

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

(Mark One)

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 1994

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  
(State or other jurisdiction of  
incorporation or organization)

36-3329400  
(I.R.S. Employer  
Identification No.)

125 South Franklin Street, Chicago, Illinois  
(Address of principal executive offices)

60606-4678  
(Zip code)

Registrant's telephone number, including area code (312) 606-4000

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 X No

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 X No

As of April 30, 1994, 45,057,595 shares of USG common stock were outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements:

USG CORPORATION  
CONSOLIDATED STATEMENT OF EARNINGS  
(Dollars in millions except per share data)  
(Unaudited)

	Three Months ended March 31, 1994 (a)	Three Months ended March 31, 1993
Net Sales	\$ 506	\$ 436
Cost of products sold	396	357
Gross Profit	110	79
Selling and administrative expenses	57	52
Amortization of excess reorganization value	42	-
Operating Profit	11	27
Interest expense	37	75
Interest income	(3)	(2)
Other expense, net	1	7
Reorganization items	-	69
Loss Before Taxes on Income and Changes in Accounting Principles	(24)	(122)
Taxes on income	10	7
Loss Before Changes in Accounting Principles	(34)	(129)

Cumulative effect of changes in accounting principles, net	-	(150)
Net Loss	(34)	(279)
Average number of common shares (b)	39,134,246	
Net Loss Per Common Share (b)	\$ (0.87)	
Dividends paid per common share (b)	-	

(a) Due to the Restructuring and implementation of fresh start accounting, financial statements after May 6, 1993 for the restructured company are not comparable to financial statements prior to that date. See "Notes to Consolidated Financial Statements - Note (3)" for more information on the Restructuring and implementation of fresh start accounting.

(b) Common shares and per share data for periods prior to May 7, 1993 are omitted because, due to the Restructuring and implementation of fresh start accounting, they are not meaningful.

See accompanying Notes to Consolidated Financial Statements.

USG CORPORATION  
CONSOLIDATED BALANCE SHEET  
(Dollars in millions)  
(Unaudited)

	As of March 31, 1994	As of December 31, 1993
<b>Assets</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 334	\$ 211
Receivables (net of reserves - 1994 \$13; 1993 \$13)	289	264
Inventories	165	145
<b>Total current assets</b>	<b>788</b>	<b>620</b>
Property, Plant and Equipment (net of reserves for depreciation and depletion - 1994 \$47; 1993 \$36)	747	754
Excess Reorganization Value (net of accumulated amortization - 1994 \$155; 1993 \$113)	688	735
Other Assets	164	54
<b>Total assets</b>	<b>2,387</b>	<b>2,163</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities:</b>		
Accounts payable	\$ 120	\$ 104
Accrued expenses	210	208
Notes payable	13	2
Long-term debt maturing within one year	118	165
Taxes on income	18	20
<b>Total current liabilities</b>	<b>479</b>	<b>499</b>
Long-Term Debt	1,257	1,309
Deferred Income Taxes	187	180
Other Liabilities	413	309
<b>Stockholders' Equity/(Deficit):</b>		
Preferred stock	-	-
Common stock	5	4
Capital received in excess of par value	223	-
Deferred currency translation	(14)	(9)
Reinvested earnings/(deficit)	(163)	(129)
<b>Total stockholders' equity/(deficit)</b>	<b>51</b>	<b>(134)</b>

Total liabilities and stockholders' equity	2,387	2,163
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See accompanying Notes to Consolidated Financial Statements.

USG CORPORATION  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(Dollars in millions)  
(Unaudited)

	Three Months ended March 31, 1994 (a)	Three Months ended March 31, 1993
Cash Flows From Operating Activities:		
Net loss	\$ (34)	\$ (279)
Adjustments to reconcile net loss to net cash:		
Amortization of excess reorganization value	42	-
Cumulative effect of accounting changes	-	150
Depreciation, depletion and other amortization	18	18
Interest expense on pay-in-kind debentures	-	17
Deferred income taxes	7	3
Net loss on asset dispositions	-	4
(Increase)/decrease in working capital:		
Receivables	(25)	(33)
Inventories	(21)	(7)
Payables	15	14
Accrued expenses	2	16
Increase in other assets	(9)	(7)
Increase in other liabilities	4	4
Increase in reorganization items	-	55
Other, net	-	(6)
Net cash flows to operating activities	(1)	(51)
Cash Flows From Investing Activities:		
Capital expenditures	(7)	(8)
Net cash flows to investing activities	(7)	(8)
Cash Flows From Financing Activities:		
Issuance of debt	114	1
Repayment of debt	(207)	(2)
Proceeds from public offering of common stock	224	-
Decrease in restricted assets	-	1
Net cash flows from financing activities	131	-
Net Increase/(Decrease) in Cash and Cash Equivalents	123	(59)
Cash and cash equivalents as of beginning of period	211	180
Cash and cash equivalents as of end of period	334	121
Supplemental Cash Flow Disclosures:		
Interest paid	22	46
Income taxes paid	4	2

(a) Due to the Restructuring and implementation of fresh start accounting, financial statements after May 6, 1993 for the restructured company are not comparable to financial statements prior to that date. See "Notes to Consolidated Financial Statements - Note (3)" for more information on the Restructuring and implementation of fresh start accounting.

See accompanying Notes to Consolidated Financial Statements.

USG CORPORATION  
Notes to Consolidated Financial Statements  
(Unaudited)

(1) The consolidated financial statements of USG Corporation and its subsidiaries ("the Corporation") included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the statements reflect all adjustments, which are of a normal recurring nature, necessary to present fairly the Corporation's financial position as of March 31, 1994 and December 31, 1993; results of operations for the three months ended March 31, 1994 and 1993; and cash flows for the three months then ended. While these interim financial statements and accompanying notes are unaudited, they have been reviewed by Arthur Andersen & Co., the Corporation's independent public accountants. These financial statements are to be read in conjunction with the financial statements and notes included in the Corporation's 1993 Annual Report on Form 10-K dated March 14, 1994.

(2) In the first quarter of 1994, the Corporation implemented a refinancing plan which included (i) a public offering of common stock (the "Equity Offering"), (ii) the placement of senior notes with certain institutional investors (the "Note Placement") and (iii) certain amendments to the Corporation's Credit Agreement (the "Credit Agreement Amendments" and, together with the Equity Offering and the Note Placement, the "Transactions").

In March 1994, the Equity Offering was completed. Of the 14,375,000 shares of common stock sold at a price of \$29.875 per share, 7,900,000 shares were newly issued by the Corporation and 6,475,000 shares were sold by Water Street Corporate Recovery Fund I, L.P. (the "Selling Stockholder"). Net proceeds received by the Corporation from the Equity Offering were \$224 million. The Corporation did not receive any proceeds from the sale of shares by the Selling Stockholder. The shares of common stock sold in the Equity Offering were registered under the Corporation's Registration Statement No. 33-52573 which was declared effective by the Securities and Exchange Commission (the "SEC") on March 9, 1994.

In February 1994, the Corporation completed the Note Placement with the issuance of \$150 million principal amount of 9 1/4% senior notes due 2001 (the "Senior 2001 Notes") in exchange for \$30 million aggregate principal amount of its outstanding 8% senior notes due 1996 (the "Senior 1996 Notes"), \$35 million aggregate principal amount of its outstanding 8% senior notes due 1997 (the "Senior 1997 Notes") and \$85 million in cash.

In conjunction with the Equity Offering and Note Placement, the Credit Agreement Amendments were completed. These amendments increased the size of the Corporation's revolving credit facility by \$70 million and amended mandatory bank term loan prepayment provisions to allow the Corporation, upon the achievement of certain financial tests, to retain additional free cash flow for capital expenditures and repayment of its public debt.

The net proceeds from the Equity Offering and Note Placement, along with \$158 million of excess cash as of December 31, 1993 (as calculated in accordance with the cash sweep mechanism of the Corporation's credit agreement) are being used by the Corporation to prepay, redeem or repurchase public and bank debt and for general corporate purposes, including capital expenditures for cost reduction, capacity improvement and future growth opportunities. In the first quarter of 1994, the Corporation (i) prepaid \$140 million of bank term loans in satisfaction of 1997 and 1998 scheduled payments, (ii) purchased \$26 million aggregate principal amount of Senior 1996 Notes and \$20 million aggregate principal amount of Senior 1997 Notes and (iii) delivered notices of redemption, at 100% of principal amount, of \$75 million of its 8% senior notes due 1995 (the "Senior 1995 Notes") and \$35 million of its 9% senior notes due 1998 (the "Senior 1998 Notes").

