston, Mass., as well as the temporary shutdowns of our gypsum wallboard line in Fort Dodge, Iowa, and our paper mill in Gypsum, Ohio and for salaried workforce reductions in the first quarter. The remaining $1 million primarily related to expenses associated with the closing of facilities in 2007.

Of the $30 million of restructuring charges recorded during the first nine months of 2008, $17 million related to North American Gypsum, $6 million to Building Products Distribution, $2 million to Worldwide Ceilings and $5 million to Corporate.

Table of Contents

2007 Restructuring and Impairment Charges

In the third quarter of 2007, we recorded a charge of $3 million pretax related to salaried workforce reductions. For the first nine months of 2007, total restructuring charges of $17.5 million pretax primarily related to salaried workforce reductions and a facility shutdown. For the full year 2007, we recorded restructuring and impairment charges that totaled $26 million pretax. This amount included $18 million for salaried workforce reductions, $2 million for facility shutdowns and $6 million for asset impairments.

Restructuring Reserve

A restructuring reserve of $12 million was included in accrued expenses on the condensed consolidated balance sheet as of September 30, 2008. We expect the majority of the remaining accrued expenses to be paid in 2009. This reserve is summarized as follows:

	Balance	Nine Months ended September 30, 2008			Balance
	as of		Cash	Other	as of
(millions)	1/1/08	Charges	Payments	Non-Cash	9/30/08
2008 Restructuring Activities:					
Salaried workforce reductions	$	$ 16	$ (13)	$ (1)	$ 2
Facility shutdowns		12	(8)		4
Subtotal		28	(21)	(1)	6
2007 Restructuring Activities:					
Salaried workforce reductions	$ 6	$	$ (1)	$	$ 5
Facility shutdowns	1	2	(2)		1
Subtotal	7	2	(3)		6
Total	$ 7	$ 30	$ (24)	$ (1)	$ 12

4. SEGMENTS

Our operations are organized into three reportable segments: North American Gypsum, Building Products Distribution and Worldwide Ceilings. Segment results were as follows:

	Three Months ended September 30,		Nine Months ended September 30,	
(millions)	2008	2007	2008	2007
Net Sales:				
North American Gypsum	$ 610	$ 698	$ 1,853	$ 2,209
Building Products Distribution	526	614	1,558	1,772
Worldwide Ceilings	227	207	675	614
Eliminations	(152)	(184)	(459)	(593)
Total USG Corporation	$ 1,211	$ 1,335	$ 3,627	$ 4,002
Operating Profit (Loss):				
North American Gypsum	$ (48)	$ (2)	$ (161)	$ 133
Building Products Distribution	4	22	10	93
Worldwide Ceilings	22	23	72	54

Corporate	(17)	(18)	(71)	(79)
Eliminations	(1)		1	7
Total USG Corporation	$ (40)	$ 25	$ (149)	$ 208

Table of Contents

The total operating loss for the third quarter of 2008 included restructuring charges totaling $5 million. On an operating segment basis, $4 million of the charges related to North American Gypsum and $1 million to Building Products Distribution.

The total operating loss for the first nine months of 2008 included restructuring charges totaling $30 million. On an operating segment basis, $17 million of the charges related to North American Gypsum, $6 million to Building Products Distribution, $2 million to Worldwide Ceilings and $5 million to Corporate.

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

See Note 3 for information related to restructuring and impairment charges and the restructuring reserve as of September 30, 2008.

5. EARNINGS PER SHARE

Basic earnings per share are based on the weighted average number of common shares outstanding. Diluted earnings per share are based on the weighted average number of common shares outstanding and the dilutive effect of restricted stock units, or RSUs, performance shares and outstanding stock options. The reconciliation of basic earnings per share to diluted earnings per share is shown in the following table:

(millions, except per-share and share data)	Net Earnings (Loss)	Shares (000)	Weighted Average Per-Share Amount
Three Months Ended September 30, 2008:			
Basic loss	$ (40)	99,115	$ (0.40)
Diluted loss	$ (40)	99,115	$ (0.40)
Three Months Ended September 30, 2007:			
Basic earnings	$ 7	98,998	$ 0.07
Dilutive effect of stock options		217	
Diluted earnings	$ 7	99,215	$ 0.07
Nine Months Ended September 30, 2008:			
Basic loss	$ (125)	99,081	$ (1.26)
Diluted loss	$ (125)	99,081	$ (1.26)
Nine Months Ended September 30, 2007:			
Basic earnings	$ 104	96,436	$ 1.07
Dilutive effect of stock options		286	
Diluted earnings	$ 104	96,722	$ 1.07

The diluted losses per share for the third quarter and first nine months of 2008 were computed using the weighted average number of common shares

-10-

Table of Contents

outstanding during those periods. Options, RSUs and performance shares with respect to 3.2 million common shares for the third quarter of 2008 and 3.3 million common shares for the first nine months of 2008 were not included in the computation of diluted loss per share for those periods because they were anti-dilutive.

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

6. COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) consisted of the following:

	Three Months ended September 30,		Nine Months ended September 30,	
(millions)	2008	2007	2008	2007
Net earnings (loss)	$ (40)	$ 7	$ (125)	$ 104
Gain (loss) on derivatives, net of tax	(64)		(16)	14
Gain (loss) on unrecognized pension and postretirement benefit costs, net of tax *	1		6	(3)
Marketable securities, net of tax	1		1	
Foreign currency translation, net of tax	(31)	20	(28)	47
Total comprehensive income (loss)	$ (133)	$ 27	$ (162)	$ 162

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

Total accumulated other comprehensive income, or AOCI, consisted of the following:

(millions)	As of September 30, 2008	As of December 31, 2007
Gain (loss) on derivatives, net of tax	$ (21)	$ (5)
Unrecognized loss on pension and postretirement benefit plans, net of tax	(56)	(62)
Foreign currency translation, net of tax	49	77
Unrealized loss on marketable securities, net of tax		(1)
Total AOCI	$ (28)	$ 9

After-tax gains on derivatives reclassified from AOCI to earnings were $5 million during the third quarter of 2008. We estimate that we will reclassify a net $14 million after-tax loss on derivatives from AOCI to earnings within the next 12 months.

7. INVENTORIES

Total inventories consisted of the following:

(millions)		As of September 30, 2008		As of December 31, 2007
Finished goods and work in progress	$	333	$	290
Raw materials		86		87
Total	$	419	$	377

Table of Contents

8. GOODWILL AND OTHER INTANGIBLE ASSETS

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

(millions)	North American Gypsum	Building Products Distribution	Worldwide Ceilings	Total
Balance as of January 1, 2008	$ 1	$ 213	$ 12	$ 226
Purchase accounting adjustment		1		1
Balance as of September 30, 2008	$ 1	$ 214	$ 12	$ 227

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