

## Dear Fellow Shareholders

USG's mission is to always search for a better way. We continued to work toward that goal in our 101st year, one of both exceptional performance and significant uncertainty.

We continued to build the value of our enterprise. We shipped a record 10.1 billion square feet of wallboard and record volumes of both joint compound products and cement board products, as new home construction and residential repair and remodeling remained among the bright spots in the U.S. economy. L&W Supply, our distribution business, also reported an increase in sales, to \$1.2 billion. Only our ceilings business reported lower sales, as U.S. non-residential construction markets fell by about 16 percent, but by carefully managing margins, we actually improved that business's profitability.

Accordingly, we had one of the best years in our history even though some results were not all that we desired. Our sales totaled \$3.5 billion, compared to \$3.3 billion in 2001, and net earnings reached \$43 million, compared to \$16 million in 2001. While there is still substantial excess capacity in the wallboard industry, SHEETROCK brand wallboard prices have remained relatively stable, at an average of about \$100 per thousand square feet in 2002, compared to approximately \$86 per thousand square feet in 2001.

## Building Our Business. And Relationships.

We also found better ways to build and operate our businesses. The highlights include the opening of a new DUROCK brand cement board manufacturing line in Baltimore, a new joint compound plant in Phoenix and the continued growth of our FIBEROCK product line. We began a multi-year initiative to improve the management of our supply chain to help both USG and our suppliers operate more productively and serve our customers better. We completed the downsizing of our ceiling business in Europe and the Asia Pacific region, rationalized its product lines and consolidated production. Acquisitions helped L&W Supply expand its presence in Oregon, metropolitan Atlanta and the greater Kansas City area. Most importantly, I am proud to report that our safety performance has been truly outstanding, even by our high standards. Our North American operations set a company record, one that is once again, well above industry norms.

At the same time, we continued to seek—and find—better ways to serve our customers. New products included FIBEROCK brand underlayment, a new environmentally friendly replacement

We shipped 10.1 billion square feet of SHEETROCK brand gypsum wallboard in 2002, enough to build 1.2 million average sized homes.

The U.S. Patent and Trademark Office awarded 23 patents last year based on inventions by USG's subsidiaries.

USG's carriers haul 1,700 truck-loads of our products each day, making more than half-a-million deliveries per year to customers in all 50 states.

for wood-based floor underlayment and TUFF-HIDE, a sprayable primer and surfacer that helps contractors work faster. Our new GEOMETRIX metal ceiling panels won a number of awards from industry publications and trade shows, as did the TOPO 3-Dimensional ceiling system.

All of our new products are aimed at helping our customers work more profitably and efficiently. So are our new services. New product availability programs match our inventories to customer requirements, so they won't have to wait for our products. New technology helps sales representatives cut the time it takes to resolve problems and answer customers' questions. A new customer extranet, myUSG.com, gives customers up-to-the-minute reports on the status of their orders and other valuable information, anytime, anywhere. Doing business with USG is easier—and more productive—than ever before.

As our regular customer surveys show, we do a good job taking care of customers—in fact, Home Depot named us their Building Materials Partner of the Year, marking the fourth time USG has earned the award in the last six years. But we can never afford to take those relationships for granted. While we were gratified by the positive feedback in our most recent survey, customers also told us there was room for improvement. We listened. And recently, we've launched a number of new initiatives that will establish us as the clear leader in the eyes of our customers. But the pursuit of customer satisfaction is not a set of programs. It's a core value at USG, something that needs to be second nature, instinctive, a part of all of our thinking and all of our actions—just as safety is. Nothing matters more to the future of our company.

The state of our operations has never been better. We lead our markets. We are taking good care of our customers and our employees, and we are well positioned for long-term growth.

### Working Our Way Through Chapter 11

We're justifiably proud of those strengths, and optimistic about the future of our operations. For our shareholders, however, the future remains uncertain as we continue through a Chapter 11 restructuring driven by asbestos litigation.

For the record, it bears repeating that USG and its subsidiaries never mined, made or sold raw asbestos. It was never used in our drywall products. Asbestos was only a minor ingredient—typically less than 5 percent—in some of our plasters and joint compounds, and by 1977, more than 25 years ago, we had stopped using it entirely.

Even so, we were forced to file for Chapter 11 to protect our assets from a flood of asbestos claims and to put this issue behind us, once and for all.

With this issue too, we have worked hard to find a better way and achieve a better outcome for our shareholders than those provided by the other companies forced into similar circumstances. Our goals from the beginning have been to fairly compensate legitimate asbestos claimants, repay in full our suppliers, bankers and other creditors, and protect the interests of our current shareholders. The proposals we have placed before the bankruptcy court would help us achieve these objectives. In the simplest terms, we believe that people who are not sick should not receive any payments, that people who were not injured by our asbestos-containing products should not receive compensation from USG and that the amount paid for claims should take into account our limited involvement with asbestos.

