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EDITED TRANSCRIPT

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THOMSON REUTERS

CORPORATE PARTICIPANTS

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PRESENTATION

Pete Lisnic *- RW Baird - Analyst*

Well, why don't we get started? My name is Pete Lisnic. I cover building products here at Baird. Our next presenter today is USG Corporation, North America's leading manufacturer of gypsum, wallboard, and related products. The company also manufactures building ceiling systems, and operates a specialty Building Products Distribution business which delivers USG and third-party products to directly to the construction site. With us today, with the Company Mr. Jim Metcalf, Chairman, President, and CEO. Jim is going to be presenting, and then to highlight is Mr. Ken Banas who will be helping. He is the treasurer of USG. So Jim, it's all yours.

Jim Metcalf *- USG - President, Chairman, CEO*

Thank you. It's great to be here. I welcome you to our city of Chicago. We've been based here for 111 years, and we're proud to have everyone sifting our fine city. What we want do over the next few minutes is talk about USG Corporation. And those of you that know us you probably know our Sheetrock brand is one of our industry-leading brands but we're more than wallboard. As you heard in the introduction, we're in building products, distribution, we now have an international footprint which we'll touch on in a few minutes, but I like to say USG Corporation, we build shelter. It's where people live, work and play in the environment.

Over the last few years, the last five years we've done through a very tough time in North America. We've done through, as I like to refer to it as a small-d depression, and we felt it was very, very important over the last five years is to lower the breakeven of the corporation and position the Company for growth. We thought during that time we were not waiting for the housing recovery. We felt we had to create our own recovery as a corporation by not only lowering our breakeven but looking at ways to organically grow our business.

So we are in the early phases of recovery. This is why we titled our -- our talk this good afternoon on building the recovery into the future. As you can see, these are the typical cautionary statements that I'm not going to ask you to read all of those, but that is for you to note.

For those of you that listened into our third quarter earnings, we had a very strong third quarter. Our revenue was up, sales, our units on wallboard we outperformed the industry. We were up approximately 14%, for numerous reasons. One was because of our innovation of UltraLight. We had positive operating profit and at the third quarter in a row of positive net earnings.

We have worked very digitally over the last five years, as I said, of lowering our breakeven. The breakeven for USG Corporation going into the recession was approximately 26 billion feet of industry shipments. We've lowered our breakeven to approximately 17.5 billion feet of industry shipments. Right now the industry's running at about 20 billion feet. So we've been very focused on growing our business and lowering our breakeven.

We do feel that the overall dynamics as we're starting to early of the recovery are moving to the mean. That's led by demographics and GDP growth. We operate in all three segments. We are not a housing play. Housing is approximately 25% of our portfolio. So when you think of USG Corporation, housing is only part of the story. New commercial is another 25% of our portfolio and then repair and remodel both residential and commercial make up 25% respectively of each one of those segments.

The issue that we had going into the recession is each one of these segments had a tremendous downdraft. Those of you that follow our Company you can say it was almost a perfect storm with housing, repair and remodel, and commercial taking very negative numbers down. For those of you that don't follow R and R, residential R and R never had a down year year-on-year and those numbers have been tracked since 1958. So we really did go through a tough patch, but we did believe that the overall demographics of the US -- we feel that the long-term mean we will be returning those levels in the planning period.

Our strategic priorities that we set forth for the Company are very simple. Strengthen, diversify, and differentiate. When we talk about strengthening our core business, that is our North American manufacturing and distribution companies. We manufacture, as you know, Sheetrock, wallboard, Joint Treatment, ceiling tile, grid, our distribution arm, which is called L&W supply, is the largest specialty dealer in North America and they -- L&W distributes not only wallboard, but steel stud, commercial insulation and seven core products that are primarily focused on the commercial business. So strengthening that core business has really been our number one priority over this recession that we are coming out of.

We also took a look at our strategy of diversifying our earnings. What we did is we wanted to position the Company of what USG looks like in the next trough. A lot of us look at when the next peak is going to be, when we get back to those historic means that I just showed you. But we really wanted to look ahead of what we look like in the next trough. Wallboard capped a very long shadow, both negatively and positively on our results and we felt we needed to diversify our earnings, so when we had that next trough, we had critical masses outside of some of our core businesses. And that was with adjacent products that we wanted to expand our product portfolio, but what most recently, the breaking news is select emerging markets.

