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EDITED TRANSCRIPT

USG - USG at CL King & Associates Inc Best Ideas Conference

EVENT DATE/TIME: SEPTEMBER 12, 2013 / 2:00PM GMT

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PRESENTATION

Jim Barrett *- CL King & Associates, Inc. - Analyst*

Good morning, everyone. I am Jim Barrett. I am the building material analyst at CL King, and I have been following USG since 2004. So we are happy to have them back. We have Matt Hilzinger who is the CFO; Matt Ackley, who is the director of investor relations; and Ken Banas, who is the treasurer. So, welcome, and it is all yours, Matt.

Matt Hilzinger *- USG Corporation - EVP and CFO*

Thank you, Jim, and thanks for the CL King team. We appreciate everybody being here. And, clearly, those that are listening on the phone, thank you for your interest as well.

When you look back over the last few years, we really been focused on creating our own recovery at USG. And, clearly, things are getting better for the Company and the economy. And the theme now for the Company is building on the recovery. We have done a lot of work, and we are now in a position that we can play some offense and not just defense.

But before I get into the balance of my presentation, I just want to have everybody read the cautionary statements so everybody is clear. The actual conditions may differ from management's expectations, so please read these fully for all of the necessary details. Thanks.

USG is an 11 -- 111-year-old Company. We aren't just a wallboard Company. We are not just a building products Company. We provide shelter where work, live, and play. That is how we think of ourselves. We have 75 production facilities throughout the world. We are an international Company focused on select parts of the world; China, the Middle East, and India in particular. And I will spend a little bit of time talking about those initiatives later on in the presentation.

We have very strong positions in Canada, Mexico, and the US. We are number one or number two in North America in ceilings and grid, wallboard surfaces, and substrates as well. But USG not only manufactures product, we distribute product as well. L&W is the largest building products distribution company in the United States, with coverage coast to coast with 145 locations. USG plays in both the residential and the commercial markets, split about 50-50.

Just a few comments on our financial performance. And I know this is a little bit dated, but it is -- these are the financial results at the end of our second quarter. So I hope everybody had a chance to at least listen in or take a look at the transcript from our second quarter earnings call at the end of July.

In the second quarter, we marked our second quarter of net income, earning $26 million of adjusted net earnings. That is two quarters in a row of net earnings. We would like to think that is a trend, considering the last five years before that. We have improved the top line over the quarter by almost $120 million and improved our gross profit percentage by 400 basis points. We had a $75 million swing in net income quarter over quarter, and each segment had very positive operating profit. And each business segment improved earnings from the prior year and the last quarter. So we are seeing improvement in our businesses, and we are seeing improved demand from last year in residential, repair, remodel, and commercial as well.

On residential, clearly, we have seen some wind at our back. We think that is reasonably durable, and I'll talk a little bit more about that in a second. Repair and remodel is starting to come back. We are starting to see some green shoots in that area. And then commercial is improving; albeit, it is still very choppy. I think what I would say is, clearly, this year is better than last year in those three segments. So we expect next year to be better than this year in those three segments. But each one is moving a slightly different pace.

This slide is a very interesting slide. And it really shows midcycles of residential repair and remodel and commercial, compared to the historical means. So if you look back over the last three or four decades, what is the meaning in terms of building activity in these three sectors, and where are we now? And I will start with residential on housing, which is about 25% of our business. That is new residential.

We expect to end 2013 somewhere between, call it, $900,000 and $1.1 million. I think we are probably going to be somewhere in the $900,000, somewhere in that lower end. But if you look at that and you look at the historical midcycle, it is about 1.5 million starts. And we are not yet at 1 million starts. So there is still potential room to move up. And our view is residential will continue to improve. If you think about birthrate exceeds death rate, net immigration policy is still positive in this country. We are still at historical lows in terms of housing inventory. Our sense is that new residential will continue to improve.

If you look at commercial -- so new commercial is about 25% of our business. And the latest forecast from McGraw-Hill is about 800 million square feet versus the historical mean of [1.3 billion]. So, again, there is still a very, very large amount of room to move back to the mean. Again, we believe that there is still going to be some choppiness, I hear both geographically and in terms of the segments within commercial. Clearly, we are seeing hotel and retail do pretty well, and I think governmental and educational are still lagging and struggling a little bit.

The last category here is repair and remodel, which is about 50% of our business and split equally between housing and commercial. And repair and remodel is also well below its historical mean. And if you think about housing and commercial, the average age of a house in the US is about 40 years old. And that is the same for commercial buildings as well. And our products did extraordinarily well in the R&R sector, when you think about wallboard and ceilings and steel studs and the stuff that L&W distributes.

