
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

X ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 (FEE REQUIRED)
For fiscal year ended December 31, 2001

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 (NO FEE REQUIRED)
For the transition period from _____ to _____.

Commission File Number 1-8864

USG CORPORATION

(Exact name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

36-3329400
(I.R.S. Employer
Identification No.)

125 S. Franklin Street, Chicago, Illinois
(Address of Principal Executive Offices)

60606-4678
(Zip Code)

Registrant's Telephone Number, Including Area Code: **(312) 606-4000**

Securities Registered Pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Exchange on Which Registered</u>
<u>Common Stock, \$0.10 par value</u>	<u>New York Stock Exchange Chicago Stock Exchange</u>
<u>Preferred Share Purchase Rights</u>	<u>New York Stock Exchange Chicago Stock Exchange</u>
<u>8.5% Senior Notes, Due 2005</u>	<u>New York Stock Exchange</u>

Securities Registered Pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

As of January 31, 2002, the aggregate market value of USG Corporation common stock held by nonaffiliates (based upon the New York Stock Exchange closing prices) was approximately \$320,668,000.

As of January 31, 2002, 43,457,312 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

1. The Corporation's definitive Proxy Statement for use in connection with the annual meeting of stockholders to be held on May 8, 2002, is incorporated by reference in Part III of this Form 10-K Report.
2. A list of exhibits incorporated by reference is presented in this Form 10-K Report beginning on page 56.

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PART I

Item 1. BUSINESS

General

United States Gypsum Company (“*U.S. Gypsum*”) was incorporated in 1901. USG Corporation (together with its subsidiaries, called the “*Corporation*”) was incorporated in Delaware on October 22, 1984. By a vote of stockholders on December 19, 1984, U.S. Gypsum became a wholly owned subsidiary of the Corporation, and the stockholders of U.S. Gypsum became the stockholders of the Corporation, all effective January 1, 1985.

Through its subsidiaries, the Corporation is a leading manufacturer and distributor of building materials producing a wide range of products for use in new residential, new nonresidential, and repair and remodel construction, as well as products used in certain industrial processes.

On June 25, 2001, the parent company of the Corporation and 10 of its United States subsidiaries (collectively, the “*Debtors*”) filed voluntary petitions for reorganization (the “*Filing*”) under chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. The chapter 11 cases of the Debtors have been consolidated for purposes of joint administration as In re: USG Corporation et al. (case no. 01-2094). This action was taken to resolve asbestos-related claims in a fair and equitable manner, to protect the long-term value of the Debtors’ businesses and to maintain the Debtors’ leadership positions in their markets. The Debtors are operating their businesses as debtors-in-possession subject to the provisions of the United States Bankruptcy Code. These cases do not include any of the Corporation’s non-U.S. subsidiaries. See Part II, Item 7. Management’s Discussion and Analysis of Results of Operations and Financial Condition and Part II, Item 8. Financial Statements and Supplementary Data - Notes to Consolidated Financial Statements, Note 2. Voluntary Reorganization Under Chapter 11 and Note 17. Litigation for additional information on the bankruptcy proceedings and asbestos litigation.

The Corporation’s operations are organized into three operating segments: North American Gypsum, Worldwide Ceilings and Building Products Distribution.

North American Gypsum

Business

North American Gypsum, which manufactures and markets gypsum and related products in the United States, Canada and Mexico, includes U.S. Gypsum in the United States, the gypsum business of CGC Inc. (“*CGC*”) in Canada, and USG Mexico, S.A. de C.V. (“*USG Mexico*”) in Mexico. U.S. Gypsum is the largest producer of gypsum wallboard in the United States and accounted for approximately one-third of total domestic gypsum wallboard sales in 2001. CGC is the largest producer of gypsum wallboard in eastern Canada. USG Mexico is the largest producer of gypsum wallboard in Mexico.

Products

North American Gypsum’s products are used in a variety of building and industrial applications. Gypsum panel products are used to finish the interior walls and ceilings in residential, commercial and institutional construction. These products provide aesthetic as well as sound-dampening and fire-retarding value. The majority of these products are sold under the SHEETROCK brand name. Also sold under the SHEETROCK brand name is a line of joint compounds used for finishing wallboard joints. The DUROCK line of cement board and accessories provides fire-resistant and water-damage-resistant assemblies for both interior and exterior construction. FIBEROCK brand gypsum fiber panels include

abuse-resistant wall panels and floor underlayment. The Corporation produces a variety of plaster products used to provide a custom finish for residential and commercial interiors. Like SHEETROCK brand gypsum wallboard, these products provide aesthetic, sound-dampening and fire-retarding value. Plaster products are sold under the trade names RED TOP, IMPERIAL and DIAMOND. The Corporation also produces gypsum-based products for agricultural and industrial customers to use in a number of applications, including soil conditioning, road repair, fireproofing and ceramics.

Manufacturing

North American Gypsum's products are manufactured at 47 plants located throughout the United States, Canada and Mexico.

Gypsum rock is mined or quarried at 15 company-owned locations in North America. In 2001, these locations provided approximately 75% of the gypsum used by the Corporation's plants in North America. Certain plants purchase synthetic gypsum or natural gypsum rock from various outside sources. Outside purchases accounted for 25% of the gypsum used in the Corporation's plants. The Corporation's geologists estimate that its recoverable rock reserves are sufficient for more than 28 years of operation based on the Corporation's average annual production of crude gypsum during the past five years. Proven reserves contain approximately 273 million tons. Additional reserves of approximately 148 million tons are found on four properties not in operation. The Corporation's total average annual production of crude gypsum during the past five years was 10 million tons.

The Corporation owns and operates seven paper mills located across the United States. Vertical integration in paper ensures a continuous supply of high-quality paper that is tailored to the specific needs of the Corporation's wallboard production processes.

The Corporation performs research and development at the USG Research and Technology Center in Libertyville, Ill. The staff at this center provides specialized technical services to the operating units and does product and process research and development. The center is especially well-equipped for carrying out fire, acoustical, structural and environmental testing of products and building assemblies. The center also has an analytical laboratory for chemical analysis and characterization of materials. Development activities can be taken to an on-site pilot plant level before being transferred to a full-size plant.

Marketing and Distribution

Distribution is carried out through L&W Supply Corporation ("*L&W Supply*"), a wholly owned subsidiary of the Corporation, building materials dealers, home improvement centers and other retailers, contractors and specialty wallboard distributors. Sales of gypsum products are seasonal in the sense that sales are generally greater from spring through the middle of autumn than during the remaining part of the year. Based on the Corporation's estimates using publicly available data, internal surveys and gypsum wallboard shipment data from the Gypsum Association, management estimates that during 2001, about 43% of total industry volume demand for gypsum wallboard was generated by new residential construction activity, 39% of volume demand was generated by residential and nonresidential repair and remodel activity, 12% of volume demand was generated by new nonresidential construction activity and the remaining 6% of volume demand was generated by other activities such as exports and temporary construction.

Competition

The Corporation competes in North America as the largest of 10 producers of gypsum wallboard products and in 2001 accounted for approximately one-third of total gypsum wallboard sales in the United States. In 2001, U.S. Gypsum shipped 9.9 billion square feet of wallboard, the highest level in the Corporation's history, out of total U.S. industry shipments (including imports) estimated at 30.2 billion square feet, the second highest level on record. Principal

competitors in the United States are: National Gypsum Company, Georgia-Pacific Corporation, James Hardie Gypsum, American Gypsum, Temple-Inland Forest Products Corporation, BPB Celotex, Lafarge North America, Inc. and other smaller, regional competitors. Major competitors in Canada include BPB Westroc, Georgia-Pacific Corporation and Lafarge North America, Inc. In Mexico, the Corporation's major competitor is Panel Rey.

Worldwide Ceilings

Business

Worldwide Ceilings, which manufactures and markets interior systems products worldwide, includes USG Interiors, Inc. ("*USG Interiors*"), the international interior systems business managed as USG International, and the ceilings business of CGC. Worldwide Ceilings is a leading supplier of interior ceilings products used primarily in commercial applications. In 2001, Worldwide Ceilings was estimated to be the largest manufacturer of ceiling grid and the second-largest manufacturer of ceiling tile in the world.

Products

Worldwide Ceilings manufactures and markets ceiling grid, ceiling tile, relocatable wall systems and, in Europe and the Asia-Pacific region, access floor systems. Its integrated line of ceilings products provides qualities such as sound absorption, fire retardation, and convenient access to the space above the ceiling for electrical and mechanical systems, air distribution and maintenance. USG Interiors' significant trade names include the AURATONE and ACOUSTONE brands of ceiling tile and the DX, FINELINE, CENTRICITEE, CURVATURA and DONN brands of ceiling grid.

Manufacturing

Worldwide Ceilings' products are manufactured at 18 plants located in North America, Europe and the Asia-Pacific region. These include 10 ceiling grid plants, 4 ceiling tile plants, 2 plants that produce other interior products and 2 plants that produce or prepare raw materials for ceiling tile and grid. Principal raw materials used in the production of Worldwide Ceilings' products include mineral fiber, steel, perlite, starch and high-pressure laminates. Certain of these raw materials are produced internally, while others are obtained from various outside suppliers. Shortages of raw materials used in this segment are not expected.

USG Interiors' primary research and development is carried out at the USG Research and Technology Center in Libertyville, Ill., and at its Solutions CenterSM in Chicago, Ill. An additional metal-forming research and development facility in Avon, Ohio, provides product design, engineering and testing services in addition to manufacturing development.

Marketing and Distribution

Worldwide Ceilings' products are sold primarily in markets related to the new construction and renovation of commercial buildings. Marketing and distribution are conducted through a network of distributors, installation contractors, L&W Supply and home improvement centers.

Competition

The Corporation estimates that it is the world's largest manufacturer of ceiling grid. Principal competitors in ceiling grid include WAVE (a joint venture between Armstrong World Industries, Inc. and Worthington Industries) and Chicago Metallic Corporation. The Corporation estimates that it is the second-largest manufacturer/marketer of acoustical ceiling tile in the world. Principal global competitors include Armstrong World Industries, Inc., OWA Faserplattenwerk GmbH

(Odenwald), BPB Celotex and AMF Mineralplatten GmbH Betriebs KG. Armstrong World Industries, Inc., the world's largest manufacturer of acoustical ceiling tile, filed chapter 11 bankruptcy in the fourth quarter of 2000 in response to pending and potential asbestos litigation filings.

Building Products Distribution

Business

Building Products Distribution consists of L&W Supply, the leading distributor of wallboard and complementary building products in the United States. In 2001, L&W Supply distributed approximately 10% of all gypsum wallboard in the United States, including approximately 28% of U.S. Gypsum's wallboard production.

Marketing and Distribution

L&W Supply was organized in 1971 by U.S. Gypsum. As of December 31, 2001, L&W operated 180 distribution locations in 37 states. It is a service-oriented organization that stocks a wide range of construction materials and delivers less-than-truckload quantities of construction materials to job sites and places them in areas where work is being done, thereby reducing or eliminating the need for handling by contractors. L&W Supply specializes in the distribution of gypsum wallboard (which accounts for approximately 46% of its total net sales), joint compound and other products manufactured primarily by U.S. Gypsum. It also distributes products manufactured by USG Interiors such as acoustical ceiling tile and grid, as well as products of other manufacturers including drywall metal, insulation, roofing products and accessories. L&W Supply leases approximately 87% of its facilities from third parties. Usually, initial leases run from three to five years with a five-year renewal option.

Competition

L&W Supply's largest competitor, Gypsum Management Supply, is an independent distributor with locations in the southern, central and western United States. There are several regional competitors such as CSR Rinker in the Southeast (primarily in Florida) and Strober Building Supply in the Northeast. L&W Supply's many local competitors include lumber dealers, hardware stores, home improvement centers and acoustical ceiling tile distributors.

Other Information

Primary supplies of energy have been adequate, and no significant curtailment of plant operations has resulted from insufficient supplies, although pricing increased dramatically in early 2001. Supplies are likely to remain sufficient for projected requirements. Energy price swap agreements are used by the Corporation to hedge the cost of certain purchased fuel.

None of the operating segments has any special working capital requirements or is materially dependent on a single customer or a few customers on a regular basis. No single customer of the Corporation accounted for 10% or more of the Corporation's 2001, 2000 or 1999 consolidated net sales. Because orders are filled upon receipt, no operating segment has any significant backlog.

Loss of one or more of the patents or licenses held by the Corporation would not have a major impact on the Corporation's business or its ability to continue operations. No material part of any of the Corporation's business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the government.

All of the Corporation's products regularly require improvement to remain competitive. The Corporation also

develops and produces comprehensive systems employing several of its products. In order to maintain its high standards and remain a leader in the building materials industry, the Corporation performs ongoing extensive research and development activities and makes the necessary capital expenditures to maintain production facilities in good operating condition.

U.S. Gypsum is a defendant in asbestos lawsuits alleging both property damage and personal injury. As a result of the Filing, all pending asbestos lawsuits against U.S. Gypsum are stayed, and no party may take any action to pursue or collect on such asbestos claims absent specific authorization of the Bankruptcy Court. Since the Filing, U.S. Gypsum has ceased making payments with respect to asbestos lawsuits, including payments pursuant to settlements of asbestos lawsuits. See Part II, Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition and Part II, Item 8. Financial Statements and Supplementary Data - Notes to Consolidated Financial Statements, Note 2. Voluntary Reorganization Under Chapter 11 and Note 17. Litigation for additional information on the bankruptcy proceedings and asbestos litigation.

See Part II, Item 8. Financial Statements and Supplementary Data - Notes to Consolidated Financial Statements, Note 16. Segments for financial information pertaining to operating segments, foreign and domestic operations and export sales.

