

USG CORP
Form 10-Q
October 26, 2012
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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, 2012

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, 2012 was 107,414,019.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

USG CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(millions, except per-share and share data)	Three months		Nine months	
	ended September 30,		ended September 30,	
	2012	2011	2012	2011
Net sales	\$828	\$763	\$2,409	\$2,184
Cost of products sold	722	717	2,099	2,064
Gross profit	106	46	310	120
Selling and administrative expenses	74	66	224	213
Restructuring and long-lived asset impairment charges	3	59	5	70
Operating profit (loss)	29	(79)	) 81	(163)
Interest expense	50	54	154	158
Interest income	(1)	) (1)	) (3)	) (5)
Loss on extinguishment of debt	—	—	41	—
Other income, net	(1)	) —	(2)	) (1)
Loss from continuing operations before income taxes	(19)	) (132)	) (109)	) (315)
Income tax expense (benefit)	11	(15)	) 9	(19)
Loss from continuing operations	(30)	) (117)	) (118)	) (296)
Income from discontinued operations, net of tax	1	2	5	6
Net loss	\$ (29)	) \$ (115)	) \$ (113)	) \$ (290)
Earnings per common share - basic:				
Loss from continuing operations	\$ (0.29)	) \$ (1.11)	) \$ (1.11)	) \$ (2.85)
Income from discontinued operations	0.01	0.02	0.04	0.05
Net loss	\$ (0.28)	) \$ (1.09)	) \$ (1.07)	) \$ (2.80)
Earnings per common share - diluted:				
Loss from continuing operations	\$ (0.29)	) \$ (1.11)	) \$ (1.11)	) \$ (2.85)
Income from discontinued operations	0.01	0.02	0.04	0.05
Net loss	\$ (0.28)	) \$ (1.09)	) \$ (1.07)	) \$ (2.80)
Average common shares	107,380,328	105,304,781	106,128,123	103,592,899
Average diluted common shares	107,380,328	105,304,781	106,128,123	103,592,899
See accompanying Notes to Condensed Consolidated Financial Statements.				

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

(millions)	Three months		Nine months	
	ended September		ended September	
	30,	30,	30,	2011
	2012	2011	2012	2011
Net loss	\$ (29)	\$ (115)	\$ (113)	\$ (290)
Other comprehensive income (loss), net of tax:				
Derivative instruments	1	10	4	18
Pension and postretirement benefits	1	4	10	10
Foreign currency translation	16	(54)	21	(31)
Other comprehensive income (loss), net of tax	\$ 18	\$ (40)	\$ 35	\$ (3)
Comprehensive loss	\$ (11)	\$ (155)	\$ (78)	\$ (293)

See accompanying Notes to Condensed Consolidated Financial Statements.

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USG CORPORATION
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Unaudited)

(millions)	As of September 30, 2012	As of December 31, 2011
Assets		
Current Assets:		
Cash and cash equivalents	\$437	\$365
Short-term marketable securities	89	164
Restricted cash	18	1
Receivables (net of reserves — \$15 and \$17)	347	316
Inventories	302	292
Income taxes receivable	7	8
Deferred income taxes	4	4
Other current assets	44	54
Assets related to discontinued operations	38	35
Total current assets	1,286	1,239
Long-term marketable securities	41	122
Property, plant and equipment (net of accumulated depreciation and depletion — \$1,709 and \$1,602)	2,083	2,104
Deferred income taxes	21	25
Other assets	233	229
Total assets	\$3,664	\$3,719
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	\$244	\$226
Accrued expenses	276	258
Current portion of long-term debt	5	7
Deferred income taxes	12	12
Income taxes payable	3	6
Liabilities related to discontinued operations	17	15
Total current liabilities	557	524
Long-term debt	2,306	2,297
Deferred income taxes	6	7
Other liabilities	673	735
Total liabilities	3,542	3,563
Stockholders' Equity:		
Preferred stock	—	—
Common stock	11	10
Treasury stock	—	—
Additional paid-in capital	2,592	2,561
Accumulated other comprehensive loss	(139	) (174
Retained earnings (accumulated deficit)	(2,355	) (2,241
Stockholders' equity of parent	109	156
Noncontrolling interest	13	—
Total stockholders' equity including noncontrolling interest	122	156
Total liabilities and stockholders' equity	\$3,664	\$3,719

See accompanying Notes to Condensed Consolidated Financial Statements.