And one of the reasons we are -- we are starting to see a little bit of green shoot in repair and remodel. And part of it is we see consumer confidence moving up. Consumer confidence is at its highest that it has been an almost five years. One small data point is over the past 18 months, home owners have added almost $2.7 trillion of paper net worth as home prices have continued to improve. And that is expected to grow. So as people believe and their confidence moves up and they believe they have more wealth, clearly that translates into better performance on repair and remodel.

One data point to consider here is if you look back historically at USG's performance over the last, call it, three or four decades -- and we will take housing as an example. The midcycle housing number is about 1.5 million starts. And our average EBITDA during that same time for 1.5 million starts is around $425 million. Through the first half of 2013, our EBITDA is about $200 million. And that is not even at 1 million starts.

So there's a lot of things that we have done, and I will talk and touch on here, in terms of improving the operating leverage of the Company. And so I think as you think about USG and you think about the prospects in the future, it is important to consider the improved operating leverage that we have demonstrated clearly over the last six months. But how much will that carry forward into the future? And that is not a projection. It is just something I think folks need to consider in terms of the earnings power of the Company.

I want to touch a little bit on our strategy. And our progress has and continues to be driven by three strategic priorities. They are pretty simple, but extraordinarily powerful. First is strength in the core. And over the last five, six years, we've focused heavily on North American manufacturing distribution, lowering the break-even. And I will touch on that in a little bit -- in a couple of minutes.

The second is diversifying our earnings. And we are really focused on two areas there -- growing adjacent products, and select international investments.

And then the third is a differentiation through innovation. It is very important from us -- from our perspective to differentiate ourselves in the marketplace with our customers. It is very important to our customers. And, clearly, it gives us a competitive edge. And we can spend some time in the Q&A session if you would like talking about UltraLight and the impact that that has had for our Company and in the industry. So, it is through these three strategic priorities that we are building on the recovery.

Getting into strengthening the core in a little bit more detail. There was great effort on getting through the Great Recession; and, in fact, sometimes refer to it as a small D depression. I mean, it was pretty tough. And the Company spent an extraordinary amount of time and resources focusing on lowering the break-even across the Company. And they did it in all areas -- manufacturing, distribution, corporate. We have taken $3.8 billion of capacity out. We have closed 125 L&W branches. We recommissioned ships that used to transport rock from Nova Scotia down to the Eastern Seaboard. We recommissioned those to Africa from a loss to a profitable venture. And nearly 5000 employees have been transitioned from the organization. And we haven't stopped. We are still doing things to lower the break-even, even as the environment is getting better.

As an example, we are finishing our shared services this year. We had IT finance supply and HR functions out in the field. Those are being consolidated into a center of excellence, where we expect and see and are beginning to see lower cost and improve service to our operations.

Another area that we are focused on right now, we are continuing to work on, is Lean Six Sigma. We have been in -- we have been using Lean Six Sigma in our manufacturing for the last four or five years with very good results. And we are now expanding that corporate-wide, driving productivity across the Company, including in my areas of finance and IT.

As an example of the power of this, prior to the Great Recession, the industry break-even was around 26 billion square feet. It is now just under 18 billion square feet as an industry. And this year, the industry expects to ship somewhere around 20 billion square feet of wallboard, and we are profitable. So that really does show from an evidential standpoint what we have been able to do in terms of lowering our break-even. And we clearly have more operating leverage now than we have had in the past. And so it is really -- it is nice that we can be in a position now to play some offense and not just defense. We are going to continue, as I said, to focus on keeping our costs low and growing organically.

And one of the ways that we are going to focus and grow organically is to diversify our earnings; kind of a second pillar of our strategic tenet. And one of those components is product adjacencies. It is about finding products that we currently make and positioning them differently and in a different market. And a great example is SECUROCK, which came out of our FIBEROCK and glass mat technologies. With a little bit of modest investment in innovation, we've developed the product for commercial roofing. And this is a new business for us. And that business really had one prior supplier, which obviously was not us. But we now can compete in that business. And we see that market, just as an example, about $500 million. How much we'll take of that is yet to be seen, but we are encouraged with what we have seen so far. But that is an example of a product adjacency and the things that we are working on. Low capital, where we can take products that we currently have and extend those.

The second is select international growth. We are not a global Company. We are focused on select international areas where we can be number one or number two in a particular market. And we have a focus right now on the Middle East and India. Many know that we sold our European operation about a year ago. We've reinvested that capital in the Middle East and in India.

