

Dear Fellow Shareholders,

In my letter to you last year, I warned that we would face challenging times ahead, and I was right. I also wrote that we could “look ahead with confidence.” I’m right about that, too.

Our pessimistic outlook for 2007 was fully justified. The year brought one of the worst housing markets we have seen in decades. The sub-prime mortgage meltdown and a credit crunch that affected the availability of conventional mortgages slammed the brakes on home sales, put large numbers of homeowners at risk of losing their homes to foreclosure and threatened the general economy. Housing starts dropped by close to 25% and have continued to fall in 2008.

All of this hurt our results. Wallboard prices fell more than \$70 during the year and our production volumes fell by 17%, to 9 billion square feet, over the same period.

Lower wallboard prices and volumes substantially reduced our sales and earnings. Net sales fell to \$5.2 billion in 2007. Net earnings for the year were \$76 million, or \$0.78 per share.

Conditions are tough, and they are likely to stay that way for some time – through 2008 at the least. Later in this report, our President, Jim Metcalf, discusses what we are doing to meet the challenges we’re facing today – ones we have faced many times before. And he’ll discuss how our efforts have resulted in lower overhead costs, greater operating efficiencies and improved customer service.

In times like these, it is imperative that we be adaptable and realistic. We are proving ourselves to be both. But it is equally important to maintain our perspective. Although we cannot control the market, we are confident that we can weather all of its cycles. Yet we also understand that an enterprise doesn’t come to lead its industry for more than a century only by focusing on the present. I would like to discuss what we expect to find farther down the road – and how we’re preparing for it today.

When we look ahead, we see a market eventually climbing back to growth. Lower interest rates and declining prices, combined with fewer new housing starts, will reduce the supply of new homes and clear excess inventories.

And over the longer term, demand will grow. North America’s population is increasing, and members of the “echo boom” generation are entering their prime years for buying a home. At the same time, retiring baby boomers are expected to strengthen the demand for second homes. In its forecast for the period 2005 to 2015, the authoritative Harvard Joint Center for Housing Studies confirmed that household formations, new home construction, and the growth of the repair and remodel market all will contribute to a rebound in residential construction.

"They are by far the easiest to do business with."

– Gypsum Specialty Dealer, Mid-Atlantic

We cannot foretell the month or even the year when the pendulum will start to swing back to growth, but it will. When it does, we'll be ready – from day one. We'll be ready with a nationwide network of low-cost plants, with outstanding customer relationships and with the resources to support profitable growth.

Low-cost production

Low-cost production is a key to our leadership, in good times and bad.

During good times, we have the capacity to meet demand and profitably serve our customers. Most recently, the plants that we built in the late 1990s contributed to the outstanding performance we enjoyed from 2002 through much of 2006.

Those new plants are just as important today. Almost twice as efficient as our oldest lines, they significantly reduce the average cost of our nationwide network and give us the flexibility to profitably serve our markets and our customers.

To maintain and expand our cost leadership, we are continuing to build in advance of demand, removing older, higher-cost manufacturing assets and replacing them with new low-cost facilities. We have new wallboard facilities under construction or in operation at Norfolk, Virginia, Tecoman, Mexico, and Washingtonville, Pennsylvania, which will be the lowest-cost facility serving the New York metropolitan market when it goes into operation this year. When our

new Stockton, California, wallboard line opens sometime around 2011, it will be the lowest-cost plant serving Northern California.

Yet simply being the low-cost producer is not enough. We're locating our new plants strategically, close to the nation's largest markets. In an era of high fuel prices, doing so gives us an important competitive advantage. We gain the cost and service benefits of having the fewest miles to market and the lowest average delivered cost across the country.

Broader markets

At the same time that we are building low-cost supply, we also are working to expand our markets and product lines. Our progress can be seen across all three of our businesses.

Because it serves the commercial market, our ceilings business tends to be less affected by downturns in the housing market. We are one of the top two players worldwide in ceiling grid and ceiling tile, and we are building the business through innovation. New product offerings and services, such as USG Design Studio, our new on-line specification tool for designers and architects, enhance opportunities for growth in the U.S. and internationally.

Our building products distribution company, L&W Supply Corporation, is a \$2.3 billion enterprise in its own right. With about 250 stores, it is the largest specialty walls and ceilings distributor in the country and the only one that has a national footprint.

“They treat us like we are their number one customer at all times.”