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USG CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)

(millions)	Nine months ended September 30,	
	2012	2011
Operating Activities		
Net loss	\$(113	) \$(290
Less: Income from discontinued operations	5	6
Loss from continuing operations	(118	) (296
Adjustments to reconcile loss from continuing operations to net cash:		
Depreciation, depletion and amortization	116	123
Loss on extinguishment of debt	41	—
Long-lived asset impairment charges	1	52
Share-based compensation expense	15	19
Deferred income taxes	4	(12
Noncash income tax benefit	—	(3
Gain on asset dispositions	(8	) (1
(Increase) decrease in working capital:		
Receivables	(33	) (50
Income taxes receivable	2	(4
Inventories	(11	) (29
Prepaid expenses	2	(2
Payables	17	35
Accrued expenses	25	(8
Decrease (increase) in other assets	3	(8
(Decrease) increase in other liabilities	(29	) 2
Other, net	—	2
Net cash provided by (used for) operating activities - continuing operations	\$27	\$(180
Investing Activities		
Purchases of marketable securities	(115	) (295
Sales or maturities of marketable securities	269	251
Capital expenditures	(41	) (37
Acquisition of mining rights	(16) —
Net proceeds from asset dispositions	14	3
Investments in joint ventures	(14) —
Loan to joint venture	(4	) (4
(Deposit) return of restricted cash	(16	) 2
Net cash provided by (used for) investing activities - continuing operations	\$77	\$(80
Financing Activities		
Issuance of debt	248	—
Repayment of debt	(281	) (5
Payment of debt issuance fees	(5) —
Loan from venture partner	2	—
Issuance of common stock	1	—
Repurchases of common stock to satisfy employee tax withholding obligations	(5) (3

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Net cash used for financing activities - continuing operations	\$ (40)	\$ (8)
Effect of exchange rate changes on cash	5	(11)
Net cash provided by operating activities - discontinued operations	4	6
Net cash used for investing activities - discontinued operations	(1)	—
Net increase (decrease) in cash and cash equivalents	\$72	\$ (273)
Cash and cash equivalents at beginning of period	365	629
Cash and cash equivalents at end of period	\$437	\$356
Supplemental Cash Flow Disclosures:		
Interest paid	\$146	\$141
Income taxes paid, net	5	7
Amount in accounts payable for capital expenditures	2	1
See accompanying Notes to Condensed Consolidated Financial Statements.		

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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, 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 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 except as noted, 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, 2012 are not necessarily indicative of the results of operations to be expected for the entire year. 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, 2011 which we filed with the SEC on February 14, 2012.

2. Discontinued Operations

On August 7, 2012, USG and its indirect wholly owned subsidiaries, USG Foreign Investments, Ltd. and USG (U.K.) Ltd., together the Sellers, entered into a Share and Asset Purchase Agreement, or SAPA, with Knauf International GmbH and Knauf AMF Ceilings Ltd., together Knauf, pursuant to which the Sellers have agreed to sell to Knauf certain of their wholly owned European business operations. Those businesses include the manufacture and distribution of DONN® brand ceiling grid and SHEETROCK® brand finishing compounds principally throughout Europe, Russia and Turkey.

Pursuant to the terms of the SAPA, Knauf has agreed to purchase the businesses being sold for a total price of approximately \$80 million. That amount is subject to a working capital adjustment at closing. In addition, USG and its subsidiaries are entitled to retain all cash and cash equivalents of the businesses being sold, which totaled approximately \$37 million at September 30, 2012, and will retain responsibility for benefits payable under USG (U.K.) Ltd.’s closed pension plan. At September 30, 2012, the liability balance on our condensed consolidated balance sheet with respect to that pension plan was approximately \$1 million.

Consummation of the transactions contemplated by the SAPA is expected to occur within the next several months; however, it is subject to the satisfaction or waiver of customary closing conditions, including receipt of necessary government approvals, the performance in all material respects by the parties of their respective obligations under the SAPA and, in the case of Knauf, the absence of any change or event which would reasonably be expected to result in a material adverse effect on the acquired businesses. There can be no assurance that the closing conditions set forth in the SAPA will be satisfied or waived. The SAPA is filed as an exhibit to this Quarterly Report on Form 10-Q.

Affiliates of Knauf are the beneficial owners of approximately 14% of USG’s outstanding shares of common stock.

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The results of our European business operations have been reclassified as discontinued operations in the condensed consolidated financial statements and accompanying footnotes presented in this report. The assets and liabilities of the discontinued operations are reflected at carrying value because their fair value less estimated costs to sell exceeds carrying value. The carrying amounts of the major classes of assets and liabilities included in the disposal group were as follows:

(millions)	As of September 30, 2012	As of December 31, 2011
Accounts receivable	\$9	\$8
Inventories	14	13
Property, plant and equipment, net	13	13
Other assets	2	1
Assets related to discontinued operations	\$38	\$35
Accounts payable	6	7
Other liabilities	11	8
Liabilities related to discontinued operations	\$17	\$15

Sales from discontinued operations, operating profit from discontinued operations and income from discontinued operations before income taxes were as follows:

(millions)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Sales from discontinued operations	\$27	\$29	\$83	\$90
Operating profit from discontinued operations	1	3	7	8
Income from discontinued operations before income taxes	1	3	7	9

3. Restructuring and Long-Lived Asset Impairment Charges

We recorded the following restructuring and long-lived asset impairment charges during the three and nine months ended September 30, 2012 and 2011:

(millions)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Severance	\$2	\$2	\$3	\$6
Lease obligations	—	4	(1)	6
Long-lived asset impairment charges	—	51	1	52
Asset impairment charges related to inventory	—	2	—	2
Other exit costs	1	—	2	4
Total	\$3	\$59	\$5	\$70

Charges in the third quarter of 2012 included severance and other exit costs primarily related to the closure of 12 L&W Supply distribution branches. Charges in the nine months ended September 30, 2012 also included severance related to our December 2011 salaried workforce reduction, exit costs related to production facilities closed in prior years and an impairment related to previously idled machinery and equipment of which we subsequently disposed.