Over the past 12 months, we have been investing with a joint venture partner on a quarry; we believe it is the world's largest gypsum quarry. And a small plant in Oman. The idea is that we will service both the Middle East and India. We expect the quarry to be functional by the end of the year, and we expect the plant to be functional sometime in the middle of 2014.

India has very little gypsum sources. It is basically at the northern part of the country. And so this gives us a strategic resource that we think is pretty powerful as we look to enter the Indian market. Gypsum is also used in the cement industry, and we would use -- expect to use that quarry to also supply some cement customers in India as well. So we are very happy with the progress of that venture. We are not taking our eye off the ball of the US and the North American market. Clearly, those are incredibly important to us.

The third tenet to our strategic priorities is innovation. And we have a long, long history of great innovation here at USG. And we are really developing products that customers want. And there has been a shift in our R&D and how we think about R&D from just creating products to creating products that are really built upon customer needs and demand.

And we have got some great game-changing products. We have, in the last year, introduced a co-branded LED lighting system with GE. As more and more companies move -- or as more and more building moves to LEED certification and green, LED lighting is becoming more important; as are our ceiling tiles within our high NRC ratings. And we have jointly developed this with GE, and it is off to a very good start.

We have UltraLight joint compound, which is now 40% lighter than classic joint compound. And, clearly, the crown jewel of our innovation over the last few years is our SECUROCK [UltraLight]. And when people think of UltraLight, they think of it in terms of the half-inch. Well, we do UltraLight in 5/8. We do it in FIRECODE 30. We do it in Type X, which is a 60-minute rated FIRECODE product. We've introduced this year UltraLight in our Mold Tough product line. So we continue to take the technology and move it into other parts of our product line.

And it has been incredibly well received by our customers. It is the contractor-preferred brand. When you think about wallboard, weight is the number one complaint. We have obviously reduced that about 30%, and we've improved the performance characteristics as well in terms of scoring and snapping and being able to put it up in highly efficient manner. And when you think about our customers, labor is an important component of their cost. And they are willing to pay a premium, and they do pay a premium, for this product as they benefit really from productivity on the labor side.

And we can produce UltraLight virtually at a cost-neutral basis. And in our view, and again I am a little biased, but if you go out and take a look at the other products, clearly our product is superior in almost every way. When you think about innovation at USG, we have got the list of things that we have done, but we did get a recognition here not too long ago from the patent board. We were recognized as one of the top innovators in the industrial material sector. And it is really a testament to our commitment to innovation, based on the strength of our patents and our research intensity.

We use an open innovation culture. So it is not just R&D, but it is R&D talking with customers. It is R&D talking with and working with our employees. We also have collaborative arrangements with outside universities and independent laboratories that help us in our product development as well. So, three tenets for our strategy, which has really been fundamental to what we have been able to do and where we are going.

I want to switch gears just a little bit and talk a little bit about our balance sheet and capital structure. Clearly, as we look out over the next few years, we have two principal goals. The first is to delever organically to investment-grade metrics; and the second is to protect our $2.2 billion US net operating loss carry-forwards, which, if you include the state benefits, is worth about $1 billion in cash for us.

So let me start a little bit with the delevering organically. If you look at our balance sheet, on an S&P -- Standard & Poor's -- defined basis, we have about $3 billion of debt and about $100 million of equity. That is way too much leverage for a cyclical business, and clearly one that requires some capital. We are paying over $200 million in interest annually. We have done a ton of work internally to take a look at our capital structure. Ken Banas has led a lot of that work. And we have determined that our optimal capital structure to be investment-grade. And I say to be investment-grade metrics is up to the agencies as to whether we ever get to investment-grade. But, clearly, we want to operate the business with investment-grade metrics.

And what does that mean? That means that we need to be somewhere at 1.5 to two times debt to EBITDA at the midcycle. Which now, if you look at it, equates to roughly about $1.5 billion plus in terms of debt reduction in order to get to the right capital structure. This is very doable when you look at our prospects.

I have spent a lot of time talking about the operations and the improved leverage. I have talked a little bit about the improving economy. So we would expect that our performance would improve as the economy improves and as we continue to work on some of our organic growth opportunities. And that is clearly going to drive cash flow.

Secondly, we have got our net operating loss, which is worth about $1 billion in terms of cash yield. And lastly, we have our converts. We have got $400 million of convertible securities held by Brookshire & Fairfax up in Montreal. Those securities are callable by us in December of this year. Right now, we have got about 10% coupon on those. It is costing us about $40 million a year. If 100% is called, it equates to an additional $35 million shares -- 35 million shares outstanding.