(3) On May 6, 1993, the Corporation completed a comprehensive restructuring

of its debt (the "Restructuring") through the implementation of a "prepackaged" plan of reorganization (the "Prepackaged Plan"). In accordance with the terms of the Prepackaged Plan, \$1.4 billion of debt and accrued interest was converted into equity, interest expense was significantly reduced and the maturities of a substantial portion of its remaining debt were extended. The Corporation accounted for the Restructuring using the principles of fresh start accounting as required by AICPA Statement of Position 90-7, "Financial Reporting by Entities in Reorganization under the Bankruptcy Code" ("SOP 90-7"). Pursuant to such principles, individual assets and liabilities were adjusted to fair market value as of May 6, 1993. Excess reorganization value, the portion of the reorganization value not attributable to specific assets, is being amortized over a five-year period, effective May 7, 1993. In August 1993, the Corporation completed an exchange offer that converted \$138 million of bank debt into senior notes due 2002. See the Corporation's 1993 Annual Report of Form 10-K dated March 14, 1994 for more information on the Restructuring, implementation of fresh start accounting and exchange of senior notes for bank debt.

Due to the Restructuring and implementation of fresh start reporting, financial statements after May 6, 1993 for the restructured company are not comparable to financial statements prior to that date. For year-to-year comparability of results, the following unaudited Pro Forma Consolidated Statement of Earnings for the three months ended March 31, 1993 has been prepared giving effect to the consummation of the Prepackaged Plan including the costs related thereto, in accordance with SOP 90-7, as if the consummation had occurred on January 1, 1993. The adjustments set forth under the caption "Pro Forma Adjustments" reflect the assumed effects of the Restructuring and the adoption of fresh start reporting prescribed by SOP 90-7.

USG CORPORATION  
PRO FORMA CONSOLIDATED STATEMENT OF EARNINGS  
Three Months ended March 31, 1993  
(unaudited)  
(Dollars in millions)

	Total Before Adjustments	Pro Forma Adjustments	Pro Forma
Net sales	\$ 436	\$ -	\$ 436
Cost of products sold	357	-	357
Gross profit	79	-	79
Selling and administrative expenses	52	-	52
Amortization of excess reorganization value	-	43 (a)	43
Operating profit/(loss)	27	(43)	(16)
Interest expense	75	(42) (b)	33
Interest income	(2)	-	(2)
Other expense, net	7	(1) (c)	6
Reorganization items	69	(69) (d)	-
Earnings/(loss) before taxes on income, extraordinary gain and changes in accounting principles	(122)	69	(53)
Taxes on income	7	(5)	2
Earnings/(loss) before extraordinary gain and changes in accounting principles	(129)	74	(55)

- (a) Reflects amortization of excess reorganization value which would have been recorded during the first quarter of 1993.
- (b) Reflects the adjustment to restate interest expense for the first quarter of 1993 to the amount that would have been recorded.
- (c) Represents the reversal of first quarter 1993 amortization of historical capitalized financing costs which were written off in connection with the Restructuring.
- (d) Represents the reversal of actual reorganization items incurred in connection with the Restructuring in the first quarter of 1993. These expenses would have been recorded in 1992 had the Restructuring occurred on January 1, 1993.

- (4) A one-time after-tax charge of \$150 million was recorded in the first quarter of 1993 representing the adoption of: (i) Statement of Financial Accounting Standard ("SFAS") No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," - \$180 million expense; and (ii) SFAS No. 109, "Accounting for Income Taxes," - \$30 million income. Neither of these standards impact cash flow.
- (5) Income tax expense amounted to \$10 million for the first quarter of 1994 due to tax expense on foreign subsidiary earnings and the inability to benefit the amortization of excess reorganization value and the domestic net operating loss carryforwards ("NOL Carryforwards"). For the first quarter of 1993, income tax expense was \$7 million due to tax expense on foreign subsidiary earnings and the inability to benefit the NOL Carryforwards as an offset to deferred taxes.

The Corporation has an NOL Carryforward of \$90 million remaining from 1992. This NOL Carryforward may be used to offset U.S. taxable income through 2007. The Internal Revenue Code (the "Code") will limit the Corporation's annual use of its NOL Carryforward to the lesser of its taxable income or approximately \$30 million plus any unused limit from prior years. Furthermore, due to the uncertainty regarding the application of the Code to the exchange of stock for debt, the Corporation's NOL Carryforward could be further reduced or eliminated. The Corporation has a \$4 million minimum tax credit which may be used to offset U.S. regular tax liability in future years.

- (6) As permitted by the Prepackaged Plan, 2,788,350 common shares were reserved for future issuance in conjunction with stock options, all of which remained in reserve as of March 31, 1994. Options for 1,673,000 common shares and 933,000 common shares were granted on June 1, 1993 and February 9, 1994, respectively, leaving an additional 182,350 common shares available for future grants.
- (7) One of the Corporation's operating subsidiaries, United States Gypsum Company ("U.S. Gypsum"), is a defendant in asbestos lawsuits alleging both property damage and personal injury. This litigation has not had a material effect on the Corporation's liquidity or earnings. Virtually all costs of the Personal Injury Cases are being paid by insurance. However, many of U.S. Gypsum's insurance carriers are denying coverage for the Property Damage Cases, although U.S. Gypsum believes that substantial coverage exists and the trial court in U.S. Gypsum's Coverage Action has so ruled (such ruling has been appealed). In view of the limited insurance funding currently available to U.S. Gypsum for Property Damage Cases resulting from continued resistance by a number of U.S. Gypsum's insurers to providing coverage, the effect of the asbestos litigation on the Corporation will depend upon a variety of factors, including the damages sought in Property Damage Cases that reach trial prior to the completion of the Coverage Action, U.S. Gypsum's ability to successfully defend or settle such cases, and the resolution of the Coverage Action. As a result, management is unable to determine whether an adverse outcome in the asbestos litigation will have a material adverse effect on the results of operations or the consolidated financial position of the Corporation.

Effective January 1, 1994, the Corporation adopted the requirements of Financial Accounting Standards Board Interpretation No. 39. In accordance with Interpretation No. 39, U.S. Gypsum recorded an accrual of \$100 million for its liabilities for asbestos-related matters which are deemed probable and can be reasonably estimated, and separately recorded an asset of \$100 million, the amount of such liabilities that is expected to be paid by uncontested insurance. Due to management's inability to reasonably estimate U.S. Gypsum's liability for Property Damage Cases and (until the implementation of *Georgine et al. v. Amchem Products In., et al* is deemed probable) future Personal Injury Cases, the liability and asset recorded relate only to pending Personal Injury Cases. The implementation of Interpretation No. 39 did not impact earnings, cash flow or net assets. See Part II, Item 1. "Legal Proceedings" for information on asbestos litigation and definitions of capitalized terms.

The Corporation and certain of its subsidiaries have been notified by

state and federal environmental protection agencies of possible involvement as one of numerous "potentially responsible parties" in a number of so-called "Superfund" sites in the United States. The Corporation does not presently anticipate any material adverse effect upon its earnings or consolidated financial position arising out of the resolution of these matters or any other pending governmental proceeding regarding environmental matters.