Item 2. PROPERTIES

The Corporation's plants, mines, quarries, transport ships and other facilities are located in North America, Europe and the Asia-Pacific region. In 2001, most of these facilities operated above 80% of capacity. The locations of the production properties of the Corporation's subsidiaries, grouped by operating segment, are as follows (plants are owned unless otherwise indicated):

North American Gypsum

Gypsum Wallboard and Other Gypsum Products

Aliquippa, Pa.	Jacksonville, Fla.	Sperry, Iowa
Baltimore, Md.	New Orleans, La.	Stony Point, N.Y.
Bridgeport, Ala.	Norfolk, Va.	Sweetwater, Texas
Boston (Charlestown), Mass.	Plaster City, Calif.	Hagersville, Ontario, Canada
Detroit (River Rouge), Mich.	Rainier, Ore.	Montreal, Quebec, Canada
East Chicago, Ind.	Santa Fe Springs, Calif.	Monterrey, Nuevo Leon, Mexico
Empire, Nev.	Shoals, Ind.	Puebla, Puebla, Mexico
Fort Dodge, Iowa	Sigurd, Utah	Saltillo, Coahuila, Mexico
Galena Park, Texas	Southard, Okla.	

As part of the Corporation's restructuring plan announced in the fourth quarter of 2001, the gypsum wallboard plant in Fremont, Calif., will be closed in 2002.

Joint Compound (surface preparation and joint treatment products)

Auburn, Wash.	Gypsum, Ohio	Edmonton, Alberta, Canada
Bridgeport, Ala.	Jacksonville, Fla.	Hagersville, Ontario, Canada
Chamblee, Ga.	Port Reading, N.J.	Montreal, Quebec, Canada
Dallas, Texas	Sigurd, Utah	Surrey, British Columbia, Canada
East Chicago, Ind.	Tacoma, Wash.	Puebla, Puebla, Mexico
Fort Dodge, Iowa	Torrance, Calif.	Port Klang, Malaysia (leased)
Galena Park, Texas	Calgary, Alberta, Canada	

Gypsum Rock (mines and quarries)

Alabaster (Tawas City), Mich.	Sigurd, Utah	Little Narrows, Nova Scotia, Canada
Empire, Nev.	Southard, Okla.	Windsor, Nova Scotia, Canada
Fort Dodge, Iowa	Sperry, Iowa	Manzanillo, Colima, Mexico
Plaster City, Calif.	Sweetwater, Texas	Monterrey, Nuevo Leon, Mexico
Shoals, Ind.	Hagersville, Ontario, Canada	Saltillo, Coahuila, Mexico

Synthetic gypsum is processed at Belledune, New Brunswick, Canada.

Paper for Gypsum Wallboard

Clark, N.J.	Jacksonville, Fla.	South Gate, Calif.
Galena Park, Texas	North Kansas City, Mo.	
Gypsum, Ohio	Oakfield, N.Y.	

Other Products

A mica-processing plant is located at Spruce Pine, N.C. Drywall metal products are manufactured at Medina, Ohio (leased). Metal lath, plaster and drywall accessories and light gauge steel framing products are manufactured at Puebla, Puebla, Mexico. Gypsum fiber panel products are produced at Gypsum, Ohio, and Port Hawkesbury, Nova Scotia, Canada. Paper-faced metal corner bead is manufactured at Auburn, Wash., and Weirton, W.Va. Various other products are manufactured at La Mirada, Calif. (adhesives and finishes), and New Orleans, La. (lime products).

Ocean Vessels

Gypsum Transportation Limited, a wholly owned subsidiary of the Corporation and headquartered in Bermuda, owns and operates a fleet of four self-unloading ocean vessels. Under a contract of affreightment, these vessels transport gypsum rock from Nova Scotia to the East Coast plants of U.S. Gypsum. Excess ship time, when available, is offered for charter on the open market.

Worldwide Ceilings

Ceiling Grid

Cartersville, Ga.	Auckland, New Zealand (leased)	Peterlee, England (leased)
Stockton, Calif.	Dreux, France	Port Klang, Malaysia (leased)
Westlake, Ohio	Oakville, Ontario, Canada	Shenzhen, China
		Viersen, Germany

A coil coater and slitter plant used in the production of ceiling grid also is located in Westlake, Ohio, and a slitter plant is located in Stockton, Calif. (leased).

Ceiling Tile

Ceiling tile products are manufactured at Cloquet, Minn., Greenville, Miss., Walworth, Wis., and Aubange, Belgium.

Other Products

Access floor systems products are manufactured at Peterlee, England (leased), and Port Klang, Malaysia (leased). Wall system products are manufactured at Medina, Ohio (leased). Mineral fiber products are manufactured at Red Wing, Minn., and Walworth, Wis.

As part of the Corporation's restructuring plan announced in the fourth quarter of 2001, the ceiling tile plant in San Juan Ixhuatepec, Mexico, the ceiling grid plant in Taipei, Taiwan, the drywall steel plant in Prestice, Czech Republic, and one of three ceiling tile manufacturing lines at the Greenville, Miss., plant will be closed in 2002.

Item 3. LEGAL PROCEEDINGS

See Part II, Item 8. Financial Statements and Supplementary Data - Notes to Consolidated Financial Statements, Note 2. Voluntary Reorganization Under Chapter 11 and Note 17. Litigation for information on legal proceedings.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None during the fourth quarter of 2001.

PART II

Item 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

See Part II, Item 8. Financial Statements and Supplementary Data - Selected Quarterly Financial Data for information with respect to the principal market on which the Corporation's common stock is traded, the range of high and low market prices, the number of stockholders of record and the amount of quarterly cash dividends.

On November 22, 1996, the Corporation entered into a retention agreement with an employee, formerly the principal stockholder of a corporation certain of whose assets were purchased by the Corporation, whereby the Corporation agreed to grant shares of unregistered common stock, \$0.10 par value, having an aggregate value equal to \$250,000, in five separate annual installments each having a value equal to \$50,000, in reliance on the private offering exemption afforded by Section 4(2) of the Securities Act of 1933, as amended. The fifth and final annual grant of 3,493 common shares was made on November 22, 2000. The unregistered common stock was freed from restriction on transfer, resale or other disposition on November 22, 2001.

Item 6. SELECTED FINANCIAL DATA

See Part II, Item 8. Financial Statements and Supplementary Data - Five-Year Summary for selected financial data.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Voluntary Reorganization Under Chapter 11

On June 25, 2001 (the "*Petition Date*"), the parent company (the "*Parent Company*") of the Corporation and the 10 United States subsidiaries listed below (collectively, the "*Debtors*") filed voluntary petitions for reorganization (the "*Filing*") under chapter 11 of the United States Bankruptcy Code (the "*Bankruptcy Code*") in the United States Bankruptcy Court for the District of Delaware (the "*Bankruptcy Court*"). The chapter 11 cases of the Debtors (collectively, the "*Chapter 11 Cases*") have been consolidated for purposes of joint administration as In re: USG Corporation et al. (case no. 01-2094). The Chapter 11 Cases do not include any of the Corporation's non-U.S. subsidiaries. The following subsidiaries filed chapter 11 petitions:

United States Gypsum Company
USG Interiors, Inc.
USG Interiors International, Inc.
L&W Supply Corporation
Beadex Manufacturing, LLC
B-R Pipeline Company
La Mirada Products Co., Inc.
Stocking Specialists, Inc.
USG Industries, Inc.
USG Pipeline Company

This action was taken to resolve asbestos-related claims in a fair and equitable manner, to protect the long-term value of the Debtors' businesses and to maintain the Debtors' leadership positions in their markets.

BACKGROUND OF THE FILING

U.S. Gypsum is a defendant in asbestos lawsuits alleging both property damage and personal injury. Chapter 11 filings during 2000 and early 2001 by other companies subject to asbestos litigation dramatically increased U.S. Gypsum's asbestos costs beyond its legitimate liability. The Corporation has been and continues to be committed to finding a legislative solution to the increase in asbestos costs. However, in 2001 it became apparent that a timely resolution to the problem through legislation was not feasible. The Corporation determined that voluntary protection under chapter 11 would be the best alternative for obtaining a fair and final resolution of U.S. Gypsum's asbestos liability and the best way to preserve value for stakeholders. See Part II, Item 8. Note 17. Litigation for additional information

on asbestos litigation.

USG was the eighth major company with a large number of asbestos claims that filed a chapter 11 petition in the 18 months prior to the Petition Date. Since 1994, U.S. Gypsum has been named in more than 250,000 asbestos-related personal injury claims and made cash payments of approximately \$575 million (before insurance recoveries) to manage and resolve asbestos-related litigation. Based on an independent study conducted in 2000 and on U.S. Gypsum's historical experience of litigating asbestos claims in the tort system, the Corporation estimated that U.S. Gypsum's probable liability for costs associated with asbestos cases pending as of December 31, 2000, and expected to be filed through 2003 to be between \$889 million and \$1,281 million. In the fourth quarter of 2000, U.S. Gypsum recorded a noncash, pretax provision of \$850 million, increasing its total accrued reserve for asbestos claims to \$1,185 million as of December 31, 2000. Substantially all of this reserve related to personal injury claims and reflected management's expectation that U.S. Gypsum's average cost per case would increase, at least in the short term, due to distortions in the tort system resulting from the bankruptcies of other defendants that led to increased settlement demands from asbestos plaintiffs. Less than 10% of the reserve related to defense and administrative costs. Between January 1, 2001, and the Petition Date, U.S. Gypsum received more than 26,000 new claims. On a cash basis, U.S. Gypsum's asbestos-related personal injury costs (before insurance) rose from \$30 million in 1997 to \$162 million in 2000 and, absent the Filing, were expected to exceed \$275 million in 2001. Because of the Filing, there is greater uncertainty concerning the liability associated with asbestos cases, as discussed below.

CONSEQUENCES OF THE FILING

The Debtors are operating their businesses as debtors-in-possession subject to the provisions of the Bankruptcy Code. All vendors are being paid for all goods furnished and services provided after the Filing. However, as a consequence of the Filing, all pending litigation against the Debtors as of the Petition Date is stayed, and no party may take any action to pursue or collect pre-petition claims except pursuant to order of the Bankruptcy Court. It is the Debtors' intention to address all pending and future asbestos-related claims and all other pre-petition claims in a plan of reorganization. However, it is impossible to predict currently how the plan will treat asbestos and other pre-petition claims and what impact any reorganization plan may have on the shares of the Corporation's common stock and other outstanding securities. The formulation and implementation of the plan of reorganization could take a significant period of time.

Three creditors' committees, one representing asbestos personal injury claimants, another representing asbestos property damage claimants and a third representing general unsecured creditors, have been appointed as official committees in the Chapter 11 Cases and, in accordance with the provisions of the Bankruptcy Code, will have the right to be heard on all matters that come before the Bankruptcy Court. The Corporation expects that the appointed committees, together with a legal representative for the interests of future asbestos claimants to be appointed by the Bankruptcy Court, will play important roles in the Chapter 11 Cases and the negotiation of the terms of any plan of reorganization. Recent developments in the Corporation's bankruptcy proceeding are discussed in Part II, Item 8. Note 17. Litigation.

CHAPTER 11 FINANCING

A \$350 million debtor-in-possession financing facility from JP Morgan Chase (the "*DIP Facility*") was approved by the Bankruptcy Court on July 31, 2001. The DIP Facility is available to supplement liquidity and fund operations during the reorganization process. The Corporation believes that cash available from operations and the DIP Facility will provide sufficient liquidity to allow its businesses to operate in the normal course without interruption. See "Available Liquidity" below for more information on the DIP Facility.

ACCOUNTING IMPACT

The Corporation is required to follow AICPA Statement of Position 90-7 ("*SOP 90-7*"), "Financial Reporting by Entities in Reorganization under the Bankruptcy Code." Pursuant to SOP 90-7, the Corporation's pre-petition liabilities that are subject to compromise are reported separately on the consolidated balance sheet. Virtually all of the Corporation's pre-petition debt is currently in default and was recorded at face value and classified within liabilities

subject to compromise. U.S. Gypsum's asbestos liability also is classified within liabilities subject to compromise. See Part II, Item 8. Note 2. Voluntary Reorganization Under Chapter 11, which includes information related to financial statement presentation, the debtor-in-possession statements and detail of the liabilities subject to compromise and chapter 11 reorganization expenses.

Consolidated Results

NET SALES

Net sales in 2001 were \$3,296 million, down 13% from 2000. This decline was primarily due to lower average selling prices for SHEETROCK brand gypsum wallboard. By midyear 2001, selling prices had dropped to their lowest level in nearly a decade. However, there was some improvement in market conditions during the second half of 2001 as demand for gypsum wallboard grew and some excess industry capacity closed, allowing U.S. Gypsum and other wallboard manufacturers to raise prices for the first time since the end of 1999.

Net sales in 2000 totaled \$3,781 million, a slight decrease from 1999's record level of \$3,810 million. Increased shipments were achieved for all major product lines in 2000 as compared with 1999. However, the impact of increased demand was offset by lower selling prices for SHEETROCK brand gypsum wallboard.

COST OF PRODUCTS SOLD

Cost of products sold in 2001 totaled \$2,882 million, down 2% versus 2000, primarily due to the absence in 2001 of \$77 million of asbestos-related noncash charges recorded by U.S. Gypsum in 2000.

Cost of products sold in 2000 was \$2,941 million, up 7% from 1999 reflecting the combination of increased volume and higher energy and raw material costs.

In addition to the fourth quarter 2000 provision for asbestos claims, U.S. Gypsum recorded asbestos-related charges to cost of products sold through September 30, 2000. These charges totaled \$77 million during the first nine months of 2000 and \$80.5 million in 1999.

SELLING AND ADMINISTRATIVE EXPENSES

Selling and administrative expenses totaled \$279 million in 2001, \$309 million in 2000 and \$338 million in 1999. As a percentage of net sales, these expenses were 8.5%, 8.2% and 8.9% in 2001, 2000 and 1999, respectively.

Expenses were down 10% in 2001 versus 2000 because of cost-reduction initiatives undertaken during the year that resulted in lower charges for compensation and benefits, marketing programs and travel. These reductions were partially offset by expenses associated with a Bankruptcy-Court-approved key employee retention program. Comparing 2000 with 1999, expenses declined 9% primarily due to lower charges for incentive compensation programs and a companywide emphasis on reducing expenses which resulted in lower expenditures for marketing programs and travel.