If the court agrees with us, we believe we will have the resources to pay our creditors in full, provide fair compensation to people who were injured by our products and allow current shareholders to retain some portion of their ownership. But these issues will be hotly contested.

At the time this report goes to press, however, the key issues, including the amount of money we will owe to asbestos claimants, are yet to be resolved. Our goal is to secure a place in USG's future for our existing shareholders, but the weight of experience suggests that goal may be difficult to reach. As far as we know, no large asbestos-related bankruptcy since the 1980s has been settled on terms similar to those that we have proposed—none were able to salvage meaningful value for shareholders. At best, the interests of our current shareholders are likely to be substantially diluted. It is possible that your investment in USG will be wiped out.

Our shareholders deserve better than this. USG is a proud organization. We have performed well, and we have kept our promises—including our promise to talk straight with shareholders. That should be enough, but in this case, it may not. We will continue to press for a fair resolution of this issue, but we must confront the reality before us—that even if we are successful, the ownership of this company is likely to change hands significantly. Until then we must focus on what we can control: our operations, our customers and our mission of finding a better way.

According to a report released last year by RAND, between two-thirds and 90 percent of all asbestos claimants are “functionally unimpaired, meaning that their asbestos exposure has not so far affected their ability to perform activities of daily life.”

USG operates 25 wallboard manufacturing plants, 12 ceiling tile and grid plants, 7 paper mills, 181 distribution centers and 3 ocean-going ships.

More than ever, we must achieve profitable growth. It has always been important to us. Now it is vital. To build our business, fairly compensate our creditors, reward the loyalty of current shareholders and resolve the issue of asbestos, we must continue to increase the value of this enterprise, just as we did in 2002. The greater our profitability, the greater our ability to keep our commitments and successfully emerge from Chapter 11.

We have what it takes, beginning with people. In days clouded by doubt, our board, our stable and experienced senior management team and everyone at USG have kept us moving forward. The times may be uncertain, but there can be no doubt about the spirit and dedication of the people of this company, my pride in their achievements or my gratitude for their support.

### Looking Ahead

The months ahead will test us. Although they are expected to decline by about 6 percent, we expect housing starts to remain relatively healthy at about 1.6 million units. Nonresidential construction is expected to continue to decline, as businesses limit their investments.

Despite somewhat weaker market conditions and tremendous uncertainty, we will strive to continue to increase the value of the business. We will make the nation's largest and most modern drywall production assets work even harder. New strategic sourcing initiatives will lower our costs for raw materials, including fuel supplies. A new carrier management system will increase logistical efficiencies, enable customers to track their orders every step of the way and improve the management of their inventories.

Our ceilings business continues to face challenging circumstances in the U.S. and internationally, but we are not waiting for an economic recovery. We substantially lowered our domestic manufacturing costs and we expect to achieve additional savings. We also have built a sustainable competitive position in the European ceiling grid market. The single, integrated drywall and ceilings salesforce we established in 2001 enables us to bring more of our products to more customers with superior value.

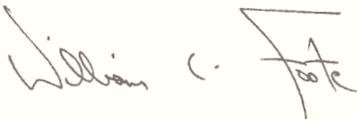
While we'll work hard to continue to reduce costs and overhead, we won't just be cutting costs—we will be investing in the business as well. We will focus our investments on improving customer satisfaction and on coming out of Chapter 11 stronger and more capable than ever. In fact,

we plan to increase our capital expenditures by more than 50 percent in 2003 to take advantage of opportunities to grow and become more efficient. We also plan to seek new cost reduction opportunities in ceilings, as well as selective opportunities to grow our businesses.

At the same time, we will continue to take part in legislative solutions to the asbestos litigation crisis, which threatens a large and growing number of U.S. companies. There must be a better way to resolve this issue, which has already cost millions of investors billions of dollars, and we are working to help find it.

We also will continue to do business according to the highest ethical standards. Recently, there has been much discussion about management integrity and corporate ethics. At USG, we have always known their importance. Our board has always been independent—in fact, with the exception of myself, it is composed entirely of outside directors, who are highly qualified and experienced. And for years, all of our managers have followed a code of ethics that addresses almost all of the issues covered by new laws.

Of far greater importance, we have lived by our values and our principles. We have done so for more than 100 years, and we will continue to do so through the uncertain times we face today. Our commitment to safety, quality and integrity is stronger than ever. We will persevere in our search for the better way. It is a heritage we can all be proud of, and it is our way forward.



William C. Foote  
Chairman, CEO and President  
February 27, 2003

The U.S. Supreme Court has twice called for Congressional action on asbestos.