- (8) USG Corporation, a holding company, owns several operating subsidiaries, including U.S. Gypsum. On January 1, 1985, all of the issued and outstanding shares of stock of U.S. Gypsum were converted into shares of USG Corporation and the holding company became a joint and several obligor for certain debentures originally issued by U.S. Gypsum. Debentures totaling \$32 million and \$36 million were on the holding company's books of account as of March 31, 1994 and December 31, 1993, respectively. Summary financial results for U.S. Gypsum are presented below (dollars in millions):

Summary Statement of Earnings	Three Months ended March 31, 1994 (a)	Three Months ended March 31, 1993
Net Sales	\$ 269	\$ 223
Cost and expenses	224	201
Amortization of excess reorganization value	15	-
Operating profit	30	22
Interest expense, net	-	-
Corporate charges	24	39
Loss before taxes on income and change in accounting principle	6	(17)
Income tax/(tax benefit)	9	(6)
Loss before change in accounting principle	(3)	(11)
Cumulative effect of change in accounting principle	-	28
Net loss	(3)	17

Summary Balance Sheet	As of March 31, 1994	As of December 31, 1993
Current assets	\$ 213	\$ 190
Property, plant and equipment, net	480	483
Excess reorganization value, net	250	265
Other assets	106	3
Total assets	1,049	941
Current liabilities	137	124
Other liabilities and obligations	247	149
Stockholder's equity	665	668
Total liabilities and stockholder's equity	1,049	941

- (a) Due to the Restructuring and implementation of fresh start accounting, financial statements after May 6, 1993 for the restructured company are not comparable to financial statements prior to that date. See "Notes to Consolidated Financial Statements - Note (3)" for more information on the Restructuring and implementation of fresh start accounting.

- (9) The Corporation issued \$478 million aggregate principal amount of 10 1/4% senior notes due 2002 (the "10 1/4% Senior Notes") in 1993. Each of U.S. Gypsum, USG Industries, Inc., USG Interiors, Inc. ("USG

Interiors"), USG Foreign Investments, Ltd., L&W Supply Corporation ("L&W Supply"), Westbank Planting Company, USG Interiors International, Inc., American Metals Corporation and La Mirada Products Co., Inc. (together, the "Combined Guarantors") guaranteed, in the manner described below, the obligations of the Corporation under the Credit Agreement and the 10 1/4% Senior Notes. The Combined Guarantors are jointly and severally liable under the guarantees. Holders of the debt issued in connection with the Credit Agreement (the "Bank Debt") have the right to: (i) determine whether, when and to what extent the guarantees will be enforced (provided that each guarantee payment will be applied to the Bank Debt and 10 1/4% Senior Notes pro rata based on the respective amounts owed thereon); and (ii) amend or eliminate the guarantees. The guarantees will terminate when the Bank Debt is retired regardless of whether the 10 1/4% Senior Notes remain outstanding. The liability of each of the Combined Guarantors on its guarantee is limited to the greater of: (i) 95% of the lowest amount, calculated as of July 13, 1988, sufficient to render the guarantor insolvent, leave the guarantor with unreasonably small capital or leave the guarantor unable to pay its debts as they become due (each as defined under applicable law); and (ii) the same amount, calculated as of the date any demand for payment under such guarantee is made, in each case plus collection costs. The guarantees are senior obligations of the applicable guarantor and rank pari passu with all unsubordinated obligations of the guarantor.

There are 43 Non-Guarantors (the "Combined Non-Guarantors"), substantially all of which are subsidiaries of Guarantors. The Combined Non-Guarantors primarily include CGC Inc. ("CGC"), the Corporation's 76%-owned Canadian subsidiary, Gypsum Transportation Limited, USG Canadian Mining Ltd. and the Corporation's Mexican, European and Pacific subsidiaries managed by USG International, Ltd. ("USG International"). The long-term debt of the Combined Non-Guarantors of \$25 million as of March 31, 1994 has restrictive covenants that restrict, among other things, the payment of dividends.

The following condensed consolidating information presents:

- (i) Condensed financial statements as of March 31, 1994 and December 31, 1993 and for the three months ended March 31, 1994 and 1993 of (a) the Corporation on a parent company only basis (the "Parent Company," which was the only entity of the Corporation included in the 1993 bankruptcy proceeding associated with the Restructuring), (b) the Combined Guarantors, (c) the Combined Non-Guarantors and (d) the Corporation on a consolidated basis. (Due to the Restructuring and implementation of fresh start accounting, the financial statements after May 6, 1993 for the restructured company are not comparable to financial statements prior to that date. Except for the following condensed financial statements, separate financial information with respect to the Combined Guarantors is not deemed material to investors and is omitted.)
- (ii) The Parent Company and Combined Guarantors shown with their investments in their subsidiaries accounted for on the equity method.
- (iii) Elimination entries necessary to consolidate the Parent Company and its subsidiaries.

USG CORPORATION  
CONDENSED CONSOLIDATING STATEMENT OF EARNINGS  
Three Months ended March 31, 1994  
(Dollars in millions)

	Parent Company	Combined Guarantors	Combined Non- Guarantors	Eliminations Consolidated
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Net Sales	\$	-	\$	443	\$	88	\$	(25)	\$	506
Gross Profit		-		92		18		-		110
Operating Profit/(Loss)		(9)		21		(1)		-		11
Equity in net loss of the Subsidiaries		32		4		-		(36)		-
Interest expense, net		33		-		1		-		34
Corporate service charge		(42)		42		-		-		-
Other expense, net		1		-		-		-		1
Loss Before Taxes on Income		(33)		(25)		(2)		36		(24)
Taxes on income		1		7		2		-		10
Net Loss		(34)		(32)		(4)		36		(34)

USG CORPORATION  
CONDENSED CONSOLIDATING STATEMENT OF EARNINGS  
Three Months ended March 31, 1993  
(Dollars in millions)

	Parent Company	Combined Guarantors	Combined Non- Guarantors	Eliminations	Consolidated					
Net Sales	\$	-	\$	369	\$	85	\$	(18)	\$	436
Gross Profit/(Loss)		-		61		18		-		79
Operating Profit		(8)		27		8		-		27
Equity in net (earnings)/loss of the Subsidiaries		11		(4)		-		(7)		-
Interest expense, net		70		2		1		-		73
Corporate service charge		(69)		69		-		-		-
Other expense, net		2		5		-		-		7
Reorganization items		69		-		-		-		69
Earnings/(Loss) Before Taxes on Income and Changes in Accounting Principles		(91)		(45)		7		7		(122)
Taxes on income/(income tax benefit)		17		(12)		2		-		7
Earnings/(Loss) Before Changes in Accounting Principles		(108)		(33)		5		7		(129)
Changes in accounting principles		(171)		22		(1)		-		(150)
Net Earnings/(Loss)		(279)		(11)		4		7		(279)

USG CORPORATION  
CONDENSED CONSOLIDATING BALANCE SHEET  
As of March 31, 1994  
(Dollars in millions)

	Parent Company	Combined Guarantors	Combined Non- Guarantors	Eliminations	Consolidated					
<b>ASSETS</b>										
<b>Current Assets:</b>										
Cash and cash equivalents	\$	310	\$	(12)	\$	36	\$	-	\$	334
Receivables, net		6		270		45		(32)		289
Inventories		-		130		38		(3)		165
Total current assets		316		388		119		(35)		788

Property, Plant and Equipment, Net	21	615	111	-	747
Investment in Subsidiaries	1,475	267	-	(1,742)	-
Excess Reorganization Value, Net	-	548	140	-	688
Other Assets	(10)	169	14	(9)	164
Total assets	1,802	1,987	384	(1,786)	2,387

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:

Accounts payable and accrued expenses	106	217	55	(30)	348
Notes payable and LTD maturing within one year	110	3	18	-	131
Total current liabilities	216	220	73	(30)	479
Long-Term Debt	1,197	35	25	-	1,257
Deferred Income Taxes	23	149	15	-	187
Other Liabilities	301	108	4	-	413
Stockholders' Equity/(Deficit):					
Common stock	5	1	6	(7)	5
Capital received in excess of par value	223	1,472	310	(1,782)	223
Deferred currency translation	-	-	(14)	-	(14)
Reinvested earnings/(deficit)	(163)	2	(35)	33	(163)
Total stockholders' equity/(deficit)	65	1,475	267	(1,756)	51
Total liabilities and stockholders' equity	1,802	1,987	384	(1,786)	2,387

USG CORPORATION  
CONDENSED CONSOLIDATING BALANCE SHEET  
As of December 31, 1993  
(Dollars in millions)