Charges in the third quarter of 2011 primarily related to the permanent closure of our gypsum quarry and ship loading facility in Windsor, Nova Scotia, Canada, including the write-down of the carrying values of property, machinery, equipment and buildings and acceleration of the Windsor facility's asset retirement obligation. Other third quarter 2011 charges related to L&W Supply's closure of nine distribution branches and its Nevada custom door and frames business. Charges in the nine months ended September 30, 2011 also included a long-lived asset impairment, severance, lease obligations and other exit costs related to production facilities closed in prior years.

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RESTRUCTURING RESERVES

Restructuring reserves totaling \$26 million were included in accrued expenses and other liabilities on the condensed consolidated balance sheet as of September 30, 2012. Total cash payments charged against the restructuring reserve in the first nine months of 2012 amounted to \$12 million. We expect future payments to be approximately \$10 million during the remainder of 2012, \$5 million in 2013 and \$11 million after 2013. All restructuring-related payments in the first nine months of 2012 were funded with cash on hand. We expect that the future payments will be funded with cash from operations or cash on hand. The restructuring reserve is summarized as follows:

(millions)	Balance	2012 Activity		Balance	
	as of 12/31/11	Charges	Cash Payments	Asset Impairment	as of 9/30/12
Severance	\$4	\$3	\$(4)	\$ —	\$3
Lease obligations	21	(1)	(4)	—	16
Asset impairments	—	1	—	(1)	—
Other exit costs	9	2	(4)	—	7
Total	\$34	\$5	\$(12)	\$(1)	\$26

4. Segments

Our operations are organized into three reportable segments: North American Gypsum, Worldwide Ceilings and Building Products Distribution. As discussed in Note 2, the results of our European business operations, previously included in our Worldwide Ceilings segment, are reflected as discontinued operations in the accompanying condensed consolidated financial statements and, as such, are not included in these tables. Segment results for our continuing operations were as follows:

(millions)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net Sales:				
North American Gypsum	\$496	\$437	\$1,455	\$1,273
Worldwide Ceilings	155	154	459	443
Building Products Distribution	300	283	863	796
Eliminations	(123)	(111)	(368)	(328)
Total	\$828	\$763	\$2,409	\$2,184

Operating Profit (Loss):

North American Gypsum	\$35	\$(70)	\$98	\$(115)
Worldwide Ceilings	24	22	69	65
Building Products Distribution	(10)	(17)	(23)	(53)
Corporate	(18)	(16)	(57)	(60)
Eliminations	(2)	2	(6)	—
Total	\$29	\$(79)	\$81	\$(163)

Restructuring and long-lived asset impairment charges by segment were as follows:

(millions)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
North American Gypsum	\$1	\$52	\$4	\$61
Worldwide Ceilings	—	—	1	—
Building Products Distribution	2	7	—	8
Corporate	—	—	—	1
Total	\$3	\$59	\$5	\$70

See Note 3 for information related to the restructuring reserve as of September 30, 2012 and restructuring and long-lived asset impairment charges for the third quarter and first nine months of 2012 and 2011.

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5. Earnings (Loss) Per Share

Basic earnings (loss) per share is based on the weighted average number of common shares outstanding. Diluted earnings per share is based on the weighted average number of common shares outstanding plus the dilutive effect, if any, of restricted stock units, or RSUs, and performance shares, the potential exercise of outstanding stock options and the potential conversion of our \$400 million of 10% convertible senior notes due 2018. The reconciliation of basic loss per share to diluted loss per share is shown in the following table.

(millions, except per-share data)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Loss from continuing operations	\$ (30)	\$ (117)	\$ (118)	\$ (296)
Income from discontinued operations	1	2	5	6
Net loss	\$ (29)	\$ (115)	\$ (113)	\$ (290)
Average common shares	107.4	105.3	106.1	103.6
Average diluted common shares	107.4	105.3	106.1	103.6
Basic earnings (loss) per average common share:				
Loss from continuing operations	\$ (0.29)	\$ (1.11)	\$ (1.11)	\$ (2.85)
Income from discontinued operations	0.01	0.02	0.04	0.05
Net loss	\$ (0.28)	\$ (1.09)	\$ (1.07)	\$ (2.80)
Diluted earnings (loss) per average common share:				
Loss from continuing operations	\$ (0.29)	\$ (1.11)	\$ (1.11)	\$ (2.85)
Income from discontinued operations	0.01	0.02	0.04	0.05
Net loss	\$ (0.28)	\$ (1.09)	\$ (1.07)	\$ (2.80)