CHAPTER 11 REORGANIZATION EXPENSES

In connection with the Filing, the Corporation recorded pretax chapter 11 reorganization expenses of \$12 million in 2001. These expenses consisted of legal and financial advisory fees of \$14 million and accelerated amortization of debt issuance costs of \$2 million, partially offset by bankruptcy-related interest income of \$4 million.

2001 PROVISIONS FOR IMPAIRMENT AND RESTRUCTURING

In the fourth quarter of 2001, the Corporation recorded impairment charges totaling \$30 million pretax (\$25 million after-tax). Included in this total was \$16 million pretax related to the Aubange, Belgium, ceiling tile plant. This impairment resulted from a decline in demand, which had been significantly affected by a worldwide slowdown in the nonresidential construction market, and from the plant's high cost structure. The remaining \$14 million pretax related to the Port Hawkesbury, Nova Scotia, gypsum fiber panel plant. This impairment resulted from high delivered costs of products manufactured at Port Hawkesbury combined with the consolidation of production of FIBEROCK products at

the Gypsum, Ohio, plant. Estimated future cash flows related to these facilities indicated that impairment charges were necessary to write down the assets to their third-party appraised fair values.

Also, in the fourth quarter of 2001, the Corporation recorded a charge of \$12 million pretax (\$10 million after-tax) related to a restructuring plan that included the shutdown of a gypsum wallboard plant in Fremont, Calif., a drywall steel plant in Prestice, Czech Republic, a ceiling tile plant in San Juan Ixhuatepec, Mexico, a ceiling tile manufacturing line in Greenville, Miss., and other restructuring activities. The restructuring plan, which is expected to be completed in 2002, is intended to allow the Corporation to optimize its manufacturing operations at a time when a weak economy threatens to cause demand for the Corporation's products to decline. The closing of the Fremont plant will eliminate approximately 250 million square feet of old, high-cost gypsum wallboard capacity.

Included in the \$12 million pretax charge was \$8 million for severance related to a workforce reduction of more than 350 positions (primarily hourly positions), \$2 million for the write-off of property, plant and equipment, and \$2 million for line shutdown and removal and contract cancellations.

The reserve for this plan was included in accrued expenses as of December 31, 2001, on the consolidated balance sheet, and payments totaling \$2 million were charged against this reserve in 2001. All payments for the 2001 restructuring plan are being funded with cash from normal operations. As of December 31, 2001, 127 employees have been terminated, and 26 open positions have been eliminated. Annual savings from the full implementation of the 2001 restructuring initiatives are estimated at \$11 million.

2000 PROVISION FOR RESTRUCTURING

In the fourth quarter of 2000, the Corporation recorded a charge of \$50 million pretax (\$31 million after-tax) related to a restructuring plan that included a salaried workforce reduction and the shutdown of gypsum wallboard manufacturing lines at U.S. Gypsum's plants located at Gypsum, Ohio, Oakfield, N.Y., and Fort Dodge, Iowa. Together, these closings eliminated approximately 700 million square feet of old, high-cost capacity. The plan also included the shutdown of a mill and ship-loading system at Alabaster, Mich. This restructuring was designed to streamline operations and improve business efficiency.

Included in the \$50 million pretax charge was \$16 million for severance related to the salaried workforce reduction of more than 500 positions, \$15 million for the write-off of property, plant and equipment, \$12 million for razing buildings and equipment, \$5 million for line shutdown and removal, and \$2 million for contract cancellations and severance for more than 100 hourly positions. An additional restructuring-related charge of \$4 million pretax (\$2 million after-tax) was included in cost of products sold for the writedown of certain inventory.

During the third quarter of 2001, the Corporation reversed \$9 million pretax (\$5 million after-tax) of the restructuring reserve recorded in the fourth quarter of 2000 due to changes from previous estimates and to reflect a change in the scope of restructuring activities undertaken. The primary change involved a decision made in September to eliminate a portion of the closure activities originally planned at the Alabaster, Mich., facility. Also, during the third quarter of 2001, the Corporation reversed restructuring-related inventory reserves totaling \$3 million pretax (\$2 million after-tax) to cost of products sold because the sale or use of certain affected inventory exceeded expectations.

Payments totaling \$21 million in 2001 and \$1 million in 2000 were charged against the 2000 restructuring reserve. All payments are being funded with cash from normal operations. The remaining restructuring reserves are considered adequate to cover committed restructuring actions.

The salaried workforce reduction program was completed as of June 30, 2001, with the termination of 394 salaried employees and the elimination of 179 open salaried positions. In addition, 73 hourly employees were terminated, and 44 open hourly positions were eliminated. Closure of the three gypsum wallboard manufacturing lines and other operations was completed by December 31, 2001. Final payments for expenses related to these closures will be made in the first half of 2002. Annual savings from the 2000 restructuring initiatives are estimated at \$40 million.

The reserve for the 2000 restructuring was included in accrued expenses as of December 31, 2000, and in liabilities subject to compromise as of December 31, 2001, on the consolidated balance sheets.

See Part II, Item 8. Note 3. Provisions for Impairment and Restructuring for additional information related to restructuring payments and reserve balances.

2000 PROVISION FOR ASBESTOS CLAIMS

In the fourth quarter of 2000, based on an independent study, USG estimated its probable liability for costs associated with asbestos cases currently pending and expected to be filed through 2003 and recorded a noncash provision of \$850 million pretax (\$524 million after-tax). This provision, combined with the existing asbestos-related reserve of \$335 million, resulted in a total reserve of \$1,185 million as of December 31, 2000. Substantially all of this reserve related to personal injury claims and reflected management's expectation that U.S. Gypsum's average cost-per-case would increase, at least in the short term, due to distortions in the tort system resulting from the bankruptcies of other defendants that led to increased settlement demands from asbestos plaintiffs. Less than 10% of the reserve related to defense and administrative costs. See Legal Contingencies below and Part II, Item 8. Note 17. Litigation for additional information on asbestos-related matters.

OPERATING PROFIT (LOSS)

Operating profit totaled \$90 million in 2001, compared with a loss of \$369 million in 2000 and profit of \$730 million in 1999. Operating profit in 2001 included pretax impairment charges of \$30 million, pretax restructuring charges of \$12 million and pretax chapter 11 reorganization expenses of \$12 million as described above. These charges were partially offset by pretax reversals of restructuring reserves of \$9 million and restructuring-related inventory reserves of \$3 million. The operating loss in 2000 included pretax charges for asbestos claims and restructuring of \$850 million and \$50 million, respectively, and a pretax restructuring-related inventory writedown of \$4 million. Excluding the net impact of these charges and reversals, pro forma operating profit was \$132 million in 2001 and \$535 million in 2000. These amounts, which represent declines of 75% and 27% from respective prior years, primarily reflect lower gross profit margins on SHEETROCK brand gypsum wallboard.

INTEREST EXPENSE

Interest expense was \$33 million, \$52 million and \$53 million in 2001, 2000 and 1999, respectively. Under SOP 90-7, virtually all of the Corporation's outstanding debt is classified as liabilities subject to compromise, and interest expense on this debt has not been accrued and recorded since the Petition Date. Consequently, comparisons of interest expense for 2001 and 2000 are not meaningful. From the Petition Date through December 31, 2001, contractual interest expense not accrued or recorded on pre-petition debt totaled \$41 million.

OTHER EXPENSE, NET

Other expense, net was \$10 million, \$4 million and \$3 million in 2001, 2000 and 1999, respectively. For 2001, other expense, net included \$7 million of net realized currency losses related to the repayment of intercompany loans by a Belgian subsidiary that is being liquidated.

INCOME TAXES (BENEFIT)

Income taxes amounted to \$36 million in 2001, while an income tax benefit of \$161 million was recorded in 2000 due to the loss before taxes resulting from the provisions relating to asbestos claims and restructuring. Income tax expense was \$263 million in 1999. The Corporation's effective tax rates were 70.0% in 2001 and 38.4% in 2000 and 1999. Excluding the net impact of the various charges and reversals listed above for the determination of 2001 and 2000 pro forma operating profit, the pro-forma effective tax rates were 43.5% in 2001 and 39.4% in 2000.

NET EARNINGS (LOSS)

Net earnings of \$16 million, or \$0.36 per share, were recorded in 2001. These earnings included after-tax impairment charges of \$25 million, or \$0.56 per share; after-tax restructuring charges of \$10 million, or \$0.24 per share; and after-tax chapter 11 reorganization expenses of \$10 million, or \$0.24 per share. These charges were partially offset by after-tax reversals of restructuring reserves of \$5 million, or \$0.12 per share, and restructuring-related inventory reserves of \$2 million, or \$0.04 per share. Excluding the net impact of these charges and reversals, pro forma net earnings in 2001 were \$54 million, and pro forma diluted earnings per share were \$1.24. As compared with prior years, net earnings for 2001 were favorably affected by the absence of asbestos-related charges and the absence of interest expense

on pre-petition debt subsequent to the Petition Date.

A net loss of \$259 million, or \$5.62 per share, was recorded in 2000. This loss included after-tax charges for asbestos claims of \$524 million, or \$11.39 per share; and restructuring of \$31 million, or \$0.66 per share; and an after-tax restructuring-related inventory writedown of \$2 million, or \$0.06 per share. Excluding these charges, pro forma net earnings in 2000 were \$298 million, and pro forma diluted earnings per share were \$6.49.

Net earnings totaled \$421 million in 1999, or \$8.39 per diluted share.

Core Business Results

<i>(millions)</i>	Net Sales			Operating Profit (Loss)		
	2001	2000	1999	2001	2000	1999
North American Gypsum:						
United States Gypsum Company	\$1,781	\$2,119	\$2,255	\$32	\$336	\$597
CGC Inc. (gypsum)	204	206	183	24	34	27
Other subsidiaries	118	112	108	24	22	27
Eliminations	<u>(153)</u>	<u>(139)</u>	<u>(130)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>1,950</u>	<u>2,298</u>	<u>2,416</u>	<u>80</u>	<u>392</u>	<u>651</u>
Worldwide Ceilings:						
USG Interiors, Inc.	475	513	487	34	64	60
USG International	210	232	226	(6)	3	-
CGC Inc. (ceilings)	40	43	39	5	3	3
Eliminations	<u>(65)</u>	<u>(83)</u>	<u>(63)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>660</u>	<u>705</u>	<u>689</u>	<u>33</u>	<u>70</u>	<u>63</u>
Building Products Distribution:						
L&W Supply Corporation	<u>1,152</u>	<u>1,373</u>	<u>1,345</u>	<u>64</u>	<u>110</u>	<u>87</u>
Corporate	-	-	-	(43)	(44)	(64)
Eliminations	(466)	(595)	(640)	1	3	(7)
Chapter 11 reorganization expenses	-	-	-	(12)	-	-
Provisions for impairment and restructuring	-	-	-	(33)	(50)	-
Provision for asbestos claims *	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(850)</u>	<u>-</u>
Total USG Corporation	<u><u>3,296</u></u>	<u><u>3,781</u></u>	<u><u>3,810</u></u>	<u><u>90</u></u>	<u><u>(369)</u></u>	<u><u>730</u></u>
* Excludes asbestos-related charges totaling \$77 million for the first nine months of 2000 recorded by U.S. Gypsum to cost of products sold. Comparable full-year charges in 1999 were \$80.5 million.						

NORTH AMERICAN GYPSUM

Net sales in 2001 were \$1,950 million, down 15% from 2000. Operating profit of \$80 million declined 80% from 2000. Net sales and operating profit in 2000 decreased 5% and 40%, respectively, versus 1999.

Despite record shipments of SHEETROCK brand gypsum wallboard, net sales for U.S. Gypsum declined in 2001 due to lower selling prices. Selling prices for SHEETROCK brand gypsum wallboard declined steadily during the first half of 2001 to a low of \$67.67 per thousand square feet in June, followed by a modest recovery in the second half of the year. By December, prices averaged \$94.06 per thousand square feet, up slightly from \$93.59 in December 2000. For the year, the average selling price was \$85.67 per thousand square feet, down 34% from \$130.61 in 2000. The average price in 1999 was a record \$153.40. The drop in wallboard prices in 2001 and 2000 reflects the transition from

short supply, as experienced in 1999, to the excess supply conditions that currently exist. This transition was caused by the addition of new industry capacity by U.S. Gypsum and other gypsum wallboard manufacturers during the past three years. U.S. Gypsum's plants operated at 90% of capacity in 2001, compared with 92% in 2000. The Corporation estimates that the U.S. wallboard industry as a whole operated at an average rate of 82% in 2001.

Shipments of SHEETROCK brand gypsum wallboard totaled 9.92 billion square feet in 2001, a 7% increase from the previous record of 9.29 billion square feet in 2000. Shipments in 1999 totaled 9.24 billion square feet. Shipments of SHEETROCK brand joint compounds and DUROCK brand cement board also set records in 2001 and were up 3% and 7%, respectively, from prior-year levels.

Operating profit for U.S. Gypsum declined significantly in 2001 and 2000 due to the lower wallboard selling prices, combined with higher manufacturing costs. Manufacturing costs for SHEETROCK brand gypsum wallboard increased versus 2000 primarily due to higher energy costs during the first half of 2001. However, energy costs stabilized and began to decrease during the second half of the year. Wallboard costs in 2001 also benefited from lower prices for wastepaper, the primary raw material of wallboard paper, and from improved operating efficiencies following the closure of several old facilities and optimization of new plants. As part of the Corporation's 2001 restructuring initiative, U.S. Gypsum will close its Fremont, Calif., wallboard plant in 2002. Manufacturing costs increased in 2000 as compared with 1999 primarily due to rising energy costs and higher prices for wastepaper. While there were no asbestos-related charges in 2001, asbestos-related charges to U.S. Gypsum's cost of products sold totaled \$77 million and \$80.5 million in 2000 and 1999, respectively.