	Parent Company	Combined Guarantors	Combined Non-Guarantors	Eliminations	Consolidated
ASSETS					
Current Assets:					
Cash and cash equivalents	\$ 187	\$ (8)	\$ 32	\$ -	\$ 211
Receivables, net	8	240	44	(28)	264
Inventories	-	114	34	(3)	145
Total current assets	195	346	110	(31)	620
Property, Plant and Equipment, Net	21	620	113	-	754
Investment in Subsidiaries	1,511	277	-	(1,788)	-
Excess Reorganization Value, Net	-	582	153	-	735
Other Assets	(35)	91	3	(5)	54
Total assets	1,692	1,916	379	(1,824)	2,163

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:

Accounts payable and accrued expenses	100	207	52	(27)	332
Notes payable and LTD maturing within one year	158	3	6	-	167
Total current liabilities	258	210	58	(27)	499
Long-Term Debt	1,249	36	24	-	1,309
Deferred Income Taxes	14	151	15	-	180
Other Liabilities	296	8	5	-	309
Stockholders' Equity/(Deficit):					
Common stock	4	1	6	(7)	4
Capital received in excess of par value	-	1,472	310	(1,782)	-
Deferred currency translation	-	-	(9)	-	(9)
Reinvested earnings/(deficit)	(129)	38	(30)	(8)	(129)
Total stockholders' equity/(deficit)	(125)	1,511	277	(1,797)	(134)
Total liabilities and stockholders' equity	1,692	1,916	379	(1,824)	2,163

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS  
Three Months ended March 31, 1994  
(Dollars in millions)

	Parent Company	Combined Guarantors	Combined Non- Guarantors	Eliminations	Consolidated
Net Cash Flows (To)/From Operating Activities	\$ (23)	\$ 17	\$ 5	\$ -	\$ (1)
Capital expenditures	-	(6)	(1)	-	(7)
Net proceeds from asset dispositions	-	-	-	-	-
Net Cash Flows To Investing Activities	-	(6)	(1)	-	(7)
Issuance of debt	85	-	29	-	114
Repayment of debt	(189)	-	(18)	-	(207)
Proceeds from public offering of stock	224	-	-	-	224
Cash dividends (paid)/ received	-	11	(11)	-	-
Net cash transfers (to)/from Corporate	26	(26)	-	-	-
Net Cash Flows (To)/From Financing Activities	146	(15)	-	-	131
Net Increase/(Decrease) in Cash and Cash Equivalents	123	(4)	4	-	123
Cash and cash equivalents at beginning of period	187	(8)	32	-	211
Cash and cash equivalents at end of period	310	(12)	36	-	334

USG CORPORATION  
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS  
Three Months Ended March 31, 1993  
(Dollars amounts in millions)

	Parent Company	Combined Guarantors	Combined Non- Guarantors	Eliminations	Consolidated
Net Cash Flows (To)/From Operating Activities	\$ (72)	\$ 17	\$ 4	\$ -	\$ (51)
Capital expenditures	-	(6)	(2)	-	(8)
Net proceeds from asset dispositions	-	-	-	-	-
Net Cash Flows To Investing Activities	-	(6)	(2)	-	(8)
Issuance of debt	-	-	1	-	1
Repayment of debt	-	-	(2)	-	(2)
Cash dividends (paid)/ received	1	-	(1)	-	-
Decrease in restricted assets	-	1	-	-	1
Net cash transfers (to)/from Corporate	65	(65)	-	-	-
Net Cash Flows (To)/From Financing Activities	66	(64)	(2)	-	-
Net Decrease in Cash and Cash Equivalents	(6)	(53)	-	-	(59)
Cash and cash equivalents at beginning of period	59	87	34	-	180
Cash and cash equivalents at end of period	53	34	34	-	121

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Results of Operations

On May 6, 1993, the Corporation completed the Restructuring. Due to the Restructuring and implementation of fresh start accounting, the Corporation's financial statements after May 6, 1993 are not comparable to financial statements prior to that date. See Part I, Item 1. "Financial Statements: Notes to Consolidated Financial Statements - Note (3)" for information on the Restructuring and implementation of fresh start accounting.

To facilitate a meaningful comparison of the Corporation's operating performance, the following discussion and analysis is presented on a traditional basis. Included in the following discussion are comparisons of EBITDA (earnings before interest, taxes, depreciation, depletion and amortization, and for the first quarter of 1993, reorganization items and changes in accounting principles). The Corporation believes EBITDA is helpful in understanding cash flow generated from operations that is available for taxes, debt service and capital expenditures. In addition, EBITDA facilitates the monitoring of covenants related to certain long-term debt and other agreements entered into in conjunction with the Restructuring. EBITDA should not be considered by investors as an alternative to net earnings as an indicator of the Corporation's operating performance or to cash flows as a measure of its overall liquidity.

Consolidated Results (dollars in millions):

	Three Months ended March 31	
	1994	1993
Net Sales	\$ 506	\$ 436
Gross Profit	110	79
% of net sales	21.7%	18.1%
Selling and administrative expenses	57	52
% of net sales	11.3%	11.9%
Amortization of excess reorganization value	42	-
Operating Profit	11	27
Calculation of EBITDA:		
Operating profit	\$ 11	\$ 27
Amortization of excess reorganization value	42	-
Depreciation and depletion	13	15
Other	-	4
EBITDA	66	46
% of net sales	13.0%	10.6%

Consolidated net sales in the first quarter of 1994, the highest first quarter amount since the first quarter of 1988, increased \$70 million, or 16.1%, over the first quarter of 1993. The increase was attributable to increased sales for nearly all of the Corporation's operating subsidiaries.

As a percentage of net sales, gross profit in first quarter, 1994, improved to 21.7% from 18.1% in the 1993 period, reflecting improved gypsum wallboard prices.

Selling and administrative expenses increased \$5 million, or 9.6%, in the first three months of 1994 over the comparable 1993 period, primarily due to higher levels of compensation and benefits and marketing program expenses. As a percentage of net sales, however, these expenses improved to 11.3% from 11.9% in the first quarter of 1993 as a result of the increase in 1994 net sales.

Effective May 7, 1993, the Corporation began amortizing its excess reorganization value which was established in accordance with fresh start accounting rules. This non-cash amortization, which will continue through April 1998, amounted to \$42 million in the first three months of 1994 with no counterpart in the prior year quarter. Consequently, 1994 operating profit is

not comparable to the prior year.

EBITDA in the first quarter of 1994 increased \$20 million, or 43.5%, over the comparable 1993 period reflecting the aforementioned gross profit performance.

Industry Segment/Core Business Results:

The Corporation has two core businesses - North American Gypsum (which includes the Gypsum Products and Building Products Distribution industry segments) and Worldwide Ceilings. First quarter comparisons of results by operating company, industry segment and core business were as follows (in millions of dollars):

	Three Months ended March 31			
	Net Sales		EBITDA	
	1994	1993	1994	1993
<b>North American Gypsum:</b>				
U.S. Gypsum	\$ 269	\$ 223	\$ 53	\$ 29
CGC (gypsum division)	24	23	2	2
Other subsidiaries	19	17	5	6
Eliminations	(18)	(14)	-	-
Total Gypsum Products	294	249	60	37
Building Products Distribution	139	113	1	-
Eliminations	(45)	(36)	-	-
Total North American Gypsum	388	326	61	37
<b>Worldwide Ceilings:</b>				
USG Interiors	96	84	13	11
USG International	45	43	1	1
CGC (interiors division)	8	8	1	2
Eliminations	(9)	(9)	-	-
Total Worldwide Ceilings	140	126	15	14
Corporate	-	-	(10)	(5)
Eliminations	(22)	(16)	-	-
Total USG Corporation	506	436	66	46

North American Gypsum

Net sales and EBITDA for North American Gypsum increased in the first quarter of 1994 \$62 million, or 19.0%, and \$24 million, or 64.9%, respectively, from the first quarter of 1993.

