

Dear Fellow Shareholders

We have kept our promises, and a promising future lies ahead.

In 2001, when we filed for Chapter 11, we committed to:

- Sustain our market leadership and operational excellence
- Maintain a strong organization
- Pay our creditors in full
- Gain the best outcome for current shareholders
- Put asbestos behind us, once and for all
- Emerge as quickly as possible, without sacrificing our other goals

Those commitments have been kept. On January 30th, 2006, we announced a watershed agreement that resolves all asbestos-related personal injury claims against USG.

Protecting Your Interests

Our years of effort, on many fronts, have succeeded. Our operations team continued to serve our customers with distinction—and lead our industry. Our finance staff assured that we had the capital required to negotiate from a position of strength. We communicated honestly and forthrightly with all key stakeholders, including shareholders, customers, suppliers, bankers and investors, and all bankruptcy committees. We worked hard to develop a broad, legislative solution to the asbestos crisis. And we succeeded in crafting an agreement that is fair, fast, final and affordable.

The agreement is *fair* for everyone who has a stake in USG. People who suffer from an asbestos-related illness will begin receiving compensation soon after the plan is approved by the courts. All of our creditors will be paid in full, with interest—an amount totaling approximately \$1.4 billion. Employees can look ahead with confidence, secure in the knowledge that our enterprise

“Now the House and the Senate need meaningful asbestos reform and they need to get it to my desk as soon as possible.”

President George W. Bush,
October 26, 2005

“It is a remarkable comeback for the 104-year-old company – and an unprecedented recovery for the stock of a company that is still doing business under protection from creditors.”

The Wall Street Journal,
February 15, 2006

is stable, proud and vibrant. And for the first time ever in a major asbestos bankruptcy agreement, shareholders will retain their ownership of the company.

After nearly five years in bankruptcy, the agreement offers a *fast* resolution. With the approval of the courts and the continued support of key stakeholder committees, we could leave Chapter 11 as early as July of this year.

When the agreement is approved, we will gain a *final* settlement of our asbestos personal injury liability. We will be able to put the issue behind us once and for all and avoid the uncertainty of lengthy, contentious bankruptcy litigation.

The agreement is *affordable*. We will finance it using funds from a number of sources, including our existing cash balances and a rights offering.

Our record-setting operating performance over the past five years has enabled us to set aside almost \$1.6 billion in cash, which provides a substantial portion of the capital required.

We plan to raise \$1.8 billion in new equity through a rights offering to our stockholders, who will have the opportunity to purchase one new share of stock for each share already owned. A backstop agreement will assure that we receive the full amount.

Under the terms of the agreement, the final amount we will pay depends on the fate of the Fairness in Asbestos Injury Resolution Act, commonly known as the FAIR Act. The Senate debated the legislation in February of 2006, but an effort to overcome a technical issue related to the Act failed by one vote, stalling the legislation.

When our plan of reorganization takes effect, we will pay \$900 million into a special trust that would pay all asbestos personal injury claims against U.S. Gypsum, now and in the future. We believe that \$900 million is an equitable settlement.

If the FAIR Act, which calls for the establishment of a \$140 billion national trust fund to pay asbestos victims, is passed and signed into law by the President, \$900 million is all that we would pay. Our trust would be consolidated into the national trust fund, and we would owe nothing more.

If the FAIR Act fails, we are obligated to make two additional payments totaling \$3.05 billion to our personal injury trust. Although it is a large sum and does not accurately reflect what we believe to be our true liability for asbestos, we are able to fund it, and doing so provides a clear path toward leaving Chapter 11 with our shareholders' equity largely intact. Should the two payments become necessary, we will raise about \$1 billion in new debt financing and add it to the funds raised by the rights offering. Making the full \$3.95 billion contribution to the trust will result in a tax refund of about \$1.1 billion, which will also be used to fund the agreement.

We are speaking with representatives of property damage claimants, but as of now, property damage claims are not a part of the agreement. Property damage claimants will retain the rights to any valid claims that remain unresolved when the bankruptcy is concluded.

