

USG CORP
Form 10-Q
October 23, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from _____ to _____
Commission File Number 1-8864

USG CORPORATION
(Exact name of registrant as specified in its charter)

Delaware 36-3329400
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) 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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of the registrant's common stock outstanding as of September 30, 2014 was 144,731,928.

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

(millions, except per-share and share data)	Three months ended		Nine months ended		
	September 30,		September 30,		
	2014	2013	2014	2013	
Net sales	\$972	\$925	\$2,770	\$2,655	
Cost of products sold	796	770	2,276	2,225	
Gross profit	176	155	494	430	
Selling and administrative expenses	76	80	230	229	
Litigation settlement charge	48	—	48	—	
Long-lived asset impairment charges	30	—	30	—	
Restructuring charges	—	—	—	3	
Operating profit	22	75	186	198	
Income from equity method investments	(12) (1) (20) (2)
Interest expense	43	51	135	151	
Interest income	—	(1) (1) (3)
Gain on deconsolidation of subsidiaries and consolidated joint ventures	—	—	(27) —	
Income (loss) from continuing operations before income taxes	(9	) 26	99	52
Income tax expense	2	2	7	1	
Income (loss) from continuing operations	(11	) 24	92	51
Loss from discontinued operations, net of tax	—	(1) (1) (1)
Net income (loss)	(11	) 23	91	50
Less: Net income attributable to noncontrolling interest	1	—	1	—	
Net income (loss) attributable to USG	\$(12	) \$23	\$90	\$50
Earnings (loss) per common share - basic:					
Income (loss) from continuing operations	\$(0.09	) \$0.23	\$0.65	\$0.48
Loss from discontinued operations	—	(0.01) (0.01) (0.01)
Net income (loss)	\$(0.09	) \$0.22	\$0.64	\$0.47
Earnings (loss) per common share - diluted:					
Income (loss) from continuing operations	\$(0.09	) \$0.22	\$0.63	\$0.47
Loss from discontinued operations	—	(0.01) (0.01) (0.01)
Net income (loss)	\$(0.09	) \$0.21	\$0.62	\$0.46
Average common shares	144,646,284	108,608,086	140,944,207	108,486,583	
Average diluted common shares	144,646,284	111,008,421	147,087,399	111,052,333	
See accompanying Notes to Consolidated Financial Statements.					

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USG CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

(millions)	Three months ended September 30, 2014		Nine months ended September 30, 2013	
Net income (loss)	\$(11	) \$23	\$91	\$50
Other comprehensive income (loss), net of tax:				
Derivatives qualifying as cash flow hedges:				
Gain/(loss) on derivatives qualifying as cash flow hedges, net of tax of \$1, \$0, \$1, and \$1, respectively	(1	) (2	) 1	—
Less: Reclassification adjustment for gain on derivatives included in net income, net of tax of \$0, \$1, \$0 and \$1, respectively	1	—	4	—
Net derivatives qualifying as cash flow hedges	(2	) (2	) (3) —
Pension and postretirement benefits:				
Changes in pension and postretirement benefits, net of tax of \$1, \$0, \$2 and \$2, respectively	3	(3	) (6	) (15
Less: Amortization of prior service credit (cost) included in net periodic pension cost, net of tax benefit of \$0, \$0, (\$1) and (\$1), respectively	3	(3	) 9	(8
Net pension and postretirement benefits	—	—	(15	) (7
Foreign currency translation:				
Changes in foreign currency translation, net of tax of \$0 in all periods	(39	) 5	(28	) (12
Less: Translation gains realized upon the deconsolidation of foreign subsidiaries, net of tax of \$0	—	—	5	—
Net foreign currency translation	(39	) 5	(33	) (12
Other comprehensive income (loss), net of tax	\$(41	) \$3	\$(51	) \$(19
Comprehensive income (loss)	\$(52) \$26	\$40	\$31

See accompanying Notes to Consolidated Financial Statements.