Net sales and EBITDA for U.S. Gypsum continue to improve as a result of increased demand and improving prices. In the first quarter of 1994, net sales increased \$46 million, or 20.6%, over first quarter 1993. EBITDA in the 1994 period was up \$24 million, or 82.8%, over the first quarter of 1993. These improvements primarily reflect continued improvement in gypsum wallboard selling prices and increased volume. Despite unfavorable weather conditions in several parts of the United States, U.S. Gypsum shipped 1.865 billion square feet of gypsum wallboard in the first quarter of 1994, the highest first quarter amount in its history and 5.6% higher than shipments in the first three months of 1993. U.S. Gypsum's gypsum wallboard plants ran at 98% of capacity in the first quarter of 1994. The average gypsum wallboard selling price increased to \$89.53 per thousand square feet in the first quarter of 1994, up \$14.56, or 19.4%, from the first quarter of 1993 and up \$7.07, or 8.6%, from the fourth quarter of 1993. First quarter 1994 shipping records of joint compound and DUROCK cement board also contributed to U.S. Gypsum's favorable results.

Increased selling prices were partially offset by increased unit manufacturing cost in the first quarter of 1994, up approximately 6% over the first quarter of 1993. The increased unit manufacturing cost resulted primarily from increased energy costs related to adverse weather and increased maintenance costs.

First quarter 1994 net sales for CGC's gypsum division increased \$1 million,

or 4.3%, over the comparable 1993 quarter due to increased volume of gypsum wallboard, which was partially offset by the impact of the strengthened U.S. dollar. EBITDA in the first quarter of 1994 remained unchanged from the prior year period.

Building Products Distribution (L&W Supply) experienced a record first quarter net sales of \$139 million, increasing \$26 million, or 23.0%, over the first three months of 1993. This increase reflects improved gypsum wallboard volume and selling prices, as well as improved results for its ceilings, joint treatment and other non-wallboard product lines. EBITDA increased \$1 million for the 1994 quarter over 1993's breakeven level.

#### Worldwide Ceilings

Net sales and EBITDA for Worldwide Ceilings increased in the first quarter of 1994 \$14 million, or 11.1%, and \$1 million, or 7.1%, respectively from the first quarter of 1993.

Compared to the first quarter of 1993, net sales and EBITDA for USG Interiors increased \$12 million, or 14.3%, and \$2 million, or 18.2%, respectively, in the first quarter of 1994 due to higher levels of retail and export sales. These results represent USG Interiors' highest first quarter sales since the first quarter of 1990 despite the continued softness in new non-residential construction markets.

Despite the continuing recession in Europe, sales in the first quarter of 1994 for USG International increased \$2 million, or 4.7%, over the first quarter of 1993, while EBITDA remained unchanged for the two periods.

#### Other Consolidated Earnings Information

Interest expense, which was significantly reduced as a result of the Restructuring, amounted to \$37 million in the first quarter of 1994, down \$38 million, or 50.7% from the first quarter 1993 level of \$75 million. The 1994 amount includes \$4 million of non-cash amortization of reorganization debt discount.

In connection with the Restructuring, reorganization items expense of \$69 million was recorded in the first quarter of 1993, representing fees and expenses associated with the Restructuring and the write-off of capitalized financing costs incurred in 1988.

Income tax expense amounted to \$10 million in the first quarter of 1994 primarily due to the inability to benefit the amortization of excess reorganization value. In the first quarter of 1993, income tax expense amounted to \$7 million.

A one-time after-tax charge of \$150 million was recorded in the first quarter of 1993 representing the adoption of: (i) SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," - \$180 million expense; and (ii) SFAS No. 109, "Accounting for Income Taxes," - \$30 million income. Neither of these standards impact cash flow.

A net loss of \$34 million was recorded in the first quarter of 1994 primarily due to the aforementioned amortization of excess reorganization value and reorganization debt discount. Together, these non-cash adjustments reduced net earnings by \$46 million, or \$1.17 per common share. In the year-earlier period, a net loss of \$279 million was recorded as a result of the high level of interest expense and one-time charges related to reorganization items and the net cumulative effect of changes in accounting principles.

#### Liquidity and Capital Resources

In the first quarter of 1994, the Corporation implemented a refinancing plan which included (i) the Equity Offering, (ii) the Note Placement and (iii) the Credit Agreement Amendments. The Transactions were designed, among other things, to (i) reduce the Corporation's financial leverage through the retirement of debt, (ii) reduce the amount of debt maturing in 1995 through 1998 and extend the final maturity of a significant portion of the Corporation's debt, (iii) improve the Corporation's financial and operating flexibility under the Credit Agreement and (iv) provide funds for capital expenditures and other general corporate purposes, including capital

expenditures for cost reduction, capacity improvement and future growth opportunities. Through use of proceeds from the Transactions and cash generated in 1993, the Corporation has reduced its domestic debt by approximately \$220 million (net of the Note Placement) as of April 30, 1994. See Part I, Item 1. "Financial Statements: Notes to Consolidated Financial Statements - Note (2)" for additional information on the Transactions.

The Corporation's liquidity and capital resources were significantly strengthened by the Transactions. The Corporation believes that cash generated by operations and the estimated levels of liquidity available to the Corporation will be sufficient to permit the Corporation to satisfy its debt service requirements and other capital requirements for the foreseeable future. However, the Corporation is subject to significant business, economic and competitive uncertainties that are beyond its control and there can be no assurance that the Corporation's financial resources will be sufficient for it to satisfy its debt service obligations and other capital requirements under all circumstances or otherwise permit the Corporation to take advantage of any appropriate growth opportunity that may arise.

#### Working Capital

As of March 31, 1994, working capital (current assets less current liabilities) amounted to \$309 million and the ratio of current assets to current liabilities was 1.65 to 1, versus December 31, 1993 when working capital amounted to \$121 million and the ratio of current assets to current liabilities was 1.24 to 1.

In the first quarter of 1994, cash and cash equivalents increased \$123 million to \$334 million, primarily due to implementation of the aforementioned refinancing in the first quarter of 1994. As of March 31, 1994, the Corporation planned to utilize approximately \$190 million of existing cash to prepay or redeem additional debt.

Comparing March 31, 1994 balances with December 31, 1993, accounts receivable (net) increased \$25 million, or 9.5%, to \$289 million, inventories increased \$20 million, or 13.8%, to \$165 million and accounts payable increased \$16 million, or 15.4%, to \$120 million. These increases were primarily due to the increased level of business.

#### Capital Expenditures

Capital expenditures amounted to \$7 million in first quarter 1994, a decrease of \$1 million from the comparable 1993 period. As a result of the aforementioned refinancing plan, which generated approximately \$92 million for capital expenditures, the Corporation augmented its capital spending program. As of March 31, 1994, capital expenditure commitments for the replacement, modernization and expansion of operations amounted to \$40 million compared with \$11 million as of December 31, 1993. In addition, the Corporation periodically evaluates possible acquisitions or combinations involving other businesses or companies, generally in businesses and markets related to the Corporation's current operations, and the Corporation believes that its available liquidity would be adequate to support any appropriate opportunity.

#### Litigation

One of the Corporation's subsidiaries, U.S. Gypsum, is a defendant in asbestos lawsuits alleging both property damage and personal injury. This litigation has not had a material effect on the Corporation's liquidity or earnings. Virtually all costs of the Personal Injury Cases are being paid by insurance. However, many of U.S. Gypsum's insurance carriers are denying coverage for the Property Damage Cases, although U.S. Gypsum believes that substantial coverage exists and the trial court in U.S. Gypsum's Coverage Action has so ruled (such ruling has been appealed). In view of the limited insurance funding currently available to U.S. Gypsum for Property Damage Cases resulting from continued resistance by a number of U.S. Gypsum's insurers to providing coverage, the effect of the asbestos litigation on the Corporation will depend upon a variety of factors, including the damages sought in Property Damage Cases that reach trial prior to the completion of the Coverage Action, U.S. Gypsum's ability to successfully defend or settle such cases, and the resolution of the Coverage Action. As a result, management is unable to determine whether an adverse outcome in the asbestos litigation will have a material adverse effect on the results of operations or the consolidated financial position of the Corporation.

Effective January 1, 1994, the Corporation adopted the requirements of Financial Accounting Standards Board Interpretation No. 39. In accordance with Interpretation No. 39, U.S. Gypsum recorded an accrual of \$100 million for its liabilities for asbestos-related matters which are deemed probable and can be reasonably estimated, and separately recorded an asset of \$100 million, the amount of such liabilities that is expected to be paid by uncontested insurance. Due to management's inability to reasonably estimate U.S. Gypsum's liability for Property Damage Cases and (until the implementation of Georgine is deemed probable) future Personal Injury Cases, the liability and asset recorded in 1994 relate only to pending Personal Injury Cases. The implementation of Interpretation No. 39 did not impact earnings, cash flow or net assets.