The diluted losses per share for the third quarter and first nine months of 2012 and 2011 were computed using the weighted average number of common shares outstanding during those periods. The approximately 35.1 million shares issuable upon conversion of our \$400 million of 10% convertible senior notes due 2018 at the initial conversion price of \$11.40 per share were not included in the computation of diluted loss per share for those periods because their inclusion was anti-dilutive. Stock options, RSUs and performance shares not included in the computation of diluted loss per share for those periods because their inclusion was anti-dilutive were as follows:

(millions, common shares)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Stock options, RSUs and performance shares	7.9	4.9	8.0	3.4

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6. Marketable Securities

Marketable securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses excluded from earnings and reported in accumulated other comprehensive income (loss), or AOCI, on our condensed consolidated balance sheets. Proceeds received from sales and maturities of marketable securities were \$269 million for the nine months ended September 30, 2012. Our investments in marketable securities consisted of the following:

(millions)	As of September 30, 2012		As of December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Corporate debt securities	\$72	\$72	\$174	\$174
U.S. government and agency debt securities	22	22	32	32
Non-U.S. government and agency debt securities	1	1	—	—
Asset-backed debt securities	7	7	18	18
Certificates of deposit	16	16	35	35
Municipal debt securities	12	12	27	27
Total marketable securities	\$130	\$130	\$286	\$286

The realized and unrealized gains and losses for the quarter ended September 30, 2012 and year ended December 31, 2011 were immaterial. Cost basis for securities sold are determined on a first-in-first-out basis.

Contractual maturities of marketable securities as of September 30, 2012 were as follows:

(millions)	Amortized	Fair
	Cost	Value
Due in 1 year or less	\$ 89	\$89
Due in 1-5 years	41	41
Total marketable securities	\$ 130	\$130

Actual maturities may differ from the contractual maturities because issuers of the securities may have the right to prepay them.

7. Intangible Assets

Intangible assets are included in other assets on the condensed consolidated balance sheets. Intangible assets with definite lives are amortized. These assets are summarized as follows:

(millions)	As of September 30, 2012			As of December 31, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Intangible Assets with Definite Lives:						
Customer relationships	\$70	\$ (39)	\$31	\$70	\$ (34)	\$36
Other	9	(6)	3	9	(5)	4
Total	\$79	\$ (45)	\$34	\$79	\$ (39)	\$40

Total amortization expense was \$2 million and \$6 million for the third quarter and first nine months of 2012, respectively, and \$2 million and \$6 million for the third quarter and first nine months of 2011, respectively. Estimated amortization expense for the remainder of 2012 and for future years is as follows:

(millions)	2012	2013	2014	2015	2016	2017 and thereafter
Estimated future amortization expense	\$2	\$7	\$7	\$7	\$7	\$ 4

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Intangible assets with indefinite lives are not amortized. These assets are summarized as follows:

(millions)	As of September 30, 2012			As of December 31, 2011		
	Gross Carrying Amount	Impairment Charges	Net	Gross Carrying Amount	Impairment Charges	Net
Intangible Assets with Indefinite Lives:						
Trade names	\$22	\$—	\$22	\$22	\$—	\$22
Other	8	—	8	8	—	8
Total	\$30	\$—	\$30	\$30	\$—	\$30

8. Debt

Total debt, including the current portion of long-term debt, consisted of the following:

(millions)	As of September 30, 2012	As of December 31, 2011
9.75% senior notes due 2014, net of discount	\$59	\$297
8.375% senior notes due 2018	350	350
7.875% senior notes due 2020, net of discount	248	—
7.75% senior notes due 2018, net of discount	499	499
6.3% senior notes due 2016	500	500
10% convertible senior notes due 2018, net of discount	385	383
Ship mortgage facility (includes \$5 million and \$7 million of current portion of long-term debt)	31	36
Industrial revenue bonds (due 2028 through 2034)	239	239
Total	\$2,311	\$2,304

CREDIT FACILITY

We have a credit facility that allows for revolving loans and letters of credit (up to \$250 million) in an aggregate principal amount not to exceed the lesser of (a) \$400 million or (b) a borrowing base determined by reference to the trade receivables and inventory of USG and its significant domestic subsidiaries. The credit facility matures on December 21, 2015 unless terminated earlier in accordance with its terms.

The credit agreement contains a single financial covenant that would require us to maintain a minimum fixed charge coverage ratio of 1.1-to-1.0 if and for so long as the excess of the borrowing base over the outstanding borrowings under the credit agreement is less than the greater of (a) \$40 million and (b) 15% of the lesser of (i) the aggregate revolving commitments at such time and (ii) the borrowing base at such time. As of September 30, 2012, our fixed charge coverage ratio was 0.46-to-1.0. Because we do not currently satisfy the required fixed charge coverage ratio, we must maintain borrowing availability of at least \$46 million under the credit facility. The credit agreement contains other covenants and events of default that are customary for similar agreements and may limit our ability to take various actions, including the payment of dividends.

