

Dear Fellow Shareholders

Few business enterprises endure 100 years. Fewer still lead their industries for such an extended time. I am proud to say that United States Gypsum Company soon will be joining that distinguished group, even if our 99th year was one of the most challenging in our long history.

In 2001, we faced excess capacity in the gypsum industry, experienced a slowdown in demand for ceiling products and began working through a Chapter 11 restructuring. Yet despite these challenges, we continued to build enterprise value. We shipped record amounts of SHEETROCK brand drywall and joint compound products. We increased our share of the drywall market. We surpassed our ambitious overhead reduction goals. And we continued to prepare for the future.

We expect it to be a future that is free of asbestos litigation. Our June 25th filing for Chapter 11 protection had nothing to do with our performance. We did it only to protect our assets, to stop paying the asbestos costs of other companies and to begin to put the issue behind us, once and for all. Thanks to the hard work of our employees, we achieved those goals – and made a soft landing. Our plants kept running, often at full capacity, and we continued to serve our customers.

We didn't miss a beat. For both our customers and the vast majority of our employees, it has been business as usual, just as we promised it would be. Open, forthright communications with our customers, employees, investors and suppliers helped us keep their trust and confidence, a key factor in our ability to move forward.

We were equally successful in addressing the challenges of a tough market. For more than a year, excess capacity in the industry has put intense pressure on wallboard prices, reducing them to an average of \$85.67 per thousand square feet in 2001, compared to an average of \$130.61 per thousand square feet in 2000. Then, a weakening economy and the terrorist attacks of September 11th reduced consumer confidence to a seven-year low and drove down demand for construction products.

Leading the Way

But we have seen tough times before, and we know how to handle them. We intensified our efforts to cut overhead, reducing expenses to \$279 million in 2001, a 10% reduction. We cut capital expenditures to their lowest level in seven years and pursued the sales of assets that are not vital to our business. We continued to shut down excess capacity by closing approximately 2 billion square feet of older, higher-cost production since 1999. We also optimized our new production capacity, consolidating our position as the low-cost producer.

So even though the course was rocky, we continued to outdistance our competitors. At 90%, our capacity utilization rate, a major determinant of profitability, was an estimated 12 points higher than our competitors' rates. We remained profitable, unlike many companies in this industry. We reported net earnings of \$16 million, even after bankruptcy-related expenses and other special charges. In an inherently cyclical business, we are leading at every point of the cycle – both the troughs and the peaks.

Our ability to lead the way through a downturn rests on the strategies we have followed since the mid-1990s. The five new plants we have opened in the U.S. since 1999 equip us to succeed in good times and bad. We have 3.4 billion square feet of new, low-cost wallboard capacity, which is crucial to maintaining our profitability in a buyers' market. The "Next Generation" SHEETROCK panels we introduced in 2000 offer measurably greater value. A single gypsum and ceilings value offering and an integrated salesforce brings all of our products to more of our customers. New FIBEROCK underlayment and sheathing products will help us win a larger share of construction budgets. L&W Supply has grown to become the leader in its market.

Now we will reap the benefits of these investments. Our goal, as always, is profitable growth. But today it is vital. To build our business, fairly compensate our creditors, reward the loyalty of our current shareholders and resolve the issue of asbestos, we must increase our enterprise value. We did it in 2001. We must continue to do it, year after year.

Keeping Our Promises

Keeping that promise means keeping our focus. We cannot control the tort litigation system, the demand for our products or the prices paid for them. So we are focusing on what we can control: our customer relationships, our costs, our continued growth.

Our operating plans accentuate the profit in profitable growth.

All of our businesses will intensify their focus on customer satisfaction. At the same time, our gypsum business will not let up its cost-reduction efforts. While we have made a great deal of progress, we think we can wring even better performance from our new production capacity. Lowering our costs even more makes us an even stronger competitor. Although the gains will be harder to achieve, we'll continue to build our market share – but not at any price. Our long-term strategies call for us to continue to prune operations at older facilities and profitably scale production to the level of demand.

The drop in new commercial and office construction hit our ceilings business especially hard. But we are not waiting for an economic recovery to improve our performance. We plan to strengthen our dealer network, concentrating on the most productive relationships. We also plan to optimize the single, integrated drywall and ceilings salesforce we created at the end of 2000. Uniting our U.S. sales teams hasn't been easy – it took more than a year for us to complete a similar move in Canada – but as our Canadian experience shows, any short-term pains are far outweighed by the gains. Our service is now more comprehensive, cost effective and convenient than ever. After months of training and preparation, we are beginning to see the results of this effort, and we expect to see more.