The Corporation and certain of its subsidiaries have been notified by state and federal environmental protection agencies of possible involvement as one of numerous "potentially responsible parties" in a number of so-called "Superfund" sites in the United States. The Corporation believes that neither these matters nor any other known governmental proceeding regarding environmental matters will have a material adverse effect upon its earnings or consolidated financial position. See Part II, Item 1. "Legal Proceedings" for more information on legal proceedings.

#### REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of  
USG Corporation:

We have reviewed the accompanying condensed consolidated balance sheet of USG CORPORATION (a Delaware corporation) AND SUBSIDIARIES as of March 31, 1994, and the related condensed consolidated statement of earnings and the condensed consolidated statement of cash flows for the three-month period ended March 31, 1994. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

As discussed in Note 3, on May 6, 1993, the Corporation completed a comprehensive financial restructuring through the implementation of a prepackaged plan of reorganization under Chapter 11 of Title 11 of the United States Bankruptcy Code and applied fresh start accounting. As such, results of operations through May 6, 1993 are not comparable with results of operations subsequent to that date.

Based on our review, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with generally accepted accounting principles.

As discussed in Note 7, in view of the limited insurance funding currently available for property damage cases resulting from the continued resistance by a number of U.S. Gypsum's insurers to providing coverage, the effect of the asbestos litigation on the Corporation will depend upon a variety of factors, including the damages sought in property damage cases that reach trial prior to the completion of the coverage action, U.S. Gypsum's ability to successfully defend or settle such cases, and the resolution of the coverage action. As a result, management is unable to determine whether an adverse outcome in the asbestos litigation will have a material adverse effect on the consolidated results of operations or the consolidated financial position of the Corporation.

As discussed in Note 7, on January 1, 1994, the Corporation changed its method of accounting for asbestos-related matters.

/s/ Arthur Andersen & Co.

ARTHUR ANDERSEN & CO.

Chicago, Illinois  
April 22, 1994

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Asbestos Litigation

One of the Corporation's subsidiaries, U.S. Gypsum, is among numerous defendants in lawsuits arising out of the manufacture and sale of asbestos-containing building materials. U.S. Gypsum sold certain asbestos-containing products beginning in the 1930's; in most cases the products were discontinued or asbestos was removed from the product formula by 1972, and no asbestos-containing products were sold after 1977. Some of these lawsuits seek to recover compensatory and in many cases punitive damages for costs associated with maintenance or removal and replacement of products containing asbestos (the "Property Damage Cases"). Others of these suits (the "Personal Injury Cases") seek to recover compensatory and in many cases punitive damages for personal injury allegedly resulting from exposure to asbestos and asbestos-containing products. It is anticipated that additional personal injury and property damage cases containing similar allegations will be filed.

As discussed below, U.S. Gypsum has substantial personal injury and property damage insurance for the years involved in the asbestos litigation. Prior to 1985, when an asbestos exclusion was added to U.S. Gypsum's policies, U.S. Gypsum purchased comprehensive general liability insurance policies covering personal injury and property damage in an aggregate face amount of approximately \$850 million. Insurers that issued approximately \$106 million of these policies are presently insolvent. After deducting insolvencies and exhaustion of policies, approximately \$625 million of insurance remains potentially available. Because U.S. Gypsum's insurance carriers initially responded to its claims for defense and indemnification with various theories denying or limiting coverage and the applicability of their policies, U.S. Gypsum filed a declaratory judgment action against them in the Circuit Court of Cook County, Illinois on December 29, 1983. (U.S. Gypsum Co. v. Admiral Insurance Co., et al.) (the "Coverage Action"). U.S. Gypsum alleges in the Coverage Action that the carriers are obligated to provide indemnification for settlements and judgments and, in some cases, defense costs incurred by U.S. Gypsum in property damage and personal injury claims in which it is a defendant. The current defendants are ten insurance carriers that provided comprehensive general liability insurance coverage to U.S. Gypsum between the 1940's and 1984. As discussed below, several carriers have settled all or a portion of the claims in the Coverage Action.

U.S. Gypsum's aggregate expenditures for all asbestos-related matters, including property damage, personal injury, insurance coverage litigation and related expenses, exceeded aggregate insurance payments by \$10.9 million in 1991, \$25.8 million in 1992, and \$8.2 million in 1993.

Property Damage Cases

The Property Damage Cases have been brought against U.S. Gypsum by a variety of plaintiffs, including school districts, state and local governments, colleges and universities, hospitals and private property owners. U.S. Gypsum is one of many defendants in four cases that have been certified as class actions and others that request such certification. One class action suit is brought on behalf of owners and operators of all elementary and secondary schools in the United States that contain or contained friable asbestos-containing material. (In re Asbestos School Litigation, U.S.D.C., E.D. Pa.)

Approximately 1,350 school districts opted out of the class, some of which have filed or may file separate lawsuits or are participants in a state court class action involving approximately 333 school districts in Michigan. (Board of Education of the City of Detroit, et al. v. The Celotex Corp., et al., Circuit Court for Wayne County, Mich.) On April 10, 1992, a state court in Philadelphia certified a class consisting of all owners of buildings leased to the federal government. (Prince George Center, Inc. v. U.S. Gypsum Co., et al., Court of Common Pleas, Philadelphia, Pa.) On September 4, 1992, a Federal district court in South Carolina conditionally certified a class comprised of all colleges and universities in the United States, which certification is presently limited to the resolution of certain allegedly "common" liability issues. (Central Wesleyan College v. W.R. Grace & Co., et al., U.S.D.C. S.C.). On December 23, 1992, a case was filed in state court in South Carolina purporting to be a "voluntary" class action on behalf of owners of all buildings containing certain types of asbestos-containing products manufactured by the nine named defendants, including U.S. Gypsum, other than buildings owned by the federal or state governments, single family residences, or buildings at issue in the four above-described class actions (Anderson County Hospital v. W.R. Grace & Co., et al., Court of Common Pleas, Hampton Co., S.C. (the "Anderson Case"). An amended complaint, which adds the Corporation as a defendant, alleges, among other things, that the guarantees executed by U.S. Gypsum in connection with the 1988 Recapitalization, as well as subsequent distributions of cash from U.S. Gypsum to the Corporation, rendered U.S. Gypsum insolvent and constitute a fraudulent conveyance. The suit seeks to set aside the guarantees and recover the value of the cash flow "diverted" from U.S. Gypsum to the Corporation in an amount to be determined. This case has not been certified as a class action and no other threshold issues, including whether the South Carolina Courts have personal jurisdiction over the Corporation, have been decided. The damages claimed against U.S. Gypsum in the class action cases are unspecified. U.S. Gypsum has denied the substantive allegations of each of the Property Damage Cases and intends to defend them vigorously except when advantageous settlements are possible.

As of March 31, 1994, 53 Property Damage Cases were pending against U.S. Gypsum; however, the number of buildings involved is greater than the number of cases because many of these cases, including the class actions referred to above, involve multiple buildings. In addition, approximately 42 property damage claims have been threatened against U.S. Gypsum.

In total, U.S. Gypsum has settled property damage claims of approximately 198 plaintiffs involved in approximately 82 cases. Twenty-five cases have been tried to verdict, 16 of which were won by U.S. Gypsum and 6 lost; two other cases, one won at the trial level and one lost, were settled during appeals. Another case that was lost at the trial court level was reversed on appeal and remanded to the trial court, which has now entered judgment for U.S. Gypsum. Appeals are pending in 5 of the tried cases. In the cases lost, compensatory damage awards against U.S. Gypsum have totaled \$11.5 million. Punitive damages totalling \$5.5 million were entered against U.S. Gypsum in four trials. Two of the punitive damage awards, totalling \$1.45 million, were paid after appeals were exhausted; a third was settled after the verdict was reversed on appeal. The remaining punitive damage award is on appeal.