The third area, differentiating through innovation has been really, really critical over the last five years. We made the strategic decision to continue to invest in innovation. Innovation really got us to the other side of this recession. We came out with and industry and a revolutionary product called Sheetrock brand UltraLight Panels. These panels are a third lighter. It was revolutionary to the industry and we came out in the middle of a recession with a product that really gave our customers something to talk about. It allowed our customers to sell more product but it also allowed our customers to put more profit to their bottom-line. So innovation has been really critical for us, and quite frankly innovation brought us to our strategic joint venture with Boral, which I will comment on in a moment.

So we talk about strengthening the core. We had to make some very hard additions. We took out wallboard capacity, almost 4 billion feet of wallboard capacity, 15 wallboard lines. We idled our paper mills. We really focused on lowering our breakeven, as I indicated earlier. Our distribution company, we reduced the footprint of distribution. We closed over a hundred branches, but more importantly we focused the distribution company more to the commercial contractor and where we can get a larger share of wallet. We closed our mining quarries and had a workforce reduction. As you can see, it was over $0.5 billion dollars of reductions where it's very critical for us to continue to keep the breakeven very low at the Company and to provide as much leverage going forward as possible.

We talk about diversifying our earnings. We felt we need today build critical mass outside of our North American businesses. We have not taken our eye off the ball in North America. It's very critical market for us. We're going to continue to grow in North America. As I said we're in the early stages of the recovery, but we felt we needed to have to diversify our earnings, not only the quantity of earnings, but also the quality of earnings of where they're coming from.

Those of you that follow us you know that we divested our European business 24 months ago. We felt that European business was going to be less valuable in five years than it is now and we had a very successful divestiture of Europe. And we made a strategic investment with a company called Boral which we're bringing technology to and industry-leading company that has a 40% market share and you can see in some very high growth markets throughout the world.

For those of you that just to bring you up to-date on Boral, it is a financial success for us. It is accretive right out of the gate. It's NPV-positive, that's balance sheet neutral at best. We are bringing our technology to a company that has a number one or number two position in the fastest growing market, construction markets, in the world. If you take China and India out of the formula, which we're going to be operating now in 12 new countries, you take China and India out, there are 500 million people in our trading area that we'll be able to grow our business with our joint venture with Boral.

What it did -- one thing we're bringing to this joint venture is our leader in innovation. We have talked about differentiating rating innovation. I touched on our UltraLight Sheetrock Panels, but we also started in 2009 with taking the weight out of many of our products. I like to refer to this as our UltraLight portfolio. It's just not one product all the way from cement board through a product we introduced this year which is called Mold Tough which is really important product when you're in high humidity areas throughout the world.

We're going to continue to innovate in lightweight. It's very important for our customers. This is what our customers said they need. It's very important for labor. Labor rates in the United States are very high. At commercial construction labor rates, a drywall hanger in the city of Chicago makes $72 an hour. In New York City they make over $100 and hour. So when you have a product that's lighter that they have more productivity on the job site, the labor savings are tremendous.

When you go into other parts of the world we're talking about our joint venture in the Far East, performance is very important. So our lightweight portfolio also has anti-sag characteristics so we're in parts of the world where humidity is very high, construction practices have open windows. They close -- or they hang the product before the buildings are closed in so the performance of this product is exceptional in this new part of the world that we're going to be working into.

Our balance sheet as we look forward is very, very important. One of our strategic imperatives -- strengthen, diversify and differentiate. It's really important for us to de-lever our balance sheet. We came out of the recession and after coming through a tough, and we feel that we want to really focus the next few years on getting to investment-grade metrics.

So we're focused. We have a balance sheet that we feel between now and 2016 is flexible for us, we think we're going to have some positive results. We just did a bond offering last week to help underwrite our Boral investment and we're quite excited to say we had a five handle on our $350 million offering that we got last week. So we're extremely focused on our balance sheet and that's something that we take seriously every day.

So with that, I just wanted to wrap up with USG. As I said, we're a company that provides shelter. We're going to continue to strengthen our balance sheet. We're going to strengthening the core of our business. We feel that innovation got us to the party with this very exciting joint venture in a parts of the world that has the fastest growth construction practice are going towards western construction practices and this will help us balance our portfolio as we get into the next trough.

So with that I would like to open it up for a few questions here from the group and then we will have a brief breakout session for those of you that are interested in getting into more detail of what we have shown you today.