Net sales and operating profit in 2001 for the gypsum business of Canada-based CGC Inc. were down 1% and 29%, respectively, versus 2000. The decline in net sales primarily reflects a 7% decrease in selling prices for CGC's SHEETROCK brand gypsum wallboard, partially offset by a 10% increase in shipments. Operating profit fell due to the lower prices and higher manufacturing costs. Comparing 2000 with 1999, net sales and operating profit increased 13% and 26%, respectively, primarily due to higher gypsum wallboard selling prices.

WORLDWIDE CEILINGS

Net sales in 2001 were \$660 million, down 6% versus 2000, while operating profit of \$33 million fell 53%. These results reflect a worldwide slowdown in the nonresidential construction market. The Corporation's domestic ceilings business, USG Interiors, Inc., reported net sales of \$475 million, down 7%, while operating profit of \$34 million dropped 47% from 2000. Domestic shipments of ceiling grid and AURATONE brand ceiling tile declined 7% and 6%, respectively, from their record levels of 2000 due to a significant slowdown in the commercial construction market in the United States. Operating profit for USG Interiors also was adversely affected by higher manufacturing costs. USG International reported a 9% decrease in net sales and an operating loss of \$6 million in 2001 versus operating profit of \$3 million in 2000. These unfavorable results were largely attributable to lower demand for ceiling tile and drywall steel in Europe. Lower sales also were experienced in the Asia/Pacific region and Latin America. As explained above, in response to the decline in demand in Europe, the Corporation determined that the carrying value of the long-lived assets at the Aubange, Belgium, ceiling tile plant was impaired. Accordingly, the Corporation recorded a pretax impairment charge of \$16 million and began implementing certain restructuring initiatives in Europe and elsewhere in the fourth quarter of 2001.

Comparing 2000 with 1999, net sales in 2000 were \$705 million, up 2%, while operating profit of \$70 million increased 11%. USG Interiors had record net sales of \$513 million in 2000, while operating profit of \$64 million rose 7%. Domestic shipments of ceiling grid and AURATONE brand ceiling tile also reached record levels in 2000. USG International reported a 3% increase in net sales, primarily due to increased sales in Europe, and recorded an operating profit of \$3 million in 2000 versus break-even results in 1999.

BUILDING PRODUCTS DISTRIBUTION

L&W Supply Corporation, the leading specialty building products distribution business in the United States, reported net sales of \$1,152 million in 2001, a 16% decrease from 2000. Operating profit of \$64 million declined 42%. Average selling prices for L&W Supply's gypsum wallboard in 2001 were down 27% from 2000. This decline was partially offset by a 33% decrease in unit costs, which primarily reflects manufacturers' selling prices to distributors. Shipments of L&W

Supply's gypsum wallboard in 2001 were virtually unchanged from the record level of 2000. Sales and profit for L&W Supply's complementary building products, primarily drywall metal, joint treatment and ceiling products, also declined from 2000 as a result of competitive market conditions. However, results for L&W Supply's insulation and roofing products improved versus 2000.

Comparing 2000 with 1999, L&W Supply reported record net sales of \$1,373 million in 2000, an increase of 2%. Operating profit of \$110 million, also a record, represented a 26% increase. These results were driven by record shipments of gypsum wallboard and strong sales of complementary building products. Average selling prices for L&W Supply's gypsum wallboard in 2000 were down 4% versus 1999. However, this decline was more than offset by a 7% increase in shipments and a 10% decrease in unit costs.

L&W remains focused on opportunities to grow in the most profitable market locations, as well as opportunities to reduce costs and optimize asset utilization. As part of this plan, L&W Supply opened four locations and closed or consolidated 16 locations during 2001, leaving a total of 180 locations in the United States as of December 31, 2001, down from 192 locations and 193 locations as of December 31, 2000 and 1999, respectively.

Market Conditions and Outlook

Industry shipments of wallboard in the United States were an estimated 30.2 billion square feet in 2001, a 3% increase from 29.3 billion square feet in 2000. This increase reflected a rebound in repair and remodel activity, partially offset by softening in new nonresidential construction.

Based on preliminary data issued by the U.S. Bureau of the Census, U.S. housing starts in 2001 were an estimated 1.602 million units, compared with actual housing starts of 1.569 million units in 2000 and 1.641 million units in 1999.

The repair and remodel market accounts for the second-largest portion of the Corporation's sales. Because many buyers remodel an existing home within two years of purchase, opportunity from this market in 2001 has been fairly solid as sales of existing homes in 2000 and 2001 remained at historically high levels.

Future demand for the Corporation's products from new nonresidential construction is determined by floor space for which contracts are signed. Installation of gypsum and ceilings products follows signing of construction contracts by about a year. Current information indicates that floor space for which contracts were signed was down significantly in 2001 as compared with 2000.

Excess industry capacity led to significant declines in market prices for gypsum wallboard over the past two years. Market conditions for gypsum wallboard improved somewhat during the second half of 2001 due to growth in demand and the closure of some excess capacity in the past year by the Corporation and other wallboard manufacturers, but it is unclear how long this trend will last.

The Corporation is cautious in its outlook for 2002. The economy remains in recession, with the unemployment rate expected to rise further, eroding consumer confidence and spending. The housing market, which was strong in 2001 due to falling mortgage rates, is expected to weaken in 2002 as the recession continues and interest rates stabilize. Commercial construction has been affected by white-collar-job layoffs and reduced corporate spending, which have caused office vacancy rates to increase to double-digit levels in many markets. Commercial construction is expected to decline again in 2002. Further slowdowns in these markets would translate into lower levels of demand for the Corporation's products and cause renewed pressure on gypsum wallboard pricing and on margins for the Corporation's other businesses. During this period of uncertainty, the Corporation will remain focused on managing the fundamentals of its business such as customer satisfaction, costs and profitability and will continue its attempt to resolve the chapter 11 proceedings as quickly as possible, consistent with the goal of achieving a fair, comprehensive and final resolution to its asbestos liability.

Liquidity and Capital Resources

WORKING CAPITAL

Working capital (current assets less current liabilities) as of December 31, 2001, amounted to \$876 million, and the ratio of current assets to current liabilities was 3.73-to-1. As of December 31, 2000, current liabilities exceeded current assets by \$20 million, and the ratio of current assets to current liabilities was 0.98-to-1.

Cash and cash equivalents as of December 31, 2001, amounted to \$493 million, compared with \$70 million as of December 31, 2000. During 2001, net cash flows from operating activities totaled \$237 million. Net cash flows to investing activities (primarily capital spending) were \$108 million. Net cash flows from financing activities (primarily increased borrowings) were \$294 million.

Receivables decreased to \$274 million as of December 31, 2001, from \$305 million as of December 31, 2000, primarily reflecting a 5% decrease in net sales for the month of December 2001 as compared with December 2000. Inventories and payables also were down from a year ago primarily due to the lower level of business. Inventories decreased to \$254 million from \$271 million, and accounts payable decreased to \$140 million from \$200 million.

DEBT

As of December 31, 2001, total debt amounted to \$1,007 million, of which \$1,005 million was included in liabilities subject to compromise. As of December 31, 2000, total debt was \$711 million. The higher level of debt as of year-end 2001 reflects a \$390 million net increase in credit facility borrowings, partially offset by a \$60 million repayment of debt outstanding in connection with an accounts receivable facility, a \$15 million repayment of a Mexican term loan, a \$10 million repurchase of 9.25% senior notes due 2001 and a \$9 million repayment of other debt (primarily international short- and long-term notes). All of these transactions occurred prior to the Filing, except for the repayment of debt associated with the accounts receivable facility.

AVAILABLE LIQUIDITY

A \$350 million DIP Facility is available to supplement liquidity and fund operations during the reorganization process. Borrowing availability under the DIP Facility is based primarily on accounts receivable and inventory levels and, to a lesser extent, property, plant and equipment. As of December 31, 2001, the Corporation had the capacity to borrow up to \$291 million. There were no outstanding borrowings under the facility at year end. However, \$11 million of standby letters of credit were issued, leaving \$280 million of unused borrowing capacity available as December 31, 2001. The Corporation believes that cash available from operations and the DIP Facility will provide sufficient liquidity to allow its businesses to operate in the normal course without interruption. As of December 31, 2001, the Corporation had \$493 million of cash and cash equivalents on a consolidated basis. Of this amount, \$147 million was in the possession of non-Debtor subsidiaries.

CAPITAL EXPENDITURES

Capital spending amounted to \$109 million in 2001, compared with \$380 million in 2000. As of December 31, 2001, remaining capital expenditure commitments for the replacement, modernization and expansion of operations amounted to \$63 million, compared with \$58 million as of December 31, 2000.

During the bankruptcy proceeding, the Corporation expects to have limited sources of capital and liquidity to fund potential future growth opportunities such as new products, acquisitions and joint ventures. In addition, one of the terms of the DIP Facility limits capital spending.

DIVIDENDS

The Corporation discontinued payment of quarterly cash dividends in the second quarter of 2001. In the first quarter of 2001, the Corporation paid a cash dividend of \$0.025 per share. In 2000, the Corporation paid four quarterly cash dividends of \$0.15 per share.

Other Matters

MARKET RISK

In the normal course of business, the Corporation uses financial instruments, including fixed and variable rate debt, to finance its operations. In addition, the Corporation uses derivative instruments to manage well-defined commodity price, foreign currency and interest rate exposures. The Corporation does not use derivative instruments for trading purposes.

Commodity Price Risk: The Corporation uses swap and option agreements to manage price exposure on anticipated purchases of natural gas, wastepaper and fuel. A sensitivity analysis has been prepared to estimate the potential loss in fair value of such instruments assuming a hypothetical 10% increase in market prices. The sensitivity analysis includes the underlying exposures that are being hedged. Based on results of the sensitivity analysis, which may differ from actual results, the Corporation's potential loss in fair value is \$11 million.

The Corporation has swap agreements in place with Enron Corp. to hedge the cost of wastepaper. As a result of Enron's bankruptcy filing in December 2001, the Corporation has discontinued hedge accounting from that point forward. Consequently, future changes in the fair value of these hedges will be recognized in earnings in the period in which the change occurs.

Foreign Currency Exchange Risk: The Corporation has operations in a number of countries and hedges the risk of changes in cash flows resulting from forecasted intercompany and third-party sales or purchases in foreign currencies. As of December 31, 2001, the Corporation had forward contracts in place to purchase the Canadian dollar equivalent of \$6 million (U.S.) at a rate of \$1.54 Canadian/\$1.00 U.S.

Interest Rate Risk: As a result of the Filing, virtually all of the Corporation's debt obligations are classified as liabilities subject to compromise. See Part II, Item 8. Note 1. Significant Accounting Policies and Note 12. Financial Instruments and Risk Management for additional information on the Corporation's financial exposures.

EURO CURRENCY CONVERSION

Effective January 1, 1999, 11 of the 15 countries that are members of the European Union introduced a new, single currency unit, the euro. Prior to full implementation of the new currency for the participating countries on January 1, 2002, there was a three-year transition period during which parties could have used either their local currencies or the euro. However, during the transition period, all exchanges between currencies of the participating countries were required to be first converted through the euro.

The Corporation prepared for the conversion to the euro in two phases. The first phase addressed the Corporation's European operations during the transition period. The second phase covered full conversion of these operations to the euro. The Corporation has not experienced any significant problems to date and does not expect the introduction of the euro currency to have a material adverse impact on its business, results of operations or financial position.

LEGAL CONTINGENCIES

As a result of the Filing, all pending asbestos lawsuits against U.S. Gypsum are stayed, and no party may take any action to pursue or collect on such asbestos claims absent specific authorization of the Bankruptcy Court. Since the Filing, U.S. Gypsum has ceased making both cash payments and accruals with respect to asbestos lawsuits, including cash payments and accruals pursuant to settlements of asbestos lawsuits. Creditors' committees have been appointed representing asbestos personal injury and property damage claimants with pending claims against U.S. Gypsum, and the Bankruptcy Court is expected to appoint a legal representative for the interests of potential future asbestos claimants. As part of the bankruptcy proceeding, it will be determined which present and future asbestos claims should be allowed, or compensated, and the aggregate value of such claims. The Corporation is unable to predict the value that the court will assign to such claims.

The Corporation and certain of its subsidiaries have been notified by state and federal environmental protection

agencies of possible involvement as one of numerous “potentially responsible parties” in a number of so-called “Superfund” sites in the United States. The Corporation believes that neither these matters nor any other known governmental proceeding regarding environmental matters will have a material adverse effect upon its results of operations or financial position. See Part II, Item 8. Note 17. Litigation for additional information on asbestos and environmental litigation.

RECENT ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board issued four new accounting standards in 2001. Statement of Financial Accounting Standards (“SFAS”) No. 141, “Business Combinations,” requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. This standard, which becomes effective January 1, 2002, will have no impact on the Corporation’s financial statements upon adoption.

SFAS No. 142, “Goodwill and Other Intangible Assets,” eliminates the amortization of goodwill over its estimated useful life. Instead, goodwill will be subject to at least an annual assessment for impairment by applying a fair-value-based test. In addition, acquired intangible assets will be separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the intangible asset can be sold, transferred, licensed, rented or exchanged. This standard, which becomes effective January 1, 2002, will have an impact on the Corporation’s financial statements because goodwill is no longer subject to amortization. The Corporation’s current annual rate of goodwill amortization is approximately \$4 million. All of the Corporation’s goodwill, which does not include any acquired intangible assets, will be assessed for impairment. As of the date of this report, the Corporation has not completed its test for impairment and therefore has not determined the full impact that the adoption of this standard will have on its financial statements.

SFAS No. 143, “Accounting for Asset Retirement Obligations,” requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. This standard, which becomes effective January 1, 2003, is likely to have an impact on the Corporation’s financial statements. However, as of the date of this report, the Corporation has not determined what impact the adoption of this standard may have on its financial statements.

SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” supersedes SFAS No. 121 and a portion of APB Opinion No. 30. This statement establishes a single accounting model for the disposal of long-lived assets and resolves significant implementation issues related to SFAS No. 121. This standard, which becomes effective January 1, 2002, will have no impact on the Corporation’s financial statements upon adoption.