In the days and weeks ahead, we will continue to work to win passage of the FAIR Act, which we have actively supported from the beginning. It is good for USG, good for the country and good for people who suffer from asbestos-related illnesses. Yet even if the Act does not become law, the agreement to resolve our bankruptcy is one of the most significant events in our 104-year history. And it tops a year of stellar performance—one of the best we've ever had.

A Record-Setting Performance

Just as our restructuring team has worked to do what's right for our shareholders, creditors and asbestos claimants, our operations team has made tremendous progress in serving our customers and preparing for the future.

The U.S. housing market remained strong through the end of the year, and housing starts reached the highest level since 1972. Our long-term strategies of investing in low-cost manufacturing and expanding our distribution business enabled us to meet the demand. After topping \$4 billion for the first time in 2004, our sales rose 14 percent to a record \$5.1 billion in 2005. We shipped a record 11.3 billion square feet of wallboard, up three percent from 2004. We also shipped record volumes of joint compound and FIBEROCK products. L&W Supply, our distribution company, achieved double-digit gains in both sales and profit. Sales in our worldwide ceilings business increased three percent, with much of the gain coming late in the year.

USG achieved record sales of more than \$5 billion in 2005.

Net earnings for the year reached \$510 million before the impact of a \$1.9 billion after-tax charge associated with the bankruptcy settlement and an \$11 million after-tax charge related to the adoption of a new accounting standard. After the charges, we reported a net loss of \$1.4 billion for the year.

Building the Enterprise

Even in the midst of Chapter 11, we never stopped working to improve our products and build our enterprise. In fact, since 2001, we have invested more than \$500 million to build the most productive and profitable operations in the industry. Improvements include new DUROCK cement board lines in Baltimore and Monterrey, Mexico, and new joint compound lines in Phoenix, Jacksonville and Baltimore. Expansions to our Aliquippa, Pennsylvania, and Jacksonville, Florida, facilities add more than 100 million square feet of new, low-cost wallboard production capacity. Upgrades to our Bridgeport, Alabama, facility created the fastest wallboard line in the world, capable of producing more than a mile of wallboard in less than 10 minutes.

The investments we have made have dramatically improved our operating performance—our wallboard lines are now running an average of more than 40 percent faster than they did five years ago. High-volume, low-cost production provides a critical strategic advantage. It gives us the flexibility needed to be successful across market cycles—we can meet market demand during peak periods and we can weather the storm during the low points of the cycle.

We continued to build our operations in 2005. In February, we announced plans to invest about \$130 million to modernize and upgrade our Norfolk, Virginia, wallboard plant. When the work is completed by mid-2007, it will more than double the plant's capacity. In September, we announced construction of a new, state-of-the-art wallboard plant in Washingtonville, Pennsylvania. Scheduled to begin operations in 2008, it will produce approximately one billion square feet of wallboard annually, while also setting new standards for environmental responsibility. The plant will produce wallboard using recaptured gypsum, utilize 100 percent recycled paper, recycle 100 percent of its production waste and operate with zero discharges into nearby waterways.

When it is completed in 2008, the new wallboard plant in Washingtonville, Pa., will serve New York, Philadelphia and other important East Coast markets.

The new Washingtonville wallboard plant will use 800,000 tons of recaptured gypsum per year produced by the scrubbers on a nearby power plant.

We also have continued to build our distribution business. Today, working under a number of locally recognized names, L&W operates more than 200 locations, and is the only specialty distributor with a national presence.

The expansion of our production and distribution facilities is part of our long-term mission to “Find a Better Way”—and continuously improve every aspect of our performance. We are especially proud of our safety performance, which remains one of the best in our own—or any—industry. In fact, 36 of our manufacturing plants achieved a perfect safety rating in 2005.

A New Chapter

Now, with the end of Chapter 11 in sight, we are ready to open a bright new chapter in our history. USG has a long tradition of leadership, and leadership remains our objective today. We will achieve it by focusing on customer service and operational excellence.

The loyalty and support of our customers, some of whom have done business with us for generations, have sustained us during Chapter 11. We’re continuing to strengthen those relationships and build new ones with new products for new markets.