QUESTIONS AND ANSWERS

Pete Lisnic - *RW Baird - Analyst*

Jim, I'll start. Can you -- I know you talked about it a little bit on third quarter call, but as you look to 2014 and maybe 2015 can you give us a little feel for what you're seeing in terms of your end markets both on res and non-res and international versus North America? And then maybe if you can also give us a little bit of insight into something that is perhaps a bit underappreciated in the model as we look to demand environment that continues to get a bit better.

Jim Metcalf - *USG - President, Chairman, CEO*

Let me start off with the latter, the underappreciated in the model. I think when you look at our portfolio, our ceilings business has been a true superstar through this recession. The ceilings business has had flat topline sales but the bottom-line has been very robust through this recession. We repositioned the ceilings business five years ago to really focus on commercial repair and remodel because everyone in the room knows what happened to the new commercial. And the commercial repair and remodel business has been a business that margins are solid and we really took a lot of the building standards to a higher performing products.

We also had a focus on our ceilings business in the big box retailers. Really repair and model is also big in those outlets, and our ceilings business has done very, very well through the big box retailers. So when you talk about our Company there's always been a discussion on wallboard and what the dynamics are of capacity utilization, but through this recession our ceilings business has been very, very successful and it needs some velocity in the topline.

So when you feel that commercial becoming coming back and we think that new commercial is still around 24 months away, we are a little pessimistic on new commercial, but that will continue to help the velocity of the ceilings business.

If you look at the look into 2014, we're optimistic. We're coming off of some very low levels. As I said, the industry, the wallboard industry demand in the United States bottomed out at about 17.5 billion square feet. This is when the industry was shipping at the peak at 38 billion, 39 billion square feet. So at 17.5 billion square feet this year, the industry will ship about 20.5 billion square feet and we think 2014 is going to be better.

And it's really led by three areas. Housing. Housing is getting better. You aren't going to see 1.5 million housing starts next year and pick your housing number we have a metric that I think is very, very useful. For every 100,000 housing starts, there's approximately 820 million feet of overall demand. So for every 100,000 is 820 million feet of overall demand. So you can kind of whatever you perfect your housing numbers if you're at the low end of a 900,000 or high end of 1.2 million for next year, every 100,000 you can put that into your model.

Commercial, as I said, is still coming offer some pretty low numbers until employment really starts getting some robust numbers real employment with the 200 in front of it we think new commercial is going to be punky. The best market that we see in North America right now particularly United States is residential and commercial repair and remodel. If you look at Home Depot comp store growth, they're low double digits. We're starting to see some nice positive traction through the big box retailer. That's very important for us because we have a pretty large market share in that segment.

So repair and remodel is the best part of the market that we see in 2014 and beyond. Housing kind of pick your number, but it's getting better but still from some very low numbers, and new commercial still has a way to go.

Pete Lisnic - *RW Baird - Analyst*

Okay. So if we could talk about wallboard and pricing a bit since you alluded to it there. The industry is at 20.5 billion square feet this year the pricing that's associated with that is markedly higher, correct? So you're at $154 or so per 1000 square feet, right? So as we go from 20.5 billion square feet to 25 billion to 30 billion square feet, a more normal environment and you're already relative to a peak of $180 per 1000 square feet, right? How should we think about the incremental leverage in the wallboard business as we go from 20.5 billion square feet to 25 billion square feet or maybe even 30 square feet?

Jim Metcalf - *USG - President, Chairman, CEO*

Well, increased volume is very good. So.

Pete Lisnic - *RW Baird - Analyst*

Right.

Jim Metcalf - *USG - President, Chairman, CEO*

I mean the good news that we are taking about how much volume is going to go through the system.

Let me just kind of step back for those of you that don't know what we did through this recession. We had to do a lot of different thing to get through the recession. We had to think differently. And one of the things that was broken in our mind was how we priced our wallboard products. And the reason we thought that is our customers thought that and they told us we had a lot of billing errors. We would have three or four price announcements during the year. None of them would catch. Some of them would catch. Even in 2006 when the market was very, very strong there were times, we will only get $3 and $5 dollars a quarter on price improvement.

So we really went around three years ago and said to our customers, what could we do differently? And what the customers said is give us some certainty for the year. So we can plug-in our costs, meaning our customers' costs for the year, and then we wouldn't be having a constant discussion on where wallboard price is up or down or sideways. That was different for us to think about okay, one price for the year, but we were in a very soft market.