Forward-Looking Statements

This report contains forward-looking statements related to management’s expectations about future conditions. The effects of the Filing and the conduct, outcome and costs of the Chapter 11 Cases, as well as the ultimate costs associated with the Corporation’s asbestos litigation, may differ from management’s expectations. Actual business or other conditions may also differ significantly from management’s expectations and accordingly affect the Corporation’s sales and profitability or other results. Actual results may differ due to various other factors, including economic conditions such as the levels of construction activity, interest rates and consumer confidence; competitive conditions such as price and product competition; increases in raw material and energy costs; and the unpredictable effects of the global war on terrorism upon domestic and international economies and financial markets. The Corporation assumes no obligation to update any forward-looking information contained in this report.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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All other schedules have been omitted because they are not required, are not applicable, or the information is included in the consolidated financial statements or notes thereto.

USG CORPORATION
CONSOLIDATED STATEMENTS OF EARNINGS

<i>(millions, except per-share data)</i>	Years Ended December 31,		
	2001	2000	1999
Net sales	\$3,296	\$3,781	\$3,810
Cost of products sold	2,882	2,941	2,742
Selling and administrative expenses	279	309	338
Chapter 11 reorganization expenses	12	-	-
Provisions for impairment and restructuring	33	50	-
Provision for asbestos claims	-	850	-
Operating profit (loss)	90	(369)	730
Interest expense	33	52	53
Interest income	(5)	(5)	(10)
Other expense, net	10	4	3
Earnings (loss) before income taxes	52	(420)	684
Income taxes (benefit)	36	(161)	263
Net earnings (loss)	16	(259)	421
<i>Net Earnings (Loss) Per Common Share:</i>			
Basic	0.36	(5.62)	8.48
Diluted	0.36	(5.62)	8.39

The notes to consolidated financial statements are an integral part of these statements.

USG CORPORATION
CONSOLIDATED BALANCE SHEETS

<i>(millions, except share data)</i>	As of December 31,	
	2001	2000
Assets		
<i>Current Assets:</i>		
Cash and cash equivalents	\$ 493	\$ 70
Receivables (net of reserves of \$17 and \$18)	274	305
Inventories	254	271
Income taxes receivable	76	-
Deferred income taxes	66	194
Other current assets	34	36
Total current assets	1,197	876
Property, plant and equipment, net	1,800	1,830
Deferred income taxes	243	257
Other assets	224	251
Total assets	3,464	3,214
Liabilities and Stockholders' Equity		
<i>Current Liabilities:</i>		
Accounts payable	140	200
Accrued expenses	181	280
Taxes on income	-	19
Notes payable	-	6
Current portion of long-term debt	-	141
Current portion of asbestos reserve	-	250
Total current liabilities	321	896
Long-term debt	2	564
Long-term asbestos reserve	-	935
Other liabilities	339	355
Liabilities subject to compromise	2,311	-
<i>Stockholders' Equity:</i>		
Preferred stock - \$1 par value; authorized 36,000,000 shares; \$1.80 convertible preferred stock (initial series); outstanding - none	-	-
Common stock - \$0.10 par value; authorized 200,000,000 shares; outstanding - 43,457,312 and 43,401,045 shares (after deducting 6,527,910 and 6,584,177 shares held in treasury)	5	5
Treasury stock	(255)	(256)
Capital received in excess of par value	408	411
Accumulated other comprehensive loss	(31)	(45)
Retained earnings	364	349
Total stockholders' equity	491	464
Total liabilities and stockholders' equity	3,464	3,214

The notes to consolidated financial statements are an integral part of these statements.

USG CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(millions)</i>	Years Ended December 31,		
	2001	2000	1999
Operating Activities			
Net earnings (loss)	\$ 16	\$(259)	\$ 421
<i>Adjustments to Reconcile Net Earnings (Loss) to Net Cash:</i>			
Provisions for impairment and restructuring	33	50	-
Provision for asbestos claims	-	850	-
Depreciation, depletion and amortization	107	96	91
Deferred income taxes	134	(365)	(42)
<i>(Increase) Decrease in Working Capital:</i>			
Receivables	32	55	(4)
Income taxes receivable	(76)	-	-
Inventories	17	(15)	(15)
Payables	82	15	24
Accrued expenses	2	(58)	58
Increase in other assets	(11)	(2)	(20)
Increase in other liabilities	16	-	20
Asbestos reserve, net of receivables	(90)	2	101
Liabilities subject to compromise	(58)	-	-
Other, net	33	(5)	(3)
Net cash from operating activities	237	364	631
Investing Activities			
Capital expenditures	(109)	(380)	(426)
Net proceeds from asset dispositions	1	3	2
Acquisition of business, net of acquired cash	-	-	(74)
Net cash to investing activities	(108)	(377)	(498)
Financing Activities			
Issuance of debt	262	197	65
Repayment of debt	(131)	(114)	(50)
Short-term borrowings (repayments), net	164	37	(21)
Cash dividends paid	(1)	(27)	(22)
Purchases of common stock	-	(207)	(72)
Issuances of common stock	-	-	12
Net cash from (to) financing activities	294	(114)	(88)
Net Increase (Decrease) in Cash and Cash Equivalents	423	(127)	45
Cash and cash equivalents at beginning of period	70	197	152
Cash and cash equivalents at end of period	493	70	197
<i>Supplemental Cash Flow Disclosures:</i>			
Interest paid	31	52	56
Income taxes (refunded) paid, net	(17)	211	281

The notes to consolidated financial statements are an integral part of these statements.

USG CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Shares (000)	Treasury Shares (000)	Common Stock	Treasury Stock	Capital Received in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Loss	Total
<i>(millions, except share data)</i>								
Balance at December 31, 1998	49,525	(296)	\$5	\$(10)	\$317	\$236	\$ (30)	\$518
<i>Comprehensive Income:</i>								
Net earnings	-	-	-	-	-	421	-	421
Foreign currency translation	-	-	-	-	-	-	(3)	(3)
Total comprehensive income	-	-	-	-	-	-	-	418
Cash dividends paid	-	-	-	-	-	(22)	-	(22)
Stock issuances	164	661	-	29	(18)	-	-	11
Purchases of common stock	-	(1,425)	-	(72)	-	-	-	(72)
Other	1	(66)	-	(3)	17	-	-	14
Net change in treasury stock	(830)	-	-	-	-	-	-	-
Balance at December 31, 1999	48,860	(1,126)	5	(56)	316	635	(33)	867
<i>Comprehensive Loss:</i>								
Net loss	-	-	-	-	-	(259)	-	(259)
Foreign currency translation	-	-	-	-	-	-	(12)	(12)
Total comprehensive loss	-	-	-	-	-	-	-	(271)
Cash dividends paid	-	-	-	-	-	(27)	-	(27)
Stock issuances	-	262	-	9	(11)	-	-	(2)
Purchases of common stock	-	(5,656)	-	(207)	-	-	-	(207)
Reduction of tax reserves	-	-	-	-	103	-	-	103
Other	(1)	(64)	-	(2)	3	-	-	1
Net change in treasury stock	(5,458)	-	-	-	-	-	-	-
Balance at December 31, 2000	43,401	(6,584)	5	(256)	411	349	(45)	464
<i>Comprehensive Income:</i>								
Net earnings	-	-	-	-	-	16	-	16
Foreign currency translation	-	-	-	-	-	-	(2)	(2)
After-tax gain on derivatives	-	-	-	-	-	-	16	16
Total comprehensive income	-	-	-	-	-	-	-	30
Cash dividends paid	-	-	-	-	-	(1)	-	(1)
Stock issuances	-	156	-	4	(3)	-	-	1
Other	-	(100)	-	(3)	-	-	-	(3)
Net change in treasury stock	56	-	-	-	-	-	-	-
Balance at December 31, 2001	43,457	(6,528)	5	(255)	408	364	(31)	491

The notes to consolidated financial statements are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Policies

NATURE OF OPERATIONS

Through its subsidiaries, USG Corporation (the “Corporation”) is a leading manufacturer and distributor of building materials, producing a wide range of products for use in new residential, new nonresidential, and repair and remodel construction, as well as products used in certain industrial processes. The Corporation’s operations are organized into three operating segments: North American Gypsum, which manufactures and markets SHEETROCK brand gypsum wallboard and related products in the United States, Canada and Mexico; Worldwide Ceilings, which manufactures and markets ceiling tile, ceiling grid and other interior systems products worldwide; and Building Products Distribution, which distributes gypsum wallboard, drywall metal, ceiling products, joint compound and other building products throughout the United States. The Corporation’s products also are distributed through building materials dealers, home improvement centers and other retailers, specialty wallboard distributors and contractors.

CONSOLIDATION

The consolidated financial statements include the accounts of the Corporation and its subsidiaries. All significant intercompany balances and transactions are eliminated in consolidation.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from these estimates.

RECLASSIFICATIONS

Certain amounts in the prior years’ consolidated financial statements and notes thereto have been reclassified to conform with the 2001 presentation.

REVENUE RECOGNITION

Revenue is recognized upon the shipment of products to customers. The Corporation’s products are shipped FOB shipping point.

SHIPPING AND HANDLING COSTS

Shipping and handling costs are included in cost of products sold.

ADVERTISING

Advertising expenses consist of media advertising and related production costs. Advertising expenses are charged to earnings as incurred and amounted to \$14 million, \$20 million and \$22 million in the years ended December 31, 2001, 2000 and 1999, respectively.

RESEARCH AND DEVELOPMENT

Research and development expenditures are charged to earnings as incurred and amounted to \$15 million in the year ended December 31, 2001, and \$21 million in each of the years ended December 31, 2000 and 1999.

EARNINGS PER SHARE

Basic earnings per share are based on the weighted average number of common shares outstanding. Diluted earnings per share are based on the weighted average number of common shares outstanding and the dilutive effect of the potential exercise of outstanding stock options. Potential common shares such as those issuable upon exercise of outstanding stock options are not included in the computation of a diluted per-share amount for a period in which a loss has occurred because they have an anti-dilutive effect.

COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income (loss) include net earnings (loss) and accumulated other comprehensive income (loss). Accumulated other comprehensive income (loss) includes foreign currency translation. For 2001, the Corporation’s accumulated other comprehensive loss also includes the after-tax gain on derivatives in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended by SFAS Nos. 137 and 138, which the Corporation adopted on January 1, 2001. The tax impact on the gain on derivatives was \$10 million in 2001. There was no tax impact on the foreign currency translation adjustments.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of highly liquid investments with original maturities of three months or less.

FOREIGN CURRENCY TRANSLATION

Foreign-currency-denominated assets and liabilities are translated into U.S. dollars at the exchange rates existing as of the respective balance sheet dates. Translation adjustments resulting from fluctuations in exchange rates are recorded as a separate component of accumulated other comprehensive income (loss) within stockholders' equity. Income and expense items are translated at the average exchange rates during the respective periods.

INVENTORY VALUATION

All of the Corporation's inventories are stated at the lower of cost or market. Most of the Corporation's domestic inventories are valued under the last-in, first-out ("LIFO") method. The remaining inventories are valued under the first-in, first-out ("FIFO") or average production cost methods. Inventories include material, labor and applicable factory overhead costs.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost, except for those assets that were revalued under fresh start accounting in May 1993. Provisions for depreciation of property, plant and equipment are determined principally on a straight-line basis over the expected average useful lives of composite asset groups. Estimated useful lives are determined to be 50 years for buildings and improvements and a range of 10 years to 25 years for machinery and equipment. Depletion is computed on a basis calculated to spread the cost of gypsum and other applicable resources over the estimated quantities of material recoverable.

LONG-LIVED ASSETS

Long-lived assets primarily include property, plant and equipment and goodwill (the excess of cost over the fair value of net assets acquired). The Corporation periodically reviews its long-lived assets for impairment by comparing the carrying value of the assets with their estimated future undiscounted cash flows. If impairment is determined, the asset is written down to estimated net realizable value. Goodwill was amortized on a straight-line basis over a period of 15 years to 40 years. Goodwill, net of accumulated amortization, amounted to \$112 million and \$120 million as of December 31, 2001 and 2000, respectively. Accumulated amortization of goodwill as of those dates totaled \$14 million and \$9 million, respectively. Goodwill is included in other assets on the consolidated balance sheets. Effective January 1, 2002, the Corporation adopted the

provisions of SFAS No. 142, "Goodwill and Other Intangible Assets," which eliminates the amortization of goodwill. See Recent Accounting Pronouncements below.

FINANCIAL INSTRUMENTS

The Corporation uses derivative instruments to manage well-defined commodity price and foreign currency exposures. The Corporation does not use derivative instruments for trading purposes. Under SFAS No. 133, as amended, all derivative instruments must be recorded on the balance sheet at fair value. For derivatives designated as fair value hedges, the changes in the fair values of both the derivative instrument and the hedged item are recognized in earnings in the current period. For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is recorded to accumulated other comprehensive income (loss) and is reclassified to earnings when the underlying transaction has an impact on earnings.

Commodity Derivative Instruments: The Corporation uses swap contracts to hedge anticipated purchases of natural gas, wastepaper and fuel to be used in its manufacturing and shipping operations. These contracts, all of which mature by December 31, 2003, are designated as cash flow hedges, and changes in fair value are recorded in accumulated other comprehensive income (loss) until the hedged transaction occurs, at which time it is reclassified to earnings.

Foreign Exchange Derivative Instruments: The Corporation has operations in a number of countries and uses forward contracts to hedge the risk of changes in cash flows resulting from forecasted intercompany and third-party sales or purchases in foreign currencies. These contracts are designated as cash flow hedges, and changes in fair value are recorded in accumulated other comprehensive income (loss) until the underlying transaction has an impact on earnings. All foreign currency forward contracts expire within 12 months.

Interest Rate Derivative Instruments: The Corporation is exposed to interest rate changes and uses swap agreements from time to time to manage this exposure. As of December 31, 2001, the Corporation had no outstanding interest rate swap agreements.

RECENT ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board issued four

new accounting standards in 2001.