SHEETROCK is already one of the best-known brands in the country. New marketing efforts are strengthening our brands even more. A new multi-year title sponsorship agreement with NASCAR puts our major brands – SHEETROCK, DUROCK, FIBEROCK and DONN - in front of thousands of our customers and millions of viewers around the world.

We want to be known as a company that’s easy to do business with. We are continuing to implement an enterprise-wide software system, called LinX, that will connect all of our operations, reduce costs for USG and our customers, and provide better, more timely information. The new training and quality programs at our customer service center are allowing us to provide the “one-and-done” service that customers are looking for. Our industry-leading Web site provides a variety of tools to help customers easily design with and specify USG products.

Thirty-six manufacturing plants earned a perfect safety rating in 2005.

USG signed a multi-year agreement to sponsor the SHEETROCK 400 and the DUROCK 300 races. NASCAR has more than 75 million fans and is the No. 2 rated sport on television.

In 2005, United States Gypsum Company shipped enough wall-board to build 1.3 million homes.

Innovative products give customers even more reasons to do business with us. In 2005, we launched a number of new products that round out our product lines and expand our share of houses and commercial buildings. Created for commercial applications, new SECUROCK brand roof board offers superior fire, wind and moisture resistance, greater versatility and less environmental impact than conventional products. We expanded our line of DUROCK products with new mortars, mastics and grouts that help contractors deliver high-quality tile installations. A new family of LEVELROCK poured self-leveling cement underlayments, designed for flooring applications, was named one of the Top 100 Products of 2005 by *Buildings* magazine.

Looking Ahead

With leading brand names, leading market shares, and industry-leading production and distribution operations, we can look ahead with confidence. Toward the end of 2005, the housing market began to show signs of cooling, but we expect it to remain strong by historical standards. We are ready, with a plan for all seasons. If demand slows, we have the option of idling or retiring older, higher-cost operations. We are committed to outperforming our competitors at every point in the cycle.

We will continue to invest for the future. Along with adding to our low-cost production capacity, we will continue to grow L&W's distribution network. We have commissioned a new ship to carry gypsum from our mines to our plants. Later this year we will begin to move into a new headquarters in Chicago, which will aid efforts to control costs and improve productivity.

We will continue to strengthen our service and our customer relationships. We will complete the implementation of our LinX system and intensify our quest for innovation. In addition to extending our current product lines, our Research and Development staff is exploring a number of new product innovations, as well as breakthrough technologies that could revolutionize wallboard and ceilings production.

We also will continue to build the best team in the industry. Increased emphasis on skills training and leadership development programs is helping to prepare the next generation of USG's leadership. A number of organizational changes further strengthened our team. As the new president of USG Corporation, Jim Metcalf will lead our continuing pursuit of operational excellence by overseeing all of our North American operating subsidiaries. Ed Bosowski is now directing our overall growth plan and strategy, as well as our international operations. We also have added further experience to our board of directors with the election of Steven F. Leer, chairman and chief executive officer of Arch Coal, Inc. With the exception of myself, all of our directors are independent as defined by both USG and NYSE standards.

In protecting the interests of shareholders throughout an asbestos-related restructuring, while leading our industry, we have achieved something few, if any, companies have ever accomplished. This singular achievement is the direct result of staying focused on our goals and true to our convictions. It is a credit to the hard work and resolve of all of USG's 14,000 employees, not just over the past 12 months, but over the past five years. They all have played a role and applied their strength to carry us through uncertain times. No one could be more proud of or grateful for what they have accomplished. For the record, however, I would like to single out Stan Ferguson and Rick Fleming for their valued counsel and untiring efforts to find a principled solution to an extraordinary challenge. USG—and I—owe them our deepest thanks. Your company is stronger than ever before. The path ahead is clear. We are moving forward.



William C. Foote

Chairman and Chief Executive Officer

February 24, 2006

"It's the most successful managerial performance in bankruptcy that I've ever seen."
Warren E. Buffett, Chairman of the Board, Berkshire Hathaway Inc.
The Wall Street Journal,
February 15, 2006