The primary objective for us is to delever at the balance sheet. But we will not risk the NOLs to do so. And converting all of the $400 million of bonds could create some potential risk to our NOL. Clearly, we are managing the risk, but let me just give a little bit of background on this. And there is nothing inherent about calling the debt that puts the NOLs at risk. But there is a very specific IRS code called Section 382 around change and control that limits the amount and the timing of NOLs. And it has to do with 5% shareholders and how much they churn the stock over a three-year rolling average. If they churn the stock greater than 50%, that can significantly limit the NOL. And that could cost us somewhere around $300 million on an MPV basis. So it is not inconsequential; I would say it is material.

And so we are exploring a number of options right now about how we manage the convert. It is at our option to call it. We can call all of it, or we can call a portion of it. Those are things that, clearly, we are taking a look at, and there is more to come on the convert as we move through the balance of the year.

So over the planning horizon, clearly, as we generate cash, it is going to really go to two areas. We are going to reinvest in the business where we think it makes absolute sense, and we are going to delever at the balance sheet. Those are the two principal areas where we are going to focus on putting our cash.

Right now, we have ample liquidity, and we have lots of flexibility and some options for our balance sheet. And I started off my remarks, really, talking about being able to build on the recovery and play a little bit of offense. And I think our balance sheet and our capital structure now clearly provides the ability to do that.

So let me briefly wrap up, and then we can get into some Q&A. But, again, we are the industry leader. We are an 111-year-old company. We are doing things differently. We are doing things a lot more efficiently and faster. We are going to continue to get lean. We are going to continue to focus on ways to lower our break-even. We are going to look at organic growth. And we have some terrific organic growth ideas. We are going to look at innovations, currency, as a way to grow domestically and abroad.

We strongly believe that there is a lot of upside in residential repair and remodel and commercial, particularly as you look at those areas moving back and reverting back to historical midcycles. So we are very excited about where we are today. We are very excited about our position in the industry and our prospects. And we really do like what we do, which is building shelter where people work, live, and play.

So with that, I will conclude my remarks and see if there are any questions. Yes sir.

QUESTIONS AND ANSWERS

Unidentified Audience Member

Can you talk about your outlook? Obviously, you had a couple of years of good price increases. Can you talk about your outlook for 2014?

Matt Hilzinger - *USG Corporation - EVP and CFO*

Yes. So, those on the phone, if you didn't pick up the question, the question was can we provide some more information clarity around our 2014 pricing.

We have, as a matter of -- first, let me say that we are very pleased with our new pricing methodology that we put in at the beginning of 2012. We had a 17% price increase in 2012; a 17% price increase in 2013. We will have a price increase in 2014; we have not disclosed what that is. Our practice has been to have personal one-on-one dialogues with our customers, whether it is the Home Depot or other customers that we have. But we do that late November, early December. We like to see what is happening in the market, and we like to see what is happening with our cost structure. But, clearly, there will be a price increase next year; it is just a matter of how much. And I just won't -- just can't be in a position to really disclose what that is.

Unidentified Audience Member

Generally speaking, is it being parallel between the big-box channels and I guess the (inaudible) distributors?

Matt Hilzinger - *USG Corporation - EVP and CFO*

I would say that, in general across the country, it's general -- there has been a price increase everywhere. Sometimes there's some regionality depending upon the cost of the wallboard and the regional sector. But in some areas, we have had price increases above our 17% and below our 17%. That is kind of the average. But it has generally been healthy in most every sector.

Unidentified Audience Member

Can you just talk about how much capacity has been pulled down (inaudible) industry? And how much is completely shuttered versus (inaudible)?

Matt Hilzinger - *USG Corporation - EVP and CFO*

Yes. I will -- the question is how much capacity have we pulled out, and how much capacity has the industry pulled out and how much could come back. And I will answer this, and then I will ask Ken to jump in.

We have taken -- we started the recession with around 12 billion feet capacity. That is somewhere around 9.5 now. We have taken about a net 2.5 out. We took 3.8 that we shuttered, and then we added 1.5 million that we started with our Washingtonville plant before the recession.

The total industry has taken about 8 billion square feet out. And from our perspective, we are going to be very, very thoughtful and very careful about adding capacity. We are going to be -- we are even, as we look right now, about adding shifts. If you look at -- and we take a look at the industry and we take a look at our capacity on an affected capacity basis. Right now, we are running at about 80%, which basically means that we can, across the network, add about 20% more throughput before we need to add a labor shift. We are going to be very, very careful about where we add a labor shift, let alone bringing back any kind of idle capacity and certainly building any kind of new capacity.