The other thing that we said was the job quoting was very toxic for us. We had a lot of job quotes out there. This is left over from when business was very good and you have to quote a high-rise where it takes three years to build it, but there weren't a lot of large jobs. So we came back to our customers and said okay, if we have one price for the year, we would like to eliminate all job quotes. So you can quote your jobs but you're going to know what your cost is for the entire year.

So that was now two years ago from where we sit today and we weren't sure how it was going to work because business was still at 17.5 billion square feet as an industry, and we were quite surprised the customers really grasped it. It was the first six months there was a little uncertainty, so the first year it worked really well. We got price improvement that year. It was one price for the year. Job quotes were eliminated. Billing errors were eliminated. A lot of customers didn't have to have a big back-office staff to eliminate all the mis-billings and so the first year we chalked up to success.

We did it again for 2013, at the end of the 2012. We got through 2013 and price for the year we came in as we said it's $154, $153, $154 and it's been pretty steady throughout the year for this year. So chalk it up to success two years in a row, and what our customers told us really beginning of the summer, they said for 2014 we really -- you're going to continue that policy. It makes us more efficient as a customer, it takes the uncertainty out for us. So we are planning the same program for 2014.

If you look at the question of historical highs, we peaked from a realized selling price in 2006 at $188. You may say well, okay, well, $154 now, $188, but $188 again with if you just put 1% inflation per year, as a low $200s right now. So we have a -- we have some tract to go. We're still in some -- a low utilization. We still, housing starts are around 1 million starts. We still had some low utilization rates. But we feel that the pricing strategy works for our customers, it works for us and we're quite pleased the way 2014 is going to shape out.

For those of you that are interested in a little deeper dive if it's on our North American portfolio we're very excited about our JV with Boral. That's something that just looking at a few pieces of paper, you may want a little more information. We would be more than happy to share that with you. We're going to be meeting --

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Pete Lisnic - *RW Baird - Analyst*

Before you do that I would like to actually ask one more question.

Jim Metcalf - *USG - President, Chairman, CEO*

Sure.

Pete Lisnic - *RW Baird - Analyst*

That's just on the extensive landscape we've seen one asset move there's been some consolidation in that wallboard space. You've got what, six or seven primary players there. Do you foresee more industry capacity rationalization as we kind of go through the middle part of the cycle here? And if so, what does that mean to the return profile and the pricing power of that wallboard business?

Jim Metcalf - *USG - President, Chairman, CEO*

If you look at the last three recessions going back from the early 80s to most recent, we started out in the early 80s with about 16 competitors. And typically the first 24 months in a recovery, consolidation happens and it's the last three it's happened. And we're starting to see it now. Two competitors changed hands in our industry, both Temple and Lafarge traded assets. They were some of the smaller single digit players. They have now been rolled up into the industry and now the industry is under eight players now.

We feel that there's some more consolidation that could happen. There's some regional players, there's some players that -- wallboard quite frankly is not core to their business and I think that will all depend on what the multiples look like going forward. The consolidation of our industry, I think has been positive, and we feel there's going to be more of it going forward.

To speak of incremental margins, we feel that more importantly it's going to be the continued growth of the industry. We feel the next three to five years we're still very early in the recovery. We truly believe there is a recovery and if you look at just the overall demographics, we are not going to be the next five years with just 1 million housing starts. Housing is going to slowly recover. You are going to start seeing a little bit of traction on commercial, and at the end of the day we're very robust and repair and remodel.

So I think more of the leverage comes influence keeping your breakeven low. We aren't done with continuing to take cost out of our system. In fact, in the third quarter we ran our manufacturing facilities -- we had the most efficient productivity we've had in ten years even when the industry was -- and we were at full out capacity. So we have learned how to run our facilities very efficiently, taking costs out, but also growing our business through some of our adjacent products that fall right to the bottom-line.

So industry consolidation, we know that is happening over here. We're aware of it. There could be some strategic areas that we may be interested in, not a strategic player because we look at our overall network, but we keep our eyes open for some strategic opportunities for us here in the United States.

Pete Lisnic - *RW Baird - Analyst*

Okay. We'll stop there. There will be a breakout session right outside the room. Thank you, Jim, thank you, Ken.