Taking into account the most recent borrowing base calculation delivered under the credit facility, which reflects trade receivables and inventory as of September 30, 2012, outstanding letters of credit and the current borrowing availability requirement of \$46 million, borrowings available under the credit facility were approximately \$174 million. As of September 30, 2012 and during the quarter then-ended, there were no borrowings under the facility. Had there been any borrowings as of that date, the applicable interest rate would have been 3.4%. Outstanding letters of credit totaled \$89 million as of September 30, 2012.

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CGC CREDIT FACILITY

Our Canadian subsidiary, CGC Inc., or CGC, has a credit agreement that allows for revolving loans and letters of credit (up to Can. \$3 million in aggregate) in an aggregate principal amount not to exceed Can. \$40 million. The credit agreement matures on June 30, 2015, unless terminated earlier in accordance with its terms. Revolving loans under the agreement may be made in Canadian dollars or U.S. dollars. Under the credit agreement, revolving loans made in Canadian dollars bear interest at a floating rate based on the prime rate plus 1.25% or the Bankers' Acceptance Discount Rate plus 2.75%, at the option of CGC. Revolving loans made in U.S. dollars bear interest at a floating rate based upon a base rate plus 1.25% or the LIBOR rate plus 2.75%, at the option of CGC. As of September 30, 2012 and during the quarter then-ended, there were no borrowings outstanding under this credit agreement. Had there been any borrowings as of that date, the applicable interest rate would have been 4.0%. As of September 30, 2012, outstanding letters of credit totaled Can. \$0.8 million. The U.S. dollar equivalent of borrowings available under this agreement as of September 30, 2012 was \$40 million.

REPURCHASE OF SENIOR NOTES

On April 12, 2012, we completed a cash tender offer pursuant to which we repurchased approximately \$118 million of our 9.75% senior notes due in 2014, or the 2014 Senior Notes, for aggregate consideration, including tender offer premium and accrued and unpaid interest, of approximately \$136 million. Subsequent to the completion of the cash tender offer, we repurchased \$123 million of the 2014 Senior Notes in privately negotiated transactions, for aggregate consideration, including premiums and accrued and unpaid interest, of \$145 million. As a result of the repurchases, in the second quarter of 2012, we recorded a loss on early extinguishment of debt of \$41 million, including premiums, the write-off of unamortized debt discount and deferred financing fees. As of September 30, 2012, \$59 million of the 2014 Senior Notes remained outstanding.

ISSUANCE OF SENIOR NOTES

On April 12, 2012, we issued \$250 million of 7.875% senior notes due March 30, 2020, or the 2020 Senior Notes. The net proceeds from the issuance of the 2020 Senior Notes and cash on hand were used to fund the repurchases of the 2014 Senior Notes and all related costs and expenses.

The 2020 Senior Notes were recorded on the condensed consolidated balance sheets at \$248 million, net of debt discount of \$2 million. We deferred \$5 million of financing costs that will be amortized to interest expense over the term of the notes. Our obligations under the 2020 Senior Notes are guaranteed on a senior unsecured basis by certain of our domestic subsidiaries. The notes are redeemable at any time, or in part from time to time, at our option on or after March 30, 2016 at stated redemption prices, plus any accrued and unpaid interest to the redemption date. In addition, we may redeem the notes at our option at any time prior to March 30, 2016, in whole or in part, at a redemption price equal to the greater of (a) 100% of the principal amount of the notes being redeemed and (b) the sum of the present value of the remaining scheduled payments of principal and interest on the notes being redeemed discounted to the redemption date on a semi-annual basis at the Treasury Rate, as defined in the indenture, plus 0.5%, plus any accrued and unpaid interest on the principal amount being redeemed to the redemption date.

The 2020 Senior Notes contain a provision, the same as or similar to the provision in our other senior notes, that requires us to offer to purchase those notes at 101% of their principal amount (plus accrued and unpaid interest) in the event of a change in control.

The indenture governing the 2020 Senior Notes contains events of default, covenants and restrictions that are the same as those governing our other senior notes, including a limitation on our ability and the ability of certain of our subsidiaries to create or incur secured indebtedness.

OTHER INFORMATION

The fair value of our debt was \$2.860 billion as of September 30, 2012 and \$2.176 billion as of December 31, 2011. The fair value was based on quoted market prices of our debt or, where quoted market prices were not available, on quoted market prices of instruments with similar terms and maturities or internal valuation models, and is classified as Level 2. See Note 10 for further discussion on fair value measurements and classifications. Interest accrued on our debt as of September 30, 2012 and December 31, 2011 was \$54 million and \$52 million, respectively.

As of September 30, 2012, we were in compliance with the covenants contained in our credit facilities.

Table of Contents**9. Derivative Instruments**

We use derivative instruments to manage selected commodity price and foreign currency exposures as described below. We do not use derivative instruments for speculative trading purposes, and we typically do not hedge beyond two years. Cash flows from derivative instruments are included in net cash used for operating activities in the condensed consolidated statements of cash flows.