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CONSOLIDATED BALANCE SHEETS

(millions)	September 30, 2014 (Unaudited)	December 31, 2013
Assets		
Cash and cash equivalents	\$ 240	\$ 810
Short-term marketable securities	64	82
Restricted cash	1	5
Receivables (net of reserves - \$11 and \$12)	434	369
Inventories	326	332
Income taxes receivable	7	3
Deferred income taxes	51	52
Other current assets	53	47
Total current assets	1,176	1,700
Long-term marketable securities	36	60
Property, plant and equipment (net of accumulated depreciation and depletion - \$1,909 and \$1,840)	1,953	2,103
Deferred income taxes	12	17
Equity method investments	739	73
Other assets	148	168
Total assets	\$ 4,064	\$ 4,121
Liabilities and Stockholders' Equity		
Accounts payable	\$ 257	\$ 284
Accrued expenses	206	216
Current portion of long-term debt	4	63
Income taxes payable	—	5
Litigation settlement accrual	48	—
Total current liabilities	515	568
Long-term debt	2,206	2,238
Long-term debt - related party	—	54
Deferred income taxes	70	66
Pension and other postretirement benefits	246	277
Other liabilities	261	256
Total liabilities	3,298	3,459
Preferred stock	—	—
Common stock	14	14
Additional paid-in capital	3,007	2,920
Accumulated other comprehensive income (loss)	(27	) 24
Retained earnings (accumulated deficit)	(2,230	) (2,320
Stockholders' equity of parent	764	638
Noncontrolling interest	2	24
Total stockholders' equity including noncontrolling interest	766	662
Total liabilities and stockholders' equity	\$ 4,064	\$ 4,121
See accompanying Notes to Consolidated Financial Statements.		

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USG CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(millions)	Nine months ended September 30,	
	2014	2013
Operating Activities		
Net income	\$91	\$50
Less: Loss from discontinued operations, net of tax	(1	) (1
Income from continuing operations	92	51
Adjustments to reconcile income from continuing operations to net cash:		
Depreciation, depletion and amortization	115	115
Litigation settlement charge	48	—
Long-lived asset impairment charges	30	—
Share-based compensation expense	16	14
Deferred income taxes	4	(1
Gain on asset dispositions	(12	) (1
Income from equity method investments	(20	) (2
Gain on deconsolidation of subsidiaries and consolidated joint ventures	(27) —
(Increase) decrease in working capital, net of deconsolidation of subsidiaries and consolidated joint ventures:		
Receivables	(70	) (57
Income taxes receivable	(1) —
Inventories	(6	) (24
Other current assets	(1	) (14
Payables	(16	) (14
Accrued expenses	(6	) (4
Decrease in other assets	—	—
Decrease in pension and other postretirement benefits	(48	) (59
Decrease in other liabilities	(12	) (4
Other, net	(6	) 12
Net cash provided by operating activities	\$80	\$12
Investing Activities		
Purchases of marketable securities	(126	) (152
Sales or maturities of marketable securities	166	144
Capital expenditures	(88	) (72
Acquisition of mining rights	—	(17
Net proceeds from asset dispositions	14	1
Investment in joint venture, including \$23 million of cash of contributed subsidiaries in 2014	(558	) (5
Insurance proceeds	3	—
Return (deposit) of restricted cash	4	(1
Net cash used for investing activities	\$(585) \$(102
Financing Activities		
Issuance of debt	3	7
Repayment of debt	(62) (3