– Ceilings Contractor, Mid-Atlantic

“They just care. They take care of you when they say they are going to and everything is in good shape.

Everything comes when it's supposed to come when you order it. They are just good.”

– Drywall Contractor, Midwest

In addition to selling 13% of all the wallboard in the country, L&W increases our revenues by selling a wide range of non-wallboard products, such as steel studs, ceilings products and insulation. In fact, during 2007, L&W's sales of non-wallboard products grew by 14% and accounted for more than half of its total sales.

L&W provides another strategic advantage as well. Every day, its nearly 2,000 delivery vehicles provide high-value “last mile” logistics services to residential and commercial job sites across the country. We are the only wallboard manufacturer to have such a direct link with contractors.

Stronger relationships

Strong, close customer relationships are vital to our performance, so we work hard to build them with specialty distributors, large retailers, architects and others. And customers are not just an abstraction to us, but real people, who we work with every day. We are on the job with them, developing relationships, and learning – and meeting – their needs.

The success of our efforts can clearly be seen in our performance surface products for walls and our substrate products for floors, countertops and other applications. They are easy to use and help customers improve their productivity and quality. The sales and profit margins of these products continue to grow. Together, our surfaces and substrates products now contribute about \$800 million in sales.

We continue to invest in satisfying customers. In 2007, we were awarded 16 U.S. patents (and 106 international patents) for new or improved products and processes. New products, like our award-winning low-dust joint compound and water-resistant Mold Tough™ gypsum panels, offer real benefits to end users and create profitable new sales, both for USG and our customers.

Advances inside our operations also help to strengthen ties with customers. Our new enterprise-wide computer system gives us the best data we've ever had to control expenses and manage our nationwide manufacturing network. It also has helped us improve key customer service metrics. Of course, there's always room for improvement, but third-party research indicates that our customer service levels are the best in our industry.

Innovative products, combined with outstanding service, give us a superior value proposition and continue to build our brands. Few brands anywhere are better known than SHEETROCK®, and inside our industry, DUROCK®, FIBEROCK® and DONN® grid are almost equally well known. Our brands are tremendous assets. They are proving their value today by helping us win the battle for customers. They will continue to prove their value tomorrow.



William C. Foote
Chairman and Chief Executive Officer

Looking ahead

We understand the value of consistent strategies, focused on businesses we know, applied over time. And we expect to emerge from the current downturn in the housing market just as we have come out of others: operationally stronger, with even closer ties to customers.

We will continue to emphasize the strong values that have earned us the trust of our customers, investors, co-workers and all of those we do business with. We'll continue to create value by capitalizing on the opportunities we find in our markets – today and tomorrow. And we will work to claim a larger share of the overall construction market, which even in a bad year totals more than three-quarters of a trillion dollars.

We have what it takes to do it. Our borrowing capacity and cash reserves give us the financial resources needed to take advantage of the opportunities found in a distressed market. We also have the human resources to manage successfully through this cycle and pursue opportunities to grow.

L&W is well positioned to extend its leadership in the fragmented building products distribution market. We already are in 17 of the nation's top 20 metro areas, and we want to expand our presence. Applying a disciplined approach to a buyer's market, we will concentrate on areas with the greatest projected growth, while pruning operations in small or slower-growth markets. We also will move to apply the best practices of new acquisition partners across our operations.

International markets offer new opportunities. Already the market leader in Canada and Mexico, we are now looking farther afield for growth. We recently announced a joint venture with a leading Chinese manufacturer to produce a complete line of products for the Chinese ceiling tile market, which is growing about 10 percent per year. We recently opened a joint treatment plant in Russia. A joint venture in Saudi Arabia manufactures and sells ceiling products in the Middle East, where there are about \$1 trillion in construction projects planned or underway.

We will continue to pursue operational excellence. Building on previous improvements, we'll keep working to reduce our costs. And even in the midst of challenging times, we'll continue to do exciting things for our customers.

The times truly are challenging. But we are confident of our products, our operations, our relationships and our financial flexibility. Most of all, I have tremendous confidence in the people I am privileged to work with, across our enterprise. In everything that counts the most, USG continues to lead, just as we have for more than a century.

A handwritten signature in black ink that reads "William C. Foote". The signature is stylized, with a large, bold "F" and "o" in the last name.

William C. Foote
Chairman and Chief Executive Officer