Our international ceiling operations are being rationalized. We scaled back a production facility in Europe and closed our construction metal and ceiling grid plants in the Czech Republic and Taiwan. Whether it means fixing, merging or closing our international facilities, we will do what is necessary to improve our results.

With 180 centers, L&W Supply has become a preferred source for high-quality construction products and reliable "last mile" logistics services. We continue to improve the portfolio of operating locations, opening new centers in attractive locations and closing those that fail to meet their objectives. We will continue that strategy. Highly selective acquisitions will focus on the best opportunities.

We also are looking at new ways to improve the productivity of our delivery vehicles and other assets.

Building Value

Profitable growth – building value – is of paramount importance, and we'll leave no stone unturned. But we will not do it at the expense of our customers. While we have historically enjoyed strong relationships with our customers, we will never take them for granted. We believe that there is always room to improve our service, and the extensive survey we conducted in 2001 tells us how. A new enterprise resource planning system, which we are now beginning to implement, will link our operations and improve the way we process transactions. New services, including job training, safety training and recycling services, will add to our value and deepen our relationships with dealer partners and contractors.

Neither will we overlook the future. Even in tough times, we are planting the seeds for tomorrow's growth. We are building a new DUROCK cement board plant in Baltimore. A new joint venture with Knauf – Knauf/USG – creates Europe's largest supplier and distributor of cement board systems for interior and exterior construction. We gain new technology that conforms to European building standards and, potentially, much stronger ties to the European market. In the U.S., we will continue to roll out new FIBEROCK gypsum fiber products. Although our FIBEROCK sales have not grown as

fast as expected, we are confident that these products will help us build a profitable new franchise in our market. We also are looking ahead to the next generation of process technology, which promises dramatic increases in productivity.

Long term, our prospects are promising. Our products are of the highest quality and help fulfill the basic need of shelter. SHEETROCK is one of the best known and most highly respected brands in the business. Our production capacity – our entire infrastructure – is the most productive and profitable in the industry. We enjoy all of the benefits of market leadership. The long-term fundamentals for construction markets are solid. Housing remains strong, and more than half of the office space in the U.S. is more than 20 years old, which should strengthen sales in the repair and renovation market.

The Challenges Ahead

The challenge is to get from here to there. The months ahead will test our leadership.

We expect little, if any, improvement in our markets. The commercial construction market will remain weak. Housing starts and the demand for drywall are likely to decline. Excess capacity will continue to be a challenge until there is a better balance between supply and demand.

What's more, we are entering a new, more challenging phase of the Chapter 11 process. We and the creditors' committees now will attempt to determine how much each of the stakeholders should receive. It is a difficult process that may well stretch beyond 2002, but we intend to keep working toward the same goals we have had from the start. We want to fairly compensate legitimate asbestos claimants, repay our suppliers, bankers and other creditors, and protect the interests of our current shareholders. We will extend our leadership by serving customers and maintaining operational excellence. We will work to retain the people who are the strength of our organization. We intend to put asbestos behind us once and for all.

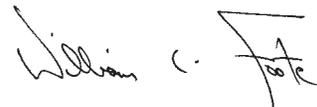
At the same time, we will continue to take part in efforts to work for a legislative solution to the asbestos litigation crisis, which has now driven close to 40 companies into bankruptcy and threatens scores of others. We also will continue to practice the credible, honest communications that have sustained strong relationships with customers, suppliers, investors and employees.

Frankly, in a situation like ours, little is certain. We are confident that we can manage our way through the slowdown in our markets – that is not in doubt. But it is impossible to predict when, or how, we will emerge from Chapter 11, or what the recoveries for our many stakeholders will be. In such circumstances, the only thing that's certain is that our profitability – our bottom line performance – counts more than ever.

To continue to build our value, we must be prepared to adapt and change – everything, except our basic beliefs. In honor of U.S. Gypsum Company's 100th birthday, which we will celebrate in May 2002, we have collected comments about the company from employees, as well as from customers, suppliers, neighbors and friends. Each comment offers a uniquely personal perspective on the evolution, culture and strengths of the enterprise. Together, they portray a values-based organization that has long been committed to safety, quality and integrity – and to finding the better way.

We will maintain and nurture those values because they have helped us navigate one of the most tumultuous centuries in human history. Because they have helped us build enduring relationships, with one another and the people we do business with. Because they make us what we are: the leader.

We are focused on building value. We have strong values. Most of all, at every level, we have outstanding people. I am proud and grateful to report that tough times have brought out their best. And with their continued loyalty, perseverance and determination, I am confident that we will move forward into a second century of growth.



William C. Foote
Chairman, CEO and President
February 14, 2002