COMMODITY DERIVATIVE INSTRUMENTS

As of September 30, 2012, we had swap and option contracts to hedge \$27 million notional amounts of natural gas. All of these contracts mature by December 31, 2013. For contracts designated as cash flow hedges, the unrealized loss that remained in AOCI as of September 30, 2012 was \$1 million. AOCI also included \$1 million of losses related to closed derivative contracts hedging underlying transactions that have not yet affected earnings. No ineffectiveness was recorded on contracts designated as cash flow hedges in the first nine months of 2012. Gains and losses on contracts designated as cash flow hedges are reclassified into earnings when the underlying forecasted transactions affect earnings. For contracts designated as cash flow hedges, we reassess the probability of the underlying forecasted transactions occurring on a regular basis. Changes in fair value on contracts not designated as cash flow hedges are recorded to earnings. The fair value of those contracts not designated as cash flow hedges was a \$1 million unrealized gain as of September 30, 2012.

FOREIGN EXCHANGE DERIVATIVE INSTRUMENTS

We have foreign exchange forward contracts to hedge changes in the value of an intercompany loan between certain foreign subsidiaries due to changes in foreign exchange rates. The notional amount of these contracts was \$32 million as of September 30, 2012, and they mature on March 27, 2013. We do not apply hedge accounting for these contracts and all changes in the fair value are recorded to earnings. As of September 30, 2012, the fair value of these contracts was an immaterial unrealized gain.

We have foreign exchange forward contracts to hedge purchases of products and services denominated in foreign currencies. The notional amount of these contracts was \$104 million as of September 30, 2012, and they mature by December 23, 2013. These forward contracts are designated as cash flow hedges and no ineffectiveness was recorded in the first nine months of 2012. Gains and losses on the contracts are reclassified into earnings when the underlying transactions affect earnings. The fair value of these contracts that remained in AOCI was a \$1 million unrealized gain as of September 30, 2012.

During the third quarter of 2012, we entered into foreign exchange forward contracts to hedge a portion of our net investment in one of our European subsidiaries. The notional amount of these contracts was \$25 million, and they mature on October 29, 2012. These forward contracts are designated as net investment hedges and no ineffectiveness was recorded in the third quarter of 2012. Gains and losses on derivatives designated as net investment hedges, to the extent they are effective as hedges, remain in AOCI until such point when the investment is either sold or liquidated. The fair value of these contracts that remained in AOCI was a \$1 million unrealized loss as of September 30, 2012.

COUNTERPARTY RISK

We are exposed to credit losses in the event of nonperformance by the counterparties to our derivative instruments. As of September 30, 2012, our derivatives were in a net asset position of \$1 million. All of our counterparties have investment grade credit ratings; accordingly, we anticipate that they will be able to fully satisfy their obligations under the contracts. Additionally, the derivatives are governed by master netting agreements negotiated between us and the counterparties that reduce our counterparty credit exposure. The agreements outline the conditions (such as credit ratings and net derivative fair values) upon which we, or the counterparties, are required to post collateral. As required by certain of our agreements, we had \$1 million of collateral provided to our counterparties related to our derivatives. No additional collateral is required under these agreements. We have not adopted an accounting policy to offset fair value amounts related to derivative contracts under our master netting arrangements. Amounts paid as cash collateral are included in receivables on our condensed consolidated balance sheets.

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FINANCIAL STATEMENT INFORMATION

The following are the pretax effects of derivative instruments on the condensed consolidated statements of operations for the three months ended September 30, 2012 and 2011.

(millions)	Amount of Gain or (Loss) Recognized in Other Comprehensive Income on Derivatives (Effective Portion)		Location of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	
	2012	2011		2012	2011
Derivatives in Cash Flow Hedging Relationships					
Commodity contracts	\$1	\$(1)	) Cost of products sold	\$(3)	\$(4)
Foreign exchange contracts	—	8	Cost of products sold	1	(2)
Derivatives in Net Investment Hedging Relationships					
Foreign exchange contracts	(1)	) \$—	Other income, net	—	\$—
Total	\$—	\$7		\$(2)	\$(6)
(millions)			Location of Gain or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives	
Derivatives Not Designated as Hedging Instruments					
Commodity contracts			Cost of products sold	\$—	\$(2)
Foreign exchange contracts			Other income, net	1	—
Total				\$1	\$(2)

The following are the pretax effects of derivative instruments on the condensed consolidated statements of operations for the nine months ended September 30, 2012 and 2011.

(millions)	Amount of Gain or (Loss) Recognized in Other Comprehensive Income on Derivatives (Effective Portion)		Location of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	
	2012	2011		2012	2011
Derivatives in Cash Flow Hedging Relationships					
Commodity contracts	\$(2)	\$(2)	) Cost of products sold	\$(8)	\$(13)
Foreign exchange contracts	(1)	) 5	Cost of products sold	1	(4)
Derivatives in Net Investment Hedging Relationships					
Foreign exchange contracts	(1)) —	Other income, net	—	—
Total	\$(4)) \$3		\$(7)	\$(17)

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(millions)	Location of Gain or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives	
		2012	2011
Derivatives Not Designated as Hedging Instruments			
Commodity contracts	Cost of products sold	\$—	\$(3)
Foreign exchange contracts	Other income, net	—	(1)
Total		\$—	\$(4)

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The following are the fair values of derivative instruments and the location on our condensed consolidated balance sheets as of September 30, 2012 and December 31, 2011.