SFAS No. 141, “Business Combinations,” requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method. This standard, which becomes effective January 1, 2002, will have no impact on the Corporation’s financial statements upon adoption.

SFAS No. 142, “Goodwill and Other Intangible Assets,” eliminates the amortization of goodwill over its estimated useful life. Instead, goodwill will be subject to at least an annual assessment for impairment by applying a fair-value-based test. In addition, acquired intangible assets will be separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the intangible asset can be sold, transferred, licensed, rented or exchanged. This standard, which becomes effective January 1, 2002, will have an impact on the Corporation’s financial statements because goodwill is no longer subject to amortization. The Corporation’s current annual rate of goodwill amortization is approximately \$4 million. All of the Corporation’s goodwill, which does not include any acquired intangible assets, will be assessed for impairment. As of the date of this report, the Corporation has not completed its test for impairment and therefore has not determined the full impact that the adoption of this standard will have on its financial statements.

SFAS No. 143, “Accounting for Asset Retirement Obligations,” requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. This standard, which becomes effective January 1, 2003, is likely to have an impact on the Corporation’s financial statements. However, as of the date of this report, the Corporation has not determined what impact the adoption of this standard may have on its financial statements.

SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” supersedes SFAS No. 121 and a portion of APB Opinion No. 30. This statement establishes a single accounting model for the disposal of long-lived assets and resolves significant implementation issues related to SFAS No. 121. This standard, which becomes effective January 1, 2002, will have no impact on the Corporation’s financial statements upon adoption.

2. Voluntary Reorganization Under Chapter 11

On June 25, 2001 (the “*Petition Date*”), the parent company (the “*Parent Company*”) of the Corporation

and the 10 United States subsidiaries listed below (collectively, the “*Debtors*”) filed voluntary petitions for reorganization (the “*Filing*”) under chapter 11 of the United States Bankruptcy Code (the “*Bankruptcy Code*”) in the United States Bankruptcy Court for the District of Delaware (the “*Bankruptcy Court*”). The chapter 11 cases of the Debtors (collectively, the “*Chapter 11 Cases*”) have been consolidated for purposes of joint administration as In re: USG Corporation et al. (case no. 01-2094). The Chapter 11 Cases do not include any of the Corporation’s non-U.S. subsidiaries. The following subsidiaries filed chapter 11 petitions:

United States Gypsum Company
USG Interiors, Inc.
USG Interiors International, Inc.
L&W Supply Corporation
Beadex Manufacturing, LLC
B-R Pipeline Company
La Mirada Products Co., Inc.
Stocking Specialists, Inc.
USG Industries, Inc.
USG Pipeline Company

This action was taken to resolve asbestos-related claims in a fair and equitable manner, to protect the long-term value of the Debtors’ businesses and to maintain the Debtors’ leadership positions in their markets.

CONSEQUENCES OF THE FILING

The Debtors are operating their businesses without interruption as debtors-in-possession subject to the provisions of the Bankruptcy Code. All vendors are being paid for all goods furnished and services provided after the Filing. However, as a consequence of the Filing, all pending litigation against the Debtors as of the Petition Date is stayed, and no party may take any action to pursue or collect pre-petition claims except pursuant to an order of the Bankruptcy Court. It is the Debtors’ intention to address all pending and future asbestos-related claims and all other pre-petition claims in a plan of reorganization. However, it is impossible to predict currently how the plan will treat asbestos and other pre-petition claims and what impact any reorganization plan may have on the shares of the Corporation’s common stock and other outstanding securities. The formulation and implementation of the plan of reorganization could take a significant period of time.

Three creditors' committees, one representing asbestos personal injury claimants, another representing asbestos property damage claimants and a third representing general unsecured creditors, have been appointed as official committees in the Chapter 11 Cases and, in accordance with the provisions of the Bankruptcy Code, will have the right to be heard on all matters that come before the Bankruptcy Court. The Corporation expects that the appointed committees, together with a legal representative for the interests of future asbestos claimants to be appointed by the Bankruptcy Court, will play important roles in the Chapter 11 Cases and the negotiation of the terms of any plan of reorganization.

Pursuant to the Bankruptcy Code, the Debtors initially had the exclusive right to propose a plan of reorganization for 120 days following the Petition Date, until October 23, 2001, unless extended. The Bankruptcy Court granted the Debtors' request to extend the period of exclusivity until May 1, 2002. The Debtors are likely to seek one or more additional extensions of the exclusivity period depending on developments in the Chapter 11 Cases. If the Debtors fail to file a plan of reorganization during such extension period, or if such plan is not accepted by the requisite numbers of creditors and equity holders entitled to vote on the plan, other parties in interest in the Chapter 11 Cases may be permitted to propose their own plan(s) of reorganization for the Debtors.

The Corporation is unable to predict at this time what the treatment of creditors and equity security holders of the respective Debtors will be under any proposed plan or plans of reorganization. Such plan or plans may provide, among other things, that all present and future asbestos-related liabilities of the Debtors will be discharged and assumed and resolved by one or more independently administered trusts established in compliance with Section 524(g) of the Bankruptcy Code. Section 524(g) of the Bankruptcy Code provides that, if certain specified conditions are satisfied, a court may issue a supplemental permanent injunction barring the assertion of asbestos-related claims against the reorganized company and channeling those claims to an independent trust for payment in whole or in part. Similar plans of reorganization have been confirmed in chapter 11 cases of other companies involved in asbestos-related litigation. However, there is no assurance that such creation of a trust for the Debtors under Section 524(g), or the issuance of such a permanent injunction, will be approved by the Bankruptcy Court.

The Corporation is unable to predict at this time what treatment will be accorded under any such reorganization plan or plans to intercompany indebtedness, licenses, transfers of goods and services, and other intercompany arrangements, transactions and relationships that were entered into prior to the Petition Date. These arrangements, transactions and relationships may be challenged by various parties in the Chapter 11 Cases, and the outcome of those challenges, if any, may have an impact on the treatment of various claims under such plan or plans.

The Bankruptcy Court may confirm a plan of reorganization only upon making certain findings required by the Bankruptcy Code, and a plan may be confirmed over the dissent of nonaccepting creditors and equity security holders if certain requirements of the Bankruptcy Code are met. The payment rights and other entitlements of pre-petition creditors and USG shareholders may be substantially altered by any plan or plans of reorganization confirmed in the Chapter 11 Cases. There is no assurance that there will be sufficient assets to satisfy the Debtors' pre-petition liabilities in whole or in part, and the pre-petition creditors of some Debtors may be treated differently than those of other Debtors. Pre-petition creditors may receive under a plan or plans less than 100% of the face value of their claims, and the interests of the Corporation's equity security holders may be substantially diluted or canceled in whole or in part. As noted above, it is not possible at this time to predict the outcome of the Chapter 11 Cases, the terms and provisions of any plan or plans of reorganization, or the effect of the chapter 11 reorganization process on the claims of the pre-petition creditors of the Debtors or the interests of the Corporation's equity security holders. Recent developments in the Corporation's bankruptcy proceeding are discussed in Note 17. Litigation.

In connection with the Filing, the Corporation implemented a Bankruptcy-Court-approved key employee retention plan that commenced on July 1, 2001, and continues until the date the Corporation emerges from bankruptcy, or June 30, 2004, whichever occurs first. Under the plan, participants receive semiannual payments beginning in January 2002. Costs associated with the plan are being accrued pro rata over the term of the plan.

CHAPTER 11 FINANCING

A \$350 million debtor-in-possession financing facility from JP Morgan Chase (the "*DIP Facility*") was

approved by the Bankruptcy Court on July 31, 2001. The DIP Facility is available to supplement liquidity and fund operations during the reorganization process. Borrowing availability under the DIP Facility is based primarily on accounts receivable and inventory levels and, to a lesser extent, property, plant and equipment. As of December 31, 2001, borrowing availability under the DIP Facility was \$280 million.

FINANCIAL STATEMENT PRESENTATION

The accompanying consolidated financial statements have been prepared in accordance with AICPA Statement of Position 90-7 (“SOP 90-7”), “Financial Reporting by Entities in Reorganization Under the Bankruptcy Code,” and on a going-concern basis, which contemplates continuity of operations, realization of assets and liquidation of liabilities in the ordinary course of business. However, as a result of the Filing, such realization of assets and liquidation of liabilities, without substantial adjustments and/or changes of ownership, are subject to uncertainty. Given this uncertainty, there is doubt about continuing the going-concern basis of presentation. While operating as debtors-in-possession under the protection of chapter 11 of the Bankruptcy Code and subject to Bankruptcy Court approval or otherwise as permitted in the ordinary course of business, the Debtors, or some of them, may sell or otherwise dispose of assets and liquidate or settle liabilities for some amounts other than those reflected in the consolidated financial statements. Further, a plan of reorganization could materially change the amounts and classifications in the historical consolidated financial statements.

As of the date of this report, virtually all of the Corporation’s pre-petition debt is in default due to the Filing. As described below, the accompanying consolidated financial statements present the Debtors’ pre-petition debt under the caption “Liabilities Subject to Compromise.” This includes debt outstanding of \$469 million under the pre-petition bank credit facilities and \$536 million of other outstanding debt. The Corporation accelerated the amortization of its debt-related costs attributable to the Debtors and recorded a pretax expense of \$2 million during the second quarter of 2001, which was included under the caption “Chapter 11 Reorganization Expenses.”

As reflected in the consolidated financial statements, liabilities subject to compromise refers to Debtors’ liabilities incurred prior to the commencement of the Chapter 11 Cases. The amounts

of the various liabilities that are subject to compromise are set forth below. These amounts represent the Corporation’s estimate of known or potential pre-petition claims to be resolved in connection with the Chapter 11 Cases. Such claims remain subject to future adjustments. Adjustments may result from (i) negotiations (ii) actions of the Bankruptcy Court (iii) further developments with respect to disputed claims (iv) rejection of executory contracts and unexpired leases (v) the determination as to the value of any collateral securing claims (vi) proofs of claim or (vii) other events. Payment terms for these amounts will be established in connection with the Chapter 11 Cases.

Pursuant to the Bankruptcy Code, schedules were filed by the Debtors with the Bankruptcy Court on October 23, 2001, setting forth the assets and liabilities of the Debtors as of the date of the Filing. Differences between amounts recorded by the Debtors and claims filed by creditors will be investigated and resolved as part of the proof-of-claim process in the Chapter 11 Cases. No bar dates have been set for the filing of proofs of claim against the Debtors. Accordingly, the ultimate number and allowed amount of such claims are not presently known.

The Debtors have received approval from the Bankruptcy Court to pay or otherwise honor certain of their pre-petition obligations, including employee wages, salaries, benefits and other employee obligations, and from limited available funds, pre-petition claims of certain critical vendors, real estate taxes, certain customer programs and warranty claims, and certain other pre-petition claims.

From the Petition Date through December 31, 2001, contractual interest expense not accrued or recorded on pre-petition debt totaled \$41 million.

The Corporation believes that cash available from operations and the DIP Facility will provide sufficient liquidity to allow its businesses to operate in the normal course without interruption. This includes its ability to meet post-petition obligations of the Debtors and to meet obligations of the nondebtor subsidiaries. The appropriateness of using the going-concern basis for the Corporation’s financial statements is dependent upon, among other things, (i) the Corporation’s ability to comply with the terms of the DIP Facility and the cash management order entered by the Bankruptcy Court in connection with the Chapter 11 Cases (ii) the ability of the Corporation to maintain adequate cash on hand (iii) the ability of the Corporation to generate cash from operations (iv) confirmation of a plan or

plans of reorganization under the Bankruptcy Code and (v) the Corporation's ability to achieve profitability following such confirmation.

Liabilities subject to compromise in the consolidated and debtor-in-possession balance sheets consist of the following items as of December 31, 2001 (dollars in millions):

Accounts payable	\$ 162
Accrued expenses	86
Debt	1,005
Asbestos reserve	1,061
<u>Other long-term liabilities</u>	<u>38</u>
Subtotal	2,352
<u>Elimination of intercompany accounts payable</u>	<u>(41)</u>
<u>Total liabilities subject to compromise</u>	<u>2,311</u>

Chapter 11 reorganization expenses in the consolidated and debtor-in-possession statements of earnings for the year ended December 31, 2001, consist of the following (dollars in millions):

Legal and financial advisory fees	\$14
Accelerated amortization of debt issuance costs	2
<u>Interest income</u>	<u>(4)</u>
<u>Total chapter 11 reorganization expenses</u>	<u>12</u>

DIP FINANCIAL STATEMENTS (unaudited)

Under the Bankruptcy Code, the Corporation is required to file periodically with the Bankruptcy Court various documents including financial statements of the Debtors (the "Debtor-In-Possession" or "DIP" financial statements). The Corporation cautions that these financial statements are prepared according to requirements under the Bankruptcy Code. While these financial statements accurately provide information required under the Bankruptcy Code, they are nonetheless unconsolidated, unaudited and prepared in a format different from that used in the Corporation's consolidated financial statements filed under the securities laws. Accordingly, the Corporation believes the substance and format do not allow meaningful comparison with the Corporation's regular publicly disclosed consolidated financial statements. The Debtors consist of the Parent Company and the following wholly owned subsidiaries: United States Gypsum Company; USG Interiors, Inc.; USG Interiors International, Inc.; L&W Supply Corporation; Beadex Manufacturing, LLC; B-R Pipeline Company; La Mirada Products Co., Inc.; Stocking Specialists, Inc.; USG Industries, Inc.; and USG Pipeline Company. The condensed financial statements of the Debtors are presented as follows:

DEBTOR-IN-POSSESSION STATEMENT OF EARNINGS (unaudited)

<i>(millions)</i>	Year Ended December 31, 2001
Net sales	\$2,947
Cost of products sold	2,628
Selling and administrative expenses	232
Chapter 11 reorganization expenses	12
Provisions for impairment and restructuring	(5)
Interest expense	29
Interest income	(2)
<u>Other expense, net</u>	<u>10</u>
Earnings before income taxes	43
<u>Income taxes</u>	<u>25</u>
<u>Net earnings</u>	<u>18</u>

