

**Dear Fellow Shareholders,**

The challenge we face is to manage for two different time frames. Along with preparing for the future across all three of our businesses, we must focus on operational excellence today – and capitalize on the opportunities we find.

Early on, we recognized that the market was softening and moved rapidly to scale back our production ahead of declining demand. By the end of 2007, we had curtailed or closed 3.3 billion square feet of higher-cost wallboard manufacturing capacity, closed or consolidated 12 L&W locations and adjusted staffing levels accordingly.

As we moved into 2008, we made additional adjustments. Closing production at our Boston plant, which was nearly 80 years old, and curtailing production at other locations further reduced our capacity. We also closed an older, higher-cost paper mill in Jacksonville, Florida. We have reduced our selling, general, and administrative expenses and capital expenditures.

No one ever welcomes such actions, but we have handled them well, thanks to the strategic decisions we made years ago – before the market declined – to modernize our manufacturing base. The impact of those decisions can clearly be seen in the Boston area, to offer just one example. While we removed our oldest plant from our network, we did not cede that important market to our competitors. In fact, the opposite is true. Our strategic alliance with Atlantic Wallboard and the opening of our new plant in Washingtonville, Pennsylvania, will

allow us to serve customers in the Northeast better than we served them before.

We know what to do. We have retained a core of skilled and experienced people who will keep us moving forward today and allow us to quickly take advantage of a market rebound. And even though we cut our total production capacity by more than 20%, key operating metrics are at or near record levels, and our customer service has improved as well.

**Operational excellence**

In addition, our commitment to safety and our other core values is unwavering. In 2007, we achieved our best safety performance ever, once again far exceeding industry standards. More than 90 percent of our facilities operated without a single lost-time injury. Four facilities earned OSHA's prestigious VPP Star Award for outstanding safety processes and performance, and more will be joining them in 2008.

As our safety performance and customer satisfaction scores show, current conditions have not kept us from making progress. L&W Supply's acquisition of California-based CALPLY and its network of 29 locations in seven western states and Mexico consolidated our leadership of the West Coast distribution market.

“Their strong point is name brand recognition and high quality of material.”  
– Drywall Specialty Dealer, Northwest

“USG seems to care about our company. They want us to succeed; they are a good partner, and we are in it together.”  
– Independent Specialty Dealer, East Coast

A new portfolio of design tools for our ceilings customers adds greater value to our products. We're expanding internationally, too.

Most of all, we're continuing to advance toward our goal of operational excellence. No matter what the environment is like, we can succeed by optimizing our manufacturing network, extending our leadership in serving customers and continuing to live our values.

Across the continent, we are delivering the highest-value products with the industry's most efficient nationwide manufacturing network. As we have scaled back production, we have concentrated our operations in our newest, most efficient facilities, while our older plants are operating at considerably lower rates.

We also are working to extract more value from our integrated supply chain, which reaches from our customers all the way back to our company-owned gypsum mines. Our new state-of-the-art paper mill in Michigan, for example, will provide a stable supply of a key commodity at a much lower cost than the mill we closed in Jacksonville.

### **Customer satisfaction**

Reducing costs is only part of the story. In downturns, when there's an abundant supply of product, customers can buy their preferred brand from their preferred supplier. Historically, that's been USG – and we want to keep it that way.

We are extending this advantage by delivering more value.

The improvements began a few years ago, with some in-depth research about our customers. We asked what was important to them and how we could help them succeed. They told us that they wanted to improve their performance, and that their biggest concerns were on-time delivery, streamlined back office processes and exciting new products.

We set out to give them all three.

In tough times, when every nickel counts, on-time performance is critical to customers like KCG, Allied Building Products, the Drake Group and Pro Build. And on-time means on-time. While products that arrive late can idle workers and delay construction schedules, deliveries that arrive too early also can cause problems if no one is there to receive the shipment or there is no room to inventory it.

Our solution relies on our new enterprise software system – the single largest systems investment we have ever made. Called LinX, the system has enabled us to dramatically improve on-time performance. We have made ourselves easier to do business with, and we are making it easier for our customers to do business as well.

Customers such as GMS, one of the leading specialty dealers in the country, told us that they were spending too much time on USG-related paperwork. Like all well-managed businesses, they want to devote their time to customers. Once again, our LinX system provided the solution. By transforming the way our order



**James S. Metcalf**  
*President and Chief Operating Officer*

center communicated with our plants, we dramatically reduced the time that customers need to devote to processing our transactions, so they can focus on what they do best.

Large home improvement retailers like The Home Depot and Lowe's told us their concerns, too. To increase sales, they need products that excite their customers and encourage them to take on more home improvement projects.

We're meeting the need. In 2007, both Home Depot and Lowe's increased the number of stores that carry our unique dust control joint compound, which dramatically contains the dust created by sanding walls before painting. New SHEETROCK® brand Mold Tough™ gypsum panels are the only products of their type that Home Depot now carries. Innovative products like these help our customers increase sales and help us win more space on their shelves.

Even with the challenges we face today, this is an exciting – and productive – time for USG. We are building the strongest relationships with customers that we have ever had – and building the infrastructure required to meet their needs. We are delivering innovative products, in the ways our customers want them delivered. We are helping them to build their businesses. And we are being rewarded for the superior value we provide.

In short, we are controlling the things we can control, and working to lead our industry at every point in the cycle. That's been our tradition – and objective – for 106 years.

A handwritten signature in black ink, appearing to read 'J. Metcalf', written in a cursive style.

**James S. Metcalf**  
*President and Chief Operating Officer*