And at a nameplate capacity right now of around 55% -- I think the industry is at 60% -- I can't speak for others out in the industry, but I can speak for us. We just don't plan to add capacity in the near-term.

Unidentified Audience Member

Matt, could you give us even a general sense of how big the opportunity is in Oman? If we look out when that is being fully up to speed?

Matt Hilzinger - *USG Corporation - EVP and CFO*

Yes, we have got a great business in the Middle East. And, clearly, the plant that we are going to do there is going to augment that business. But let me speak specifically to India.

When we look out by our reconnaissance by 2020, we think that the India business could be about two billion square feet. So, to give you a perspective right now, the US total industry shipping about 20. So it is about 10% of the US market. It is a very similar -- could be a very similar market to what we have in Canada and Mexico, which are great businesses for us. But it is a new market. There is not really a dominant player in India. It is very focused primarily on commercial, not residential. And when you think about commercial sectors, it is primarily around big metropolitan areas. A lot of the commercial buildings that are being built are Western-style architecture. They are Western-style -- influenced by Western-style architects, or they have been trained in the West. And so a lot of the buildings that they are building look like the room that we are standing in. Or as you walk around Manhattan, they look like that. And so there is a, what we believe, a growing need for wallboard in that that country. And we -- again, we don't believe there is a dominant player there. We believe that we can capture the number one or number two role there.

And when you think -- I talked a little bit about this earlier. When you think about gypsum -- and that is the key thing, you have got to have gypsum to make wallboard. There is not a really good strategic sourcing within India. There is a little bit at the northern part of the country, but that is really why we're -- we opened Oman, is to really be able to provide a source to that rock for us in India. And we are going to be paced and thoughtful as we go into that market before we put hard assets in the ground. But we are excited about the prospects in India. And the market is growing. I mean it's -- I know there's some ups and downs in India, but when you take a look at that market growth, particularly compared to North American markets, we see that as an attractive place to go.

Unidentified Audience Member

On your comments about the leverage, it seems to suggest (inaudible)?

Matt Hilzinger - *USG Corporation - EVP and CFO*

I can't comment on your number.

Unidentified Audience Member

(multiple speakers). But if that was your goal, let's say, is that going to be -- how much is that more about hitting the steep average on residential starts, on remodel? Or how much of it is more about (multiple speakers) price increases? And which ones (multiple speakers)?

Matt Hilzinger - *USG Corporation - EVP and CFO*

I think there is a component of both of those. And, clearly, on a volume basis, I don't think there is one particular sector here that could grow so far beyond housing, for instance. It is hard to think that you are going to be at 1.7 million housing starts and have an anemic repair and remodeling market and an anemic commercial market. So I think all three markets have to revert back to the mean in some form or fashion. So, clearly, that's a big piece of it on the volume piece.

On the price these, we are going to continue to look at price as a way to drive the right return on invested capital. One thing, a data point here, is if you look back over the last 41 years, prices moved in the same direction as housing starts. So as housing starts move up, you generally get price appreciation. So one of the questions that we often get is how to get a price increase when you are at a (inaudible) capacity of 55% and the industry is at 60%.

If you look back historically, you generally get a price increase when the economy is improving and housing starts to move up. So I think it is a combination of both. We are excited about it. And our expectation -- our expectation, not a projection, but our expectation is that we would outperform our historical numbers when we move back to -- I mean, we are doing it now, right? We would expect to outperform in the future (inaudible).

Unidentified Audience Member

Do you think pricing overall -- I know you can't comment on industry, but the industry is much more rational today. Capacity [will come out] (inaudible). Would you assume that pricing should be much higher than in prior cycles?

Matt Hilzinger - *USG Corporation - EVP and CFO*

So, the question. I forgot to introduce the questions before. The question is is pricing going to maintain, and is there ability to continue to move up pricing.

Our sense is we take it year by year. But as demand improves, we are seeing a little bit of cost creep in. Those things lend themselves to price increases. So our view is that we would like to see price increases. These are dialogues that we need to have with our customers as time goes on. But we are going to continue to manage the business conservatively. We are going to continue to -- that is why we need to continue to lower our break-even. It is why we are so focused on keeping our costs low is because some of this stuff is you want, you desire, but we need to make sure that we are driving our costs low. We want to keep our margins right and get to the right return on invested capital.

Jim Barrett - *CL King & Associates, Inc. - Analyst*

On that note I think we are (multiple speakers) time.

Matt Hilzinger - *USG Corporation - EVP and CFO*

Jim, thank you very much.

Jim Barrett - *CL King & Associates, Inc. - Analyst*

Thank you very much, Matt. And thanks, everyone, for (inaudible).