DEBTOR-IN-POSSESSION BALANCE SHEET (unaudited)*(millions)*

As of December 31, 2001

Assets*Current Assets:*

Cash and cash equivalents	\$ 346
Receivables (net of reserves - \$13)	234
Inventories	215
Income taxes receivable	77
Deferred income taxes	66
Other current assets	33
Total current assets	971
Property, plant and equipment (net of reserves for depreciation and depletion - \$481)	1,581
Deferred income taxes	258
Other assets	494
Total assets	3,304

Liabilities and Stockholders' Equity*Current Liabilities:*

Accounts payable	112
Accrued expenses	153
Total current liabilities	265
Other liabilities	333
Liabilities subject to compromise	2,311
<i>Stockholders' Equity:</i>	
Preferred stock	-
Common stock	5
Treasury stock	(255)
Capital received in excess of par value	95
Accumulated other comprehensive income	12
Retained earnings	538
Total stockholders' equity	395
Total liabilities and stockholders' equity	3,304

DEBTOR-IN-POSSESSION STATEMENT OF CASH FLOWS (unaudited)*(millions)*

Year Ended December 31, 2001

Operating Activities

Net earnings	\$ 18
<i>Adjustments to Reconcile Net Earnings to Net Cash:</i>	
Provisions for impairment and restructuring	(5)
Corporate service charge	4
Depreciation, depletion and amortization	90
Deferred income taxes	140
Gain on asset dispositions	(1)
<i>(Increase) Decrease in Working Capital:</i>	
Receivables	(69)
Income taxes receivable	(77)
Inventories	6
Payables	71
Accrued expenses	6
Pre-petition intercompany receivable	7
Post-petition intercompany receivable	(84)
Increase in other assets	(61)
Increase in other liabilities	16
Asbestos reserve, net of receivables	(90)
Liabilities subject to compromise	(58)
Other, net	56
<u>Net cash to operating activities</u>	<u>(31)</u>

Investing Activities

Capital expenditures	(66)
Net proceeds from asset dispositions	1
<u>Net cash to investing activities</u>	<u>(65)</u>

Financing Activities

Issuance of debt	262
Repayment of debt	(56)
Short-term borrowings, net	200
Cash dividends paid	(1)
<u>Net cash from financing activities</u>	<u>405</u>

Net Increase in Cash and Cash Equivalents	309
Cash and cash equivalents at beginning of period	37
<u>Cash and cash equivalents at end of period</u>	<u>346</u>

Supplemental Cash Flow Disclosures:

Interest paid	26
Income taxes refunded, net	(32)

INTERCOMPANY TRANSACTIONS

In the normal course of business, the operating subsidiaries and the Parent Company engage in intercompany transactions. To document the relations created by these transactions, the Parent Company and the operating subsidiaries, from the formation of USG Corporation in 1985, have been parties to intercompany loan agreements that evidence their obligations as borrowers or rights as lenders arising out of intercompany cash transfers and various allocated intercompany charges (the “*Intercompany Corporate Transactions*”).

The Corporation operates a consolidated cash management system under which the cash receipts of the domestic operating subsidiaries are ultimately concentrated in Parent Company accounts. Cash disbursements for those operating subsidiaries originate from those Parent Company concentration accounts. Allocated intercompany charges from the Parent Company to the operating subsidiaries primarily include expenses related to rent, property taxes, information technology, and research and development, while allocated intercompany charges between certain operating subsidiaries primarily include expenses for shared marketing, sales, customer service, engineering and accounting services. Detailed accounting records are maintained of all cash flows and intercompany charges through the system in either direction. Net balances, receivables or payables of such cash transactions are tracked on a regular basis, with interest earned or paid on the balances. During the first six months of 2001, the Corporation took steps to secure the obligations from each of the principal domestic operating subsidiaries under the intercompany loan agreements when it became clear that the asbestos liability claims of United States Gypsum Company (“*U.S. Gypsum*”) were becoming an increasingly greater burden on the Corporation’s cash resources. As of December 31, 2001, U.S. Gypsum’s net pre-petition payable balance to the Parent Company for Intercompany Corporate Transactions was \$332 million. USG Interiors, Inc.’s net pre-petition payable balance to the Parent Company was \$111 million. L&W Supply Corporation had a net pre-petition receivable balance from the Parent Company of \$42 million.

In addition to the above transactions, the operating subsidiaries engage in ordinary course purchase and sale of products with other operating subsidiaries (the “*Intercompany Trade Transactions*”). Detailed accounting records also are maintained of all such transactions, and settlements are made on a monthly

basis.

Certain Intercompany Trade Transactions between U.S. and non-U.S. operating subsidiaries are settled via wire transfer payments utilizing several payment systems.

3. Provisions for Impairment and Restructuring

2001 IMPAIRMENTS

In the fourth quarter of 2001, the Corporation recorded a pretax impairment charge of \$16 million related to the Aubange, Belgium, ceiling tile plant. This impairment resulted from a decline in demand, which had been significantly affected by a worldwide slowdown in the nonresidential construction market, and from the plant’s high cost structure. In addition, the Corporation recorded a pretax impairment charge of \$14 million related to the Port Hawkesbury, Nova Scotia, gypsum fiber panel plant. This impairment resulted from high delivered costs of products manufactured at Port Hawkesbury combined with the consolidation of production of FIBEROCK products at the Gypsum, Ohio, plant. Estimated future cash flows related to these facilities indicated that impairment charges were necessary to write down the assets to their third-party appraised fair values.

2001 RESTRUCTURING PLAN

Also, in the fourth quarter of 2001, the Corporation recorded a pretax charge of \$12 million related to a restructuring plan that included the shutdown of a gypsum wallboard plant in Fremont, Calif., a drywall steel plant in Prestice, Czech Republic, a ceiling tile plant in San Juan Ixhuatepec, Mexico, a ceiling tile manufacturing line in Greenville, Miss., and other restructuring activities. The restructuring plan, which is expected to be completed in 2002, is intended to allow the Corporation to optimize its manufacturing operations at a time when a weak economy threatens to cause demand for the Corporation’s products to decline.

Included in the \$12 million charge was \$8 million for severance related to a workforce reduction of more than 350 positions (primarily hourly positions), \$2 million for the write-off of property, plant and equipment, and \$2 million for line shutdown and removal and contract cancellations.

The reserve for this plan was included in accrued expenses as of December 31, 2001, on the consolidated balance sheet, and payments totaling \$2 million were charged against this reserve in 2001. All payments for the 2001 restructuring plan are being funded with cash

from normal operations. As of December 31, 2001, 127 employees have been terminated, and 26 open positions have been eliminated.

2000 RESTRUCTURING PLAN

In the fourth quarter of 2000, the Corporation recorded a pretax charge of \$50 million related to a restructuring plan that included a salaried workforce reduction and the shutdown of three gypsum wallboard manufacturing lines and other operations. This restructuring was designed to streamline operations and improve business efficiency.

Included in the \$50 million charge was \$16 million for severance related to the salaried workforce reduction of more than 500 positions, \$15 million for the write-off of property, plant and equipment, \$12 million for razing buildings and equipment, \$5 million for line shutdown and removal, and \$2 million for contract cancellations and severance for more than 100 hourly positions. An additional restructuring-related charge of \$4 million was included in cost of products sold for the writedown of certain inventory.

During the third quarter of 2001, the Corporation reversed \$9 million pretax of the restructuring reserve recorded in the fourth quarter of 2000 due to changes from previous estimates and to reflect a change in the scope of restructuring activities undertaken. The primary change involved a decision made in September to eliminate a portion of the closure activities originally

planned at the Alabaster, Mich., facility. Also, during the third quarter of 2001, the Corporation reversed restructuring-related inventory reserves totaling \$3 million to cost of products sold because the sale or use of certain affected inventory exceeded expectations.

Payments totaling \$21 million in 2001 and \$1 million in 2000 were charged against the 2000 restructuring reserve. All payments are being funded with cash from normal operations. The remaining restructuring reserves are considered adequate to cover committed restructuring actions.

The salaried workforce reduction program was completed as of June 30, 2001, with the termination of 394 salaried employees and the elimination of 179 open salaried positions. In addition, 73 hourly employees were terminated, and 44 open hourly positions were eliminated. Closure of the three gypsum wallboard manufacturing lines and other operations was completed by December 31, 2001. Final payments for expenses related to these closures will be made in the first half of 2002.

The reserve for the 2000 restructuring was included in accrued expenses as of December 31, 2000, and in liabilities subject to compromise as of December 31, 2001, on the consolidated balance sheets.

RESTRUCTURING RESERVES

The following table details the reserves and activity for the 2001 and 2000 restructuring plans (dollars in millions):

	Provisions for Restructuring	Writedown of Assets to Net Realizable Value	Cash Payments	Reversal of Reserve	Reserve Balance 12/31/01
<i>2001 Restructuring:</i>					
Severance (primarily hourly)	\$ 8	\$ -	\$ (2)	\$ -	\$ 6
Property, plant and equipment write-off	2	(2)	-	-	-
Line shutdown/removal and contract cancellations	2	-	-	-	2
Subtotal	12	(2)	(2)	-	8
<i>2000 Restructuring:</i>					
Severance (salaried)	16	-	(16)	-	-
Property, plant and equipment write-off	15	(15)	-	-	-
Razing buildings and equipment	12	-	(3)	(6)	3
Line shutdown/removal	5	-	(2)	(2)	1
Contract cancellations and severance (hourly)	2	-	(1)	(1)	-
Subtotal	50	(15)	(22)	(9)	4
Total	62	(17)	(24)	(9)	12

4. Shutdown of Plasterco

In the third quarter of 1999, U.S. Gypsum announced the planned shutdown of its Plasterco, Va., plant. In conjunction with the announcement, U.S. Gypsum recorded a \$22 million charge to cost of products sold for expenses related to the closing of the plant and adjacent gypsum mine. The Plasterco facility was closed on December 23, 1999, following the start-up of U.S. Gypsum's new plant in Bridgeport, Ala., earlier in the year.

5. Acquisition of Sybex, Inc.

In the fourth quarter of 1999, the Corporation acquired Sybex, Inc., the holding company of Beadex Manufacturing Company, Inc. and The Synkoloid Company of Canada. Sybex operated joint compound and paper-faced metal corner bead plants in the United States and Canada.

6. Earnings Per Share

The reconciliation of basic earnings per share to diluted earnings per share is shown in the following table:

<i>(millions, except share data)</i>	Net Earnings (Loss)	Shares (000)	Average Per-Share Amount
<i>2001:</i>			
Basic earnings	\$ 16	43,430	\$ 0.36
Dilutive effect of stock options		5	
<u>Diluted earnings</u>	<u>16</u>	<u>43,435</u>	<u>0.36</u>
<i>2000:</i>			
Basic loss	(259)	45,972	(5.62)
<u>Diluted loss</u>	<u>(259)</u>	<u>45,972</u>	<u>(5.62)</u>
<i>1999:</i>			
Basic earnings	421	49,697	8.48
Dilutive effect of stock options		519	
<u>Diluted earnings</u>	<u>421</u>	<u>50,216</u>	<u>8.39</u>

For 2000, the diluted loss per share was based on the weighted average number of common shares outstanding during the year. Common stock equivalents were not included in the diluted loss per share calculation because they had an anti-dilutive effect. Including the common stock equivalents, the weighted average number of shares outstanding in 2000 would have been 46,067,121.

7. Common Stock

DIVIDENDS

The Corporation discontinued payment of quarterly cash dividends in the second quarter of 2001. In the first quarter of 2001, the Corporation paid a cash dividend of \$0.025 per share. In 2000, the Corporation paid four quarterly cash dividends of \$0.15 per share.

SHARE REPURCHASES

The Corporation concluded a share repurchase program in the third quarter of 2000. Under the program, which began in 1998, the Corporation purchased a total of 7.3 million shares. Share repurchases by year amounted to 5.7 million shares in 2000, 1.4 million shares in 1999 and 0.2 million shares in 1998.

STOCKHOLDER RIGHTS PLAN

The Corporation's stockholder rights plan, which will expire on March 27, 2008, has four basic provisions. First, if an acquirer buys 15% or more of the Corporation's outstanding common stock, the plan allows other stockholders to buy, with each right, additional shares of the Corporation at a 50% discount. Second, if the Corporation is acquired in a merger or other business combination transaction, rights holders will be entitled to buy shares of the acquiring company at a 50% discount. Third, if an acquirer buys between 15% and 50% of the Corporation's outstanding common stock, the Corporation can exchange part or all of the rights of the other holders for shares of the Corporation's stock on a one-for-one basis or shares of a new junior preferred stock on a one-for-one-hundredth basis. Fourth, before an acquirer buys 15% or more of the Corporation's outstanding common stock, the rights are redeemable for \$0.01 per right at the option of the Corporation's board of directors (the "Board"). This provision permits the Board to enter into an acquisition transaction that is determined to be in the best interests of stockholders. The Board is authorized to reduce the 15% threshold to not less than 10%.

In November 2001, the independent members of the Board reviewed the Corporation's stockholder rights plan in accordance with its policy, adopted in 2000, to review the rights plan every three years. The independent members of the Board considered a variety of relevant factors, including the effect of the Filing, and concluded that the rights plan continued to be in the best interests of the Corporation and should be retained in its present form.