(millions)	Balance Sheet Location	Fair Value		Balance Sheet Location	Fair Value	
		9/30/12	12/31/11		9/30/12	12/31/11
Derivatives in Cash Flow Hedging Relationships						
Commodity contracts	Other current assets	\$2	\$1	Accrued expenses	\$2	\$8
Foreign exchange contracts	Other current assets	1	3	Accrued expenses	—	—
Derivatives in Net Investment Hedging Relationships						
Foreign exchange contracts	Other current assets	—	—	Accrued expenses	1	—
Total derivatives in hedging relationships		\$3	\$4		\$3	\$8
Derivatives Not Designated as Hedging Instruments						
Commodity contracts	Other current assets	\$1	\$—	Accrued expenses	\$—	\$—
Foreign exchange contracts	Other current assets	—	—	Accrued expenses	—	—
Total derivatives not designated as hedging instruments		\$1	\$—		\$—	\$—
Total derivatives		Total assets		Total liabilities		
		\$4	\$4	\$3	\$8	

As of September 30, 2012, we had no derivatives designated as fair value hedges.

10. Fair Value Measurements

Certain assets and liabilities are required to be recorded at fair value. There are three levels of inputs that may be used to measure fair value. Level 1 is defined as quoted prices for identical assets and liabilities in active markets. Level 2 is defined as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets. Level 3 is defined as valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable. Certain assets and liabilities are measured at fair value on a nonrecurring basis rather than on an ongoing basis, such as when there is evidence of impairment or when a new liability is being established that requires fair value measurement.

The cash equivalents shown in the table below primarily consist of money market funds that are valued based on quoted prices in active markets and as a result are classified as Level 1. We use quoted prices, other readily observable market data and internally developed valuation models when valuing our derivatives and marketable securities and have classified them as Level 2. Derivatives are valued using the income approach including discounted-cash-flow models or a Black-Scholes option pricing model and readily observable market data. The inputs for the valuation models are obtained from data providers and include end-of-period spot and forward natural gas prices and foreign currency exchange rates, natural gas price volatility and LIBOR and swap rates for discounting the cash flows implied from the derivative contracts. Marketable securities are valued using income and market value approaches and values are based on quoted prices or other observable market inputs received from data providers. The valuation process may include pricing matrices, or prices based upon yields, credit spreads or prices of securities of comparable quality, coupon, maturity and type.

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Our assets and liabilities measured at fair value on a recurring basis were as follows:

	Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)		Total	
	9/30/12	12/31/11	9/30/12	12/31/11	9/30/12	12/31/11	9/30/12	12/31/11
(millions)								
Cash equivalents	\$201	\$128	\$40	\$31	\$—	\$—	\$241	\$159
Marketable securities:								
Corporate debt securities	—	—	72	174	—	—	72	174
U.S. government and agency debt securities	—	—	22	32	—	—	22	32
Non-U.S. government and agency debt securities	—	—	1	—	—	—	1	—
Asset-backed debt securities	—	—	7	18	—	—	7	18
Certificates of deposit	—	—	16	35	—	—	16	35
Municipal debt securities	—	—	12	27	—	—	12	27
Derivative assets	—	—	4	4	—	—	4	4
Derivative liabilities	—	—	(3)	(8)	—	—	(3)	(8)

Certain assets and liabilities are measured at fair value on a nonrecurring basis rather than on an ongoing basis, but are subject to fair value adjustments in certain circumstances, such as when there is evidence of impairment or when a new liability is being established that requires fair value measurement.

During the second quarter of 2012, we reviewed our property, plant and equipment for potential impairment by comparing the carrying values of those assets with their estimated future undiscounted cash flows for their remaining useful lives and determined that impairment existed for machinery and equipment for a previously idled production line. We measured the fair value of that machinery and equipment as of June 30, 2012 using measurements classified as Level 3. As a result, as disclosed in Note 3, we recorded long-lived asset impairment charges of \$1 million that are included in restructuring and long-lived asset impairment charges in the condensed consolidated statements of operations for the nine months ended September 30, 2012.

During the third quarter of 2011, we decided that we would permanently close our gypsum quarry and ship loading facility in Windsor, Nova Scotia, Canada. We measured the fair value of the Windsor real property, buildings, machinery and equipment as of September 30, 2011 by evaluating the current economic conditions for similar use assets using measurements classified as Level 3 and maximizing the use of available and reliable inputs observable in the marketplace. The fair value of the real property and buildings was estimated after considering a range of possible outcomes based on recent comparable sales and similar properties currently being marketed. Due to the lack of an established secondary market for the machinery and equipment and the lack of an income stream attributable to the machinery and equipment, the fair values were developed based upon a market approach considering comparable equipment adjusted for condition, age, functionality, obsolescence, marketability and location. As a result of our evaluation, long-lived Windsor assets with a carrying amount of \$57 million were written down to their fair value of \$6 million, resulting in a long-lived asset impairment charge of \$51 million that is included in our condensed consolidated statements of operations for the three and nine months ended September 30, 2011.