In 1991, 13 new Property Damage Cases were filed against U.S. Gypsum, 11 were dismissed before trial, 8 were settled, 2 were closed following trial or appeal, and 100 were pending at year-end. U.S. Gypsum expended \$22.2 million for the defense and resolution of Property Damage Cases and received insurance payments of \$13.8 million in 1991. During 1992, 7 new Property Damage Cases were filed against U.S. Gypsum, 10 were dismissed before trial, 18 were settled, 3 were closed following trial or appeal, and 76 were pending at year-end. U.S. Gypsum expended \$34.9 million for the defense and resolution of Property Damage Cases and received insurance payments of \$10.2 million in 1992. In 1993, 5 new Property Damage Cases were filed against U.S. Gypsum, 7 were dismissed before trial, 11 were settled, 1 was closed following trial or appeal, 2 were consolidated into 1, and 61 were pending at year-end. U.S. Gypsum expended \$13.9 million for the defense and resolution of Property Damage Cases and received insurance payments of \$7.6 million in 1993.

In the Property Damage Cases litigated to date, a defendant's liability for compensatory damages, if any, has been limited to damages associated with the presence and quantity of asbestos-containing products manufactured by that defendant which are identified in the buildings at issue, although plaintiffs in some cases have argued that principles of joint and several liability should apply. Because of the unique factors inherent in each of the Property Damage Cases, including the lack of reliable information as to product

identification and the amount of damages claimed against U.S. Gypsum in many cases, including the class actions described above, management is unable to make a reasonable estimate of the cost of disposing of pending Property Damage Cases.

#### Personal Injury Cases

U.S. Gypsum was among numerous defendants in asbestos personal injury suits and administrative claims involving approximately 53,000 claimants pending as of March 31, 1994. All asbestos bodily injury claims pending in the federal courts, including approximately one-third of the Personal Injury Cases pending against U.S. Gypsum, have been consolidated in the United States District Court for the Eastern District of Pennsylvania.

U.S. Gypsum is a member, together with 19 other former producers of asbestos-containing products, of the Center for Claims Resolution (the "Center"). The Center has assumed the handling, including the defense and settlement, of all Personal Injury Cases pending against U.S. Gypsum and the other members of the Center. Each member of the Center is assessed a portion of the liability and defense costs of the Center for the Personal Injury Cases handled by the Center, according to predetermined allocation formulas. Five of U.S. Gypsum's insurance carriers that in 1985 signed an Agreement Concerning Asbestos-Related Claims (the "Wellington Agreement") are supporting insurers (the "Supporting Insurers") of the Center. The Supporting Insurers are obligated to provide coverage for the defense and indemnity costs of the Center's members pursuant to the coverage provisions in the Wellington Agreement. Claims for punitive damages are defended but not paid by the Center; if punitive damages are recovered, insurance coverage may be available under the Wellington Agreement depending on the terms of particular policies and applicable state law. Punitive damages have not been awarded against U.S. Gypsum in any of the Personal Injury Cases. Virtually all of U.S. Gypsum's personal injury liability and defense costs are paid by those of its insurance carriers that are Supporting Insurers. The Supporting Insurers provided approximately \$350 million of the total coverage referred to above, of which approximately \$262 million remains unexhausted.

On January 15, 1993, U.S. Gypsum and the other members of the Center were named as defendants in a class action filed in the U.S. District Court for the Eastern District of Pennsylvania (Georgine et al. v. Amchem Products Inc., et al., Case No. 93-CV-0215) (hereinafter "Georgine," formerly known as "Carlough"). The complaint generally defines the class of plaintiffs as all persons who have been occupationally exposed to asbestos-containing products manufactured by the defendants and who had not filed an asbestos personal injury suit as of the date of the filing of the class action. Simultaneously with the filing of the class action, the parties filed a settlement agreement in which the named plaintiffs, proposed class counsel, and the defendants agreed to settle and compromise the claims of the proposed class. The settlement, if approved by the court, will implement for all future Personal Injury Cases, except as noted below, an administrative compensation system to replace judicial claims against the defendants, and will provide fair and adequate compensation to future claimants who can demonstrate exposure to asbestos-containing products manufactured by the defendants and the presence of an asbestos-related disease. Class members will be given the opportunity to "opt out," or elect to be excluded from the settlement, although the defendants reserve the right to withdraw from the settlement if the number of opt outs is, in their sole judgment, excessive. In addition, in each year a limited number of claimants will have certain rights to prosecute their claims for compensatory (but not punitive) damages in court in the event they reject the compensation offered by the administrative processing of their claim.

The Center members, including U.S. Gypsum, have instituted proceedings against those of their insurance carriers that had not consented to support the settlement, seeking a declaratory judgment that the settlement is reasonable and, therefore, that the carriers are obligated to fund their portion of it. Consummation of the settlement is contingent upon, among other things, court approval of the settlement and a favorable ruling in the declaratory judgment proceedings against the non-consenting insurers. It is anticipated that appeals will follow the district court's ruling on the fairness and reasonableness of the settlement.

Each of the defendants has committed to fund a defined portion of the settlement, up to a stated maximum amount, over the initial ten year period of the agreement (which is automatically extended unless terminated by the defendants). Taking into account the provisions of the settlement agreement

concerning the maximum number of claims that must be processed in each year and the total amount to be made available to the claimants, the Center estimates that U.S. Gypsum will be obligated to fund a maximum of approximately \$125 million of the class action settlement, exclusive of expenses, with a maximum payment of less than \$18 million in any single year; of the total amount of U.S. Gypsum's obligation, all but approximately \$7 million is expected to be paid by U.S. Gypsum's insurance carriers.

During 1991, approximately 13,100 Personal Injury Cases were filed against U.S. Gypsum and approximately 6,300 were settled or dismissed. U.S. Gypsum incurred expenses of \$15.1 million in 1991 with respect to Personal Injury Cases of which \$15.0 million was paid by insurance. During 1992, approximately 20,100 Personal Injury Cases were filed against U.S. Gypsum and approximately 10,600 were settled or dismissed. U.S. Gypsum incurred expenses of \$21.6 million in 1992 with respect to Personal Injury Cases of which \$21.5 million was paid by insurance. During 1993, approximately 26,900 Personal Injury Cases were filed against U.S. Gypsum and approximately 22,900 were settled or dismissed. U.S. Gypsum incurred expenses of \$34.9 million in 1993 with respect to Personal Injury Cases of which \$34.0 million was paid by insurance. As of December 31, 1993, 1992, and 1991, approximately 59,000, 54,000, and 43,000 Personal Injury Cases were outstanding against U.S. Gypsum, respectively.

U.S. Gypsum's average settlement cost for Personal Injury Cases over the past three years has been approximately \$1,600 per claim, exclusive of defense costs. Management anticipates that its average settlement cost is likely to increase due to such factors as the possible insolvency of co-defendants, although this increase may be offset to some extent by other factors, including the possibility for block settlements of large numbers of cases and the apparent increase in the percentage of asbestos personal injury cases that appear to have been brought by individuals with little or no physical impairment. Through the Center, U.S. Gypsum has reached settlements on approximately 26,700 pending Personal Injury Cases for an amount estimated at approximately \$32 million. These settlements will be consummated and the cases closed over a three year period. In management's opinion, based primarily upon U.S. Gypsum's experience in the Personal Injury Cases disposed of to date and taking into consideration a number of uncertainties, it is probable that all asbestos-related Personal Injury Cases pending against U.S. Gypsum as of December 31, 1993, can be disposed of for a total amount, including both indemnity costs and legal fees and expenses, estimated to be between \$100 million and \$120 million (of which all but \$2 million or \$5 million, respectively, is expected to be paid by insurance). The estimated cost of resolving pending claims takes into account, among other factors, (i) an increase in the number of pending claims; (ii) the settlements of certain large blocks of claims for higher per-case averages than have historically been paid; (iii) the committed but unconsummated settlements described above; and (iv) a small increase in U.S. Gypsum's historical settlement average.

Assuming that the Georgine class action settlement referred to above is approved substantially in its current form, management estimates, based on assumptions supplied by the Center, U.S. Gypsum's maximum total exposure in Personal Injury Cases during the next ten years (the initial term of the agreement), including liability for pending claims and claims resolved as part of the class action settlement, as well as defense costs and other expenses, at approximately \$262 million, of which approximately \$250 million is expected to be paid by insurance. U.S. Gypsum's additional exposure for claims filed by persons who have opted out of Georgine would depend on the number of such claims that are filed, which cannot presently be determined.