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Loans from joint venture partner	—	3	
Issuance of common stock	4	3	
Repurchases of common stock to satisfy employee tax withholding obligations	(7) (9)
Net cash (used for) provided by financing activities	\$(62	) \$1	
Effect of exchange rate changes on cash	(2	) (4)
Net cash used for operating activities - discontinued operations	(1	) (1)
Net decrease in cash and cash equivalents	\$(570	) \$(94)
Cash and cash equivalents at beginning of period	810	546	
Cash and cash equivalents at end of period	\$240	\$452	
Supplemental Cash Flow Disclosures:			
Interest paid, net of capitalized interest	\$127	\$137	
Income taxes paid, net	9	4	
Noncash Investing and Financing Activities:			
Amount in accounts payable for capital expenditures	7	8	
Contribution of wholly-owned subsidiaries and joint venture investments as consideration for investment in USG Boral Building Products	121	—	
Conversion of \$75 million of 10% convertible senior notes due 2018, net of discount	(73) —	
Issuance of common stock upon conversion of debt	75	—	
Accrued interest on debt conversion	(2) —	
See accompanying Notes to Consolidated Financial Statements.			

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USG CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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. Organization, Consolidation and Presentation of Financial Statements

PREPARATION OF FINANCIAL STATEMENTS

We prepared the accompanying unaudited consolidated financial statements of USG Corporation in accordance with applicable United States Securities and Exchange Commission, or SEC, guidelines pertaining to interim financial information. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, or U.S. GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ materially from those estimates. In the opinion of our management, the financial statements reflect all adjustments, which are of a normal recurring nature, necessary for a fair presentation of our financial results for the interim periods. The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results of operations to be expected for the entire year.

On our consolidated statements of operations for the three months and nine months ended September 30, 2013, income from equity method investments, which was previously included in "Other income, net," is reflected as "Income from equity method investments" to conform to the current year presentation. On our consolidated statement of cash flow for the nine months ended September 30, 2013, income from equity method investments previously included in "Other, net" has been reclassified to "Income from equity method investments."

Our investment with Boral Limited in a 50/50 joint venture, USG Boral Building Products or UBBP, was consummated on February 27, 2014 (February 28, 2014 Eastern Standard Time (Australia)), and as a result, seven months of results of UBBP were recorded in our accompanying consolidated statement of operations for the nine months ended September 30, 2014. See Note 2 for further description of our investment in UBBP.

Effective April 1, 2014, we changed the composition of our reportable segments to reflect the change in management over our businesses in Mexico and Latin America and the contribution of our businesses in Asia-Pacific, India and Oman into UBBP. Accordingly, our segments are now structured around our key products and business units: (1) Gypsum, (2) Ceilings, (3) Distribution and (4) UBBP. As a result of these changes, our Mexico and Latin America businesses have been combined, with their Gypsum results included within our Gypsum segment, previously referred to as North American Gypsum, and their Ceiling results included within our Ceilings segment, previously referred to as Worldwide Ceilings. Our prior period results have been recast to reflect these changes and present comparative year over year results. See Notes 2 and 4.

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, 2013, which we filed with the SEC on March 3, 2014.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity," which includes amendments that change the requirements for reporting discontinued operations and require additional disclosures about discontinued operations. Under the new guidance, only disposals representing a strategic shift in operations - that is, a major effect on the organization's operations and financial results - should be presented as discontinued operations. Examples include a disposal of a major geographic area, a major line of business, or a major equity method investment. Additionally, ASU 2014-08 requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. This update is effective for us in the first quarter of 2015. We do not expect that the adoption of ASU 2014-08 will have a significant impact to our consolidated financial statements or disclosures.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." ASU 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)," and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The standard will be effective for us in the first quarter of 2017, with early adoption not permitted. There are two transition methods available under the new standard, either cumulative effect or retrospective. We are currently evaluating the impact of this ASU and have not yet selected a transition method.

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In August 2014, the FASB issued ASU 2014-15, "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern," which requires management to assess, at each annual and interim reporting period, the entity's ability to continue as a going concern within one year of date of the financial statements are issued and provide related disclosures. The new standard will be effective for us for the year ended December 31, 2016, with early adoption permitted. We do not expect that the adoption of ASU 2014-15 will have a significant impact to our consolidated financial statements or disclosures.