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11. Employee Retirement Plans

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

(millions)	Three months		Nine months	
	ended September 30,		ended September 30,	
	2012	2011	2012	2011
Pension:				
Service cost of benefits earned	\$8	\$7	\$23	\$21
Interest cost on projected benefit obligation	16	15	48	47
Expected return on plan assets	(18	) (16	) (52	) (49
Net amortization	9	7	26	20
Net pension cost	\$15	\$13	\$45	\$39
Postretirement:				
Service cost of benefits earned	\$1	\$1	\$3	\$4
Interest cost on projected benefit obligation	2	3	6	10
Net amortization	(9	) (5	) (27	) (16
Net postretirement cost	\$(6	) \$(1	) \$(18	) \$(2

During the second quarter of 2012, we made a contribution to the USG Corporation Retirement Plan Trust, or Trust, that was recorded on the condensed consolidated balance sheet at \$20.6 million. This contribution consisted of 1,249,219 shares of our common stock, or the Contributed Shares, and was recorded on the condensed consolidated balance sheet at the June 25, 2012 closing price of \$16.48 per share. The Contributed Shares are not reflected on the condensed consolidated statement of cash flows because they were treated as a noncash financing activity. The Contributed Shares were valued for purposes of crediting the contribution to the Trust at a discounted value of \$16.01 per share (\$16.48 less a 2.80% discount), or approximately \$20 million in the aggregate, by Evercore Trust Company, N.A., or Evercore, an independent fiduciary that has been appointed as investment manager with respect to the Contributed Shares. The Contributed Shares were registered for resale, and Evercore has authority to sell some or all of them in its discretion as fiduciary. During the third quarter of 2012, we contributed \$30 million in cash to the Trust. During the first and second quarters of 2012, we contributed \$2 million and \$7 million, respectively, in cash to our pension plan in Canada.

12. Share-Based Compensation

During the first nine months of 2012, we granted share-based compensation to eligible participants under our Long-Term Incentive Plan. We recognize expense on all share-based grants over the service period, which is the shorter of the period until the employees' retirement eligibility dates or the service period of the award for awards expected to vest. Expense is generally reduced for estimated forfeitures.

STOCK OPTIONS

We granted stock options to purchase 760,687 shares of common stock during the first nine months of 2012 with an exercise price equal to the closing price of our common stock on the date of grant. The stock options generally become exercisable in four equal annual installments beginning one year from the date of grant, although they may become exercisable earlier in the event of death, disability, retirement or a change in control. The stock options generally expire 10 years from the date of grant, or earlier in the event of death, disability or retirement.

We estimated the weighted average fair value of each stock option granted to be \$8.39 on the date of grant using a Black-Scholes option valuation model that uses the assumptions noted below. We based expected volatility on a 50% weighting of our historical volatilities and 50% weighting of our implied volatilities. The risk-free rate was based on zero coupon U.S. government issues at the time of grant. The expected term was developed using the simplified method, as permitted by the SEC because there is not sufficient historical stock option exercise experience available. The weighted-average assumptions used in the valuations were as follows: expected volatility of 59.03%, risk-free rate of 1.24%, expected term (in years) of 6.26 and expected dividends of zero.

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RESTRICTED STOCK UNITS

We granted RSUs with respect to 598,121 shares of common stock during the first nine months of 2012 that generally vest in four equal annual installments beginning one year from the date of grant. RSUs granted as special retention awards generally vest after a specified number of years from the date of grant or at a specified date and RSUs granted with performance goals vest if those goals are attained. Generally, RSUs may vest earlier in the case of death, disability, retirement or a change in control. Each RSU is settled in a share of our common stock after the vesting period. The fair value of each RSU granted is equal to the closing price of our common stock on the date of grant. The RSUs granted during the first nine months of 2012 had a weighted average fair value of \$15.21.

PERFORMANCE SHARES

We granted 225,127 performance shares during the first nine months of 2012. The performance shares generally vest after a three-year period based on our total stockholder return relative to the performance of the Dow Jones U.S. Construction and Materials Index, with adjustments to that index in certain circumstances, for the three-year period. The number of performance shares earned will vary from 0 to 200% of the number of performance shares awarded depending on that relative performance. Vesting will be pro-rated based on the number of full months employed during the performance period in the case of death, disability, retirement or a change-in-control, and pro-rated awards earned will be paid at the end of the three-year period. Each performance share earned will be settled in common stock.

We estimated the weighted average fair value of each performance share granted to be \$22.96 during the first nine months of 2012 using a Monte Carlo simulation that uses the assumptions noted below. Expected volatility is based on implied volatility of our traded options and the daily historical volatilities of our peer group. The risk-free rate was based on zero coupon U.S. government issues at the time of grant. The expected term represents the period from the valuation date to the end of the performance period.

The weighted-average assumptions used in the valuations were as follows: expected volatility