#### Coverage Action

As indicated above, all of U.S. Gypsum's carriers initially denied coverage for the Property Damage Cases and the Personal Injury Cases, and U.S. Gypsum initiated the Coverage Action to establish its right to such coverage. U.S. Gypsum has voluntarily dismissed the Supporting Insurers referred to above from the personal injury portion of the Coverage Action because they are committed to providing personal injury coverage in accordance with the Wellington Agreement. U.S. Gypsum's claims against the remaining carriers for coverage for the Personal Injury Cases have been stayed since 1984.

On January 7, 1991, the trial court in the Coverage Action ruled on the applicability of U.S. Gypsum's insurance policies to settlements and one adverse judgment in eight Property Damage Cases. The court ruled that the eight cases were generally covered, and imposed coverage obligations on

particular policy years based upon the dates when the presence of asbestos-containing material was "first discovered" by the plaintiff in each case. The court awarded reimbursement of approximately \$6.2 million spent by U.S. Gypsum to resolve the eight cases. U.S. Gypsum has appealed the court's ruling with respect to the policy years available to cover particular claims, and the carriers have appealed most other aspects of the court's ruling. The appeal process is likely to take up to a year or more from the date of this report.

U.S. Gypsum's experience in the Property Damage Cases suggests that "first discovery" dates in the eight cases referred to above (1978 through 1985) are likely to be typical of most pending cases. U.S. Gypsum's total insurance coverage for the years 1978 through 1984 is approximately \$350 million (after subtracting insolvencies and discounts given to settling carriers). However, some pending cases, as well as some cases filed in the future, may be found to have first discovery dates later than August 1, 1984, after which U.S. Gypsum's insurance policies did not provide coverage for asbestos-related claims. In addition, as described below, the first layer excess carrier for the years 1980 through 1984 is insolvent and U.S. Gypsum may be required to pay amounts otherwise covered by those and other insolvent policies. Accordingly, if the court's ruling is affirmed, U.S. Gypsum will likely be required to bear a portion of the cost of the property damage litigation.

Eight carriers, including two of the Supporting Insurers, have settled U.S. Gypsum's claims for both property damage and personal injury coverage and have been dismissed from the Coverage Action entirely. Four of these carriers have agreed to pay all or a substantial portion of their policy limits to U.S. Gypsum beginning in 1991 and continuing over the next four years. Three other excess carriers, including the two settling Supporting Insurers, have agreed to provide coverage for the Property Damage Cases and the Personal Injury Cases subject to certain limitations and conditions, when and if underlying primary and excess coverage is exhausted. It cannot presently be determined when such coverage might be reached. Taking into account the above settlements, including participation of certain of the settling carriers in the Wellington Agreement, and consumption through December 31, 1993, carriers providing a total of approximately \$90 million of unexhausted insurance have agreed, subject to the terms of the various settlement agreements, to cover both Personal Injury Cases and Property Damage Cases. Carriers providing an additional \$250 million of coverage that was unexhausted as of December 31, 1993 have agreed to cover Personal Injury Cases under the Wellington Agreement, but continue to contest coverage for Property Damage Cases and remain defendants in the Coverage Action. U.S. Gypsum will continue to seek negotiated resolutions with its carriers in order to minimize the expense and delays of litigation.

Insolvency proceedings have been instituted against four of U.S. Gypsum's insurance carriers. Midland Insurance Company, declared insolvent in 1986, provided excess insurance (\$4 million excess of \$1 million excess of \$500,000 primary in each policy year) from February 15, 1975 to February 15, 1978; Transit Casualty Company, declared insolvent in 1985, provided excess insurance (\$15 million excess of \$1 million primary in each policy year) from August 1, 1980 to December 31, 1985; Integrity Insurance Company, declared insolvent in 1986, provided excess insurance (\$10 million quota share of \$25 million excess of \$90 million) from August 1, 1983 to July 31, 1984; and American Mutual Insurance Company, declared insolvent in 1989, provided the primary layer of insurance (\$500,000 per year) from February 1, 1963 to April 15, 1971. It is possible that U.S. Gypsum will be required to pay a presently indeterminable portion of the costs that would otherwise have been covered by these policies. In addition, portions of various policies issued by Lloyd's and other London market companies between 1966 and 1979 have also become insolvent; under the Wellington Agreement, U.S. Gypsum must pay these amounts, which total approximately \$12 million.

It is not possible to predict the number of additional lawsuits alleging asbestos-related claims that may be filed against U.S. Gypsum. The number of Personal Injury Cases pending against U.S. Gypsum has increased in each of the last several years. In addition, many Property Damage Cases are still at an early stage and the potential liability therefrom is consequently uncertain. In view of the limited insurance funding currently available for the Property Damage Cases resulting from the continued resistance by a number of U.S. Gypsum's insurers to providing coverage, the effect of the asbestos litigation on the Corporation will depend upon a variety of factors, including the damages sought in the Property Damage Cases that reach trial prior to the completion of the Coverage Action, U.S. Gypsum's ability to successfully defend or settle such cases, and the resolution of the Coverage Action. As a result, management is unable to determine whether an adverse outcome in the

asbestos litigation will have a material adverse effect on the results of operations or the consolidated financial position of the Corporation.

#### Accounting Change

Effective January 1, 1994, the Corporation adopted the requirements of Financial Accounting Standards Board Interpretation No. 39. In accordance with Interpretation No. 39, U.S. Gypsum recorded an accrual of \$100 million for its liabilities for asbestos-related matters which are deemed probable and can be reasonably estimated, and separately recorded an asset of \$100 million, the amount of such liabilities that is expected to be paid by uncontested insurance. Due to management's inability to reasonably estimate U.S. Gypsum's liability for Property Damage Cases and (until the implementation of Georgine is deemed probable) future Personal Injury Cases, the liability and asset recorded in 1994 relate only to pending Personal Injury Cases. The implementation of Interpretation No. 39 did not impact earnings, cash flow or net assets.

#### Environmental Litigation

The Corporation and certain of its subsidiaries have been notified by state and federal environmental protection agencies of possible involvement as one of numerous "potentially responsible parties" in a number of so-called "Superfund" sites in the United States. In substantially all of these sites, the involvement of the Corporation or its Subsidiaries is expected to be minimal. The Corporation believes that appropriate reserves have been established for its potential liability in connection with all Superfund sites but is continuing to review its accruals as additional information becomes available. Such reserves take into account all known or estimable costs associated with these sites including site investigations and feasibility costs, site cleanup and remediation, legal costs, and fines and penalties, if any. In addition, environmental costs connected with site cleanups on USG-owned property are also covered by reserves established in accordance with the foregoing. The Corporation believes that neither these matters nor any other known governmental proceeding regarding environmental matters will have a material adverse effect upon its earnings or consolidated financial position.

#### Item 6. Exhibits and Reports on Form 8-K

- (a) (15) Letter of Arthur Andersen & Co. regarding unaudited financial information.
- (b) There were no reports on Form 8-K filed during the first quarter of 1994.

#### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

USG CORPORATION

By /s/ Dean H. Goossen  
Dean H. Goossen, Corporate Secretary,  
USG Corporation

May 12, 1994

By /s/ Raymond T. Belz  
Raymond T. Belz, Vice President and  
Controller, USG Corporation

May 12, 1994

USG Corporation  
125 South Franklin Street  
Chicago, Illinois 60606

Gentlemen:

We are aware that USG Corporation has incorporated by reference into previously filed Registration Statement Numbers 33-22581, 33-22930, 33-36303, 33-40136 and 33-63554 its Form 10-Q for the quarter ended March 31, 1994, which includes our report dated April 22, 1994, covering the unaudited condensed financial information contained therein. Pursuant to Regulation C of the Securities Act of 1933, these reports are not considered a part of the registration statement prepared or certified by our firm or reports prepared or certified by our firm within the meaning of Sections 7 and 11 of the Act.

Very truly yours,

/s/ Arthur Andersen & Co.

ARTHUR ANDERSEN & CO.