2. Equity Method Investments

Equity method investments as of September 30, 2014 and December 31, 2013, were as follows:

(dollars in millions)	September 30, 2014		December 31, 2013	
	Carrying Value	Ownership Percentage	Carrying Value	Ownership Percentage
USG Boral Building Products (a)	692	50%	N/A	N/A
Other equity method investments	47	33% - 50%	\$73	33% - 50%
Total equity method investments	\$739		\$73	

(a) The carrying value of our investment in UBBP as of September 30, 2014, includes transaction costs of approximately \$32 million incurred in the fourth quarter of 2013 and first nine months of 2014.

Investment in USG Boral Building Products ("UBBP")

On February 27, 2014, we formed a 50/50 joint venture, USG Boral Building Products ("UBBP"), with Boral Limited ("Boral") and certain of its subsidiaries. UBBP manufactures, distributes and sells certain building products, mines raw gypsum and sells natural and synthetic gypsum throughout Asia, Australasia and the Middle East (the "Territory"). The products that UBBP manufactures and distributes include products for wall, ceiling, floor lining and exterior systems that utilize gypsum, wallboard, referred to as plasterboard in the region, mineral fiber ceiling tiles, steel grid and studs and joint compound.

On February 27, 2014, as consideration for our 50% ownership in UBBP, we (i) made a cash payment of \$513 million to Boral, which includes a \$500 million base price and \$13 million of customary estimated working capital and net debt adjustments, (ii) contributed to UBBP our subsidiaries and joint venture investments in China, Singapore, India, Malaysia, New Zealand, Australia, the Middle East and Oman, see Note 15, and (iii) granted to UBBP licenses to use certain of our intellectual property rights in the Territory. We funded our cash payment with the net proceeds from our October 2013 issuance of \$350 million of 5.875% senior notes and cash on hand. In the event certain performance targets are satisfied by UBBP, we will be obligated to pay Boral scheduled earnout payments in an aggregate amount up to \$75 million, comprised first of \$25 million based on performance during the first three years after closing and then up to \$50 million based on performance during the first five years after closing. In October 2014, we paid an additional \$2 million to Boral in conjunction with customary post-closing adjustments.

We account for our 50% investment in UBBP using the equity method of accounting, and we initially measured its carrying value at cost of approximately \$676 million as of February 27, 2014. Our existing wholly-owned subsidiaries and consolidated variable interest entities that were contributed into the joint venture were deconsolidated resulting in a gain of \$27 million, which is included in our consolidated statement of operations for the nine months ended September 30, 2014. Approximately \$11 million of the gain relates to the remeasurement of our retained investment in the contributed subsidiaries to a preliminary fair value, determined using a discounted cash flow model with several inputs, including a weighted-average discount rate of approximately 11% and a weighted-average long-term growth rate of approximately 2%. Additionally, we recorded a liability of \$23 million representing the present value of the first earnout payment, which is included in other liabilities on our accompanying consolidated balance sheet as of September 30, 2014. We are not currently required under applicable accounting guidance to record a liability for the second earnout payment, as such, a liability has not been recorded on our consolidated balance sheet as of September 30, 2014.

All of our investments accounted for under the equity method are initially recorded at cost, and subsequently adjusted for our share of the net income or loss and cash contributions and distributions to or from these entities. Because the

underlying net assets in our investments are denominated in a foreign currency, translation gains or losses will impact the recorded value of our investment and, for the nine months ended September 30, 2014, resulted in a net loss of \$13 million recorded in accumulated other comprehensive income (loss). For the nine months ended September 30, 2014, our

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accompanying consolidated statement of operations includes \$20 million of equity income, representing our share of seven months of results of UBBP of \$19 million and our share of income from our other equity method investments of \$1 million.

Summarized financial information for our equity method investments is as follows:

(in millions)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2014	2013	2014 (a)	2013
USG Boral Building Products:				
Net sales	\$286	N/A	\$655	N/A
Gross profit	77	N/A	179	N/A
Operating profit	31			