8. Inventories

As of December 31, 2001 and 2000, the LIFO values of domestic inventories were \$198 million and \$197 million, respectively, and would have been \$5 million higher for 2001 and \$2 million higher for 2000 if they were valued under the FIFO and average production cost methods. All nondomestic inventory is valued under FIFO or average production cost methods. The LIFO value of U.S. domestic inventories exceeded that computed for U.S. federal income tax purposes by \$30 million as of December 31, 2001 and 2000. Inventory classifications as of December 31 were as follows:

<i>(millions)</i>	2001	2000
Finished goods and work in progress	\$164	\$175
Raw materials	75	80
Supplies	15	16
<u>Total</u>	<u>254</u>	<u>271</u>

9. Property, Plant and Equipment

Property, plant and equipment classifications as of December 31 were as follows:

<i>(millions)</i>	2001	2000
Land and mineral deposits	\$ 90	\$ 89
Buildings and improvements	600	575
<u>Machinery and equipment</u>	<u>1,702</u>	<u>1,636</u>
	2,392	2,300
<u>Reserves for depreciation and depletion</u>	<u>(592)</u>	<u>(470)</u>
<u>Total</u>	<u>1,800</u>	<u>1,830</u>

10. Leases

The Corporation leases certain of its offices, buildings, machinery and equipment, and autos under noncancelable operating leases. These leases have various terms and renewal options. Lease expense amounted to \$74 million, \$70 million and \$62 million in the years ended December 31, 2001, 2000 and 1999, respectively. Future minimum lease payments required under operating leases with initial or remaining noncancelable terms in excess of one year as of December 31, 2001, were \$56 million in 2002, \$42 million in 2003, \$34 million in 2004, \$26 million in 2005 and \$18 million in 2006. The aggregate obligation subsequent to 2006 was \$28 million.

11. Debt

As of December 31, 2001, virtually all of the Corporation's pre-petition debt is in default due to the Filing. Pre-petition debt, which is included in liabilities subject to compromise as of December 31, consisted of the following:

<i>(millions)</i>	2001
Revolving credit facilities	\$ 469
9.25% senior notes due 2001	131
8.5% senior notes due 2005	150
<u>Industrial revenue bonds</u>	<u>255</u>
<u>Total</u>	<u>1,005</u>

Long-term debt, the current portion of long-term debt and notes payable as reported on the consolidated balance sheets as of December 31 consisted of the following:

<i>(millions)</i>	2001	2000
DIP Facility	\$ -	\$ -
Revolving credit facilities	-	79
9.25% senior notes due 2001	-	141
Receivables facility	-	60
8.5% senior notes due 2005	-	150
Industrial revenue bonds	-	255
<u>Other</u>	<u>2</u>	<u>26</u>
<u>Total</u>	<u>2</u>	<u>711</u>

DIP FACILITY

In connection with the Filing, a \$350 million DIP Facility was provided by JP Morgan Chase to supplement liquidity and fund operations during the reorganization process. Any borrowings under the facility represent a super priority claim in the bankruptcy proceeding. The facility matures on June 25, 2004. Borrowing availability is based primarily on accounts receivable and inventory levels and, to a lesser extent, property, plant and equipment. As of December 31, 2001, the Corporation had the capacity to borrow up to \$291 million. There were no outstanding borrowings under the facility at year end. However, \$11 million of standby letters of credit were issued, leaving \$280 million of unused borrowing capacity available as of December 31, 2001.

The interest rate for the facility is based on LIBOR plus 200 to 250 basis points depending on the level of borrowings. The terms of the facility include, among other requirements, limits on asset sales and capital expenditures and minimum EBITDA levels. As of

December 31, 2001, the Corporation was in compliance with the terms and conditions of the agreement.

OTHER INFORMATION

Prior to the Filing, the Corporation utilized revolving credit facilities with borrowing capacity of up to \$600 million.

The Corporation has \$131 million of 9.25% senior notes that were due September 30, 2001. However, as a result of the Filing, these notes became subject to compromise and therefore were not repaid.

The Corporation had an accounts receivable facility under which certain trade receivables were transferred to Chase Manhattan Bank as trustee to be held for the benefit of certificate holders in such trust. However, as a result of the Filing, on July 12, 2001, all outstanding obligations under the accounts receivable facility were repaid and the facility was terminated. As of December 31, 2000, the outstanding balance of receivables held under the trust was \$156 million, and debt outstanding under the facility was \$60 million.

The fair market value of total debt outstanding (including debt classified under liabilities subject to compromise) was \$729 million and \$537 million as of December 31, 2001 and 2000, respectively. The fair market values were based on quoted market prices or, where quoted market prices were not available, on instruments with similar terms and maturities. However, because virtually all of the Corporation's debt is subject to compromise, the fair market value of total debt as of December 31, 2001, is not necessarily indicative of the ultimate settlement value that will be determined by the Bankruptcy Court.

As of December 31, 2001, debt not subject to compromise of \$2 million is scheduled to mature in varying amounts through 2005.

12. Financial Instruments and Risk Management

As of January 1, 2001, and December 31, 2001, the net after-tax derivative gain in accumulated other comprehensive loss was \$64 million and \$16 million, respectively. During 2001, \$15 million of accumulated after-tax gains (\$24 million pretax) were reclassified from accumulated other comprehensive loss to earnings. As of December 31, 2001, the estimated after-tax gain expected to be reclassified within the next 12 months from accumulated other comprehensive loss into earnings is \$5 million. The amounts reported below as fair values represent the market value as obtained from broker quotations. Any negative fair values are

estimates of the amounts USG would need to pay to cancel the contracts or transfer them to other parties.

COMMODITY RISK MANAGEMENT

The Corporation uses swap contracts to hedge anticipated purchases of natural gas, wastepaper and fuel to be used in its manufacturing and shipping operations. During the second quarter of 2001, the Corporation received after-tax proceeds of \$21 million (\$35 million pretax) from the termination of certain natural gas swap contracts that were scheduled to mature through 2005. In accordance with SFAS No. 133, the net after-tax gain resulting from the termination of these contracts remains in accumulated other comprehensive income (loss) and is reclassified into earnings in the same periods during which the hedged forecasted transactions are scheduled to occur.

The Corporation has swap agreements in place with Enron Corp. to hedge the cost of wastepaper. As a result of Enron's bankruptcy filing in December 2001, the Corporation has discontinued hedge accounting with respect to wastepaper swaps from that point forward. Consequently, future changes in the fair value of these hedges will be recognized in earnings in the period in which the change occurs.

As of December 31, 2001 and 2000, the Corporation had swap agreements to exchange monthly payments on notional amounts of commodities amounting to \$48 million and \$205 million, respectively. These agreements mature within two years. The fair values of these swap agreements as of December 31, 2001 and 2000, were \$(4) million and \$105 million, respectively.

FOREIGN EXCHANGE RISK MANAGEMENT

As of December 31, 2001 and 2000, the Corporation had foreign currency contracts in place, primarily Canadian dollars, to hedge its exposure to exchange rate fluctuations on transactions denominated in foreign currencies. These foreign exchange contracts mature on the anticipated date of the underlying transaction, and all contracts mature by March 31, 2002. The notional amounts of foreign currency contracts as of December 31, 2001 and 2000, were \$6 million and \$52 million, respectively. The fair value of these contracts as of December 31, 2001 and 2000, was zero.

INTEREST RATE RISK MANAGEMENT

The Corporation uses interest rate swap agreements from time to time to manage the impact of interest rate changes on the underlying floating-rate debt. The

Corporation had no swap agreements in place as of December 31, 2001. As of December 31, 2000, the Corporation had swap agreements in place to convert \$27 million of notional principal from floating-rate to fixed-rate instruments. The fair value of these contracts as of December 31, 2000, was zero.

COUNTERPARTY RISK

The Corporation is exposed to credit losses in the event of nonperformance by the counterparties on its financial instruments. Except for Enron Corp., as explained above, all other counterparties have investment grade credit standing; accordingly, the Corporation anticipates that these counterparties will be able to satisfy fully their obligations under the contracts. The Corporation does not generally obtain collateral or other security to support financial instruments subject to credit risk but monitors the credit standing of all counterparties.

13. Employee Retirement Plans

The Corporation and most of its subsidiaries have defined benefit pension plans for all eligible employees. Benefits of the plans are generally based on employees' years of service and compensation during the final years of employment. The Corporation also maintains plans that provide retiree health care and life insurance benefits for all eligible employees. Employees generally become eligible for the retiree benefit plans when they meet minimum retirement age and service requirements. The cost of providing most retiree health care benefits is shared with retirees. The components of net pension and postretirement benefit costs are summarized in the following tables:

<i>(millions)</i>	Pension Benefits		
	2001	2000	1999
Service cost of benefits			
earned	\$ 19	\$ 16	\$ 19
Interest cost on projected			
benefit obligation	48	47	43
Expected return on plan assets	(56)	(54)	(49)
Net amortization	4	3	2
Net pension cost	15	12	15

<i>(millions)</i>	Postretirement Benefits		
	2001	2000	1999
Service cost of benefits			
earned	\$ 6	\$ 6	\$ 7
Interest cost on projected			
benefit obligation	16	16	15
Net amortization	(1)	(2)	-
Net postretirement cost	21	20	22

The following tables summarize pension and postretirement benefit obligations, plan assets and funded status as of December 31:

<i>(millions)</i>	Pension		Postretirement	
	2001	2000	2001	2000
<i>Change in Benefit Obligation:</i>				
Benefit obligation				
as of January 1	\$670	\$632	\$222	\$195
Service cost	19	16	6	6
Interest cost	48	47	16	16
Employee contributions	11	12	3	2
Benefits paid	(80)	(55)	(12)	(12)
Plan amendment	10	3	-	(1)
Actuarial loss	27	17	1	16
Foreign currency rate change	(3)	(2)	-	-
Benefit obligation				
as of December 31	702	670	236	222

<i>(millions)</i>	Pension		Postretirement	
	2001	2000	2001	2000
<i>Change in Plan Assets:</i>				
Fair value as of January 1	\$652	\$667	\$ -	\$ -
Actual return on plan assets	(17)	14	-	-
Employer contributions	13	17	-	-
Employee contributions	11	12	-	-
Benefits paid	(80)	(55)	-	-
Foreign currency rate change	(4)	(3)	-	-
Fair value as of December 31	575	652	-	-

<i>Funded Status:</i>				
As of December 31	(127)	(18)	(236)	(222)
Unrecognized prior service cost	18	6	(6)	(6)
Unrecognized net (gain) loss	86	(7)	(30)	(32)
Net balance sheet liability	(23)	(19)	(272)	(260)

<i>Assumptions as of December 31:</i>				
Discount rate	7.25%	7.50%	7.25%	7.50%
Pension plans expected return	9%	9%	-	-
Compensation increase rate	5%	5%	5%	5%

The assumed health-care-cost trend rate used to measure the accumulated postretirement benefit obligation will be 7.0% in 2002, with a rate gradually declining to 4.75% in 2007 and remaining at that level thereafter. A one-percentage-point change in the assumed health-care-cost trend rate would have the following effects:

<i>(millions)</i>	One Percentage	One Percentage
	Point Increase	Point Decrease
Effect on total service and interest cost components	\$ 4	\$ (3)
Effect on postretirement benefit obligation	33	(27)

14. Stock-Based Compensation

The Corporation has issued stock options from three successive plans under its long-term equity program. Under each of the plans, options were granted at an exercise price equal to the market value on the date of grant. All options granted under the plans have 10-year terms and vesting schedules of two or three years. The options expire on the 10th anniversary of the date of grant, except in the case of retirement, death or disability, in which case they expire on the earlier of the fifth anniversary of such event or the expiration of the original option term.

The Corporation accounts for stock-based compensation in accordance with Accounting Principles Board Opinion No. 25 and discloses such compensation under the provisions of SFAS 123, "Accounting for Stock-Based Compensation."

The fair value of each option grant was estimated as of the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions for options granted:

	2001	2000	1999
Expected life (years)	7.4	7.4	7.4
Risk-free interest rate	6.8%	6.2%	6.5%
Expected volatility	46.2%	31.3%	31.4%
Dividend yield	0.12%	1.29%	0.88%

The weighted average fair values of options granted on January 2, 2001, and May 1, 2001, were \$12.31 and \$6.73, respectively. The weighted average fair values of options granted on January 3, 2000, and January 2, 1999, were \$18.84 and \$22.05, respectively.

If the Corporation had elected to recognize compensation cost for stock-based compensation grants

consistent with the method prescribed by SFAS No. 123, net earnings (loss) and net earnings (loss) per common share would have changed to the following pro forma amounts:

<i>(millions, except per-share data)</i>	2001	2000	1999
<i>Net Earnings(Loss):</i> As reported	\$ 16	\$(259)	\$ 421
Pro forma	13	(262)	416
<i>Basic EPS:</i> As reported	0.36	(5.62)	8.48
Pro forma	0.31	(5.70)	8.38
<i>Diluted EPS:</i> As reported	0.36	(5.62)	8.39
Pro forma	0.31	(5.70)	8.29

Stock option activity was as follows:

<i>(options in thousands)</i>	2001	2000	1999
<i>Options:</i>			
Outstanding, January 1	2,051	1,790	2,034
Granted	800	330	316
Exercised	(72)	(22)	(553)
Canceled	(41)	(47)	(7)
Outstanding, December 31	2,738	2,051	1,790
Exercisable, December 31	1,640	1,437	1,087
Available for grant, December 31	1,737	2,488	566

Weighted Average Exercise Price:

Outstanding, January 1	\$ 38.12	\$ 36.49	\$ 30.43
Granted	22.44	46.14	50.87
Exercised	10.31	10.31	22.29
Canceled	36.94	44.79	48.99
Outstanding, December 31	34.29	38.12	36.49
Exercisable, December 31	37.89	33.70	28.05

The following table summarizes information about stock options outstanding as of December 31, 2001:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options	Contractual Life (yrs.)	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
\$ 5 - 15	67	1.9	\$ 10	63	\$ 10
15 - 25	916	8.2	22	121	22
25 - 35	776	3.8	32	776	32
35 - 55	979	6.9	48	680	50
Total	2,738	6.3	34	1,640	38

As of December 31, 2001, common shares totaling 2,737,600 were reserved for future issuance in conjunction with existing stock option grants. In

addition, 1,737,311 common shares were reserved for future grants. Shares issued in option exercises may be from original issue or available treasury shares.

15. Income Taxes

Earnings (loss) before income taxes consisted of the following:

<i>(millions)</i>	2001	2000	1999
U.S.	\$ 52	\$(471)	\$ 633
Foreign	-	51	51
Total	52	(420)	684

Income taxes (benefit) consisted of the following:

<i>(millions)</i>	2001	2000	1999
<i>Current:</i>			
Federal	\$(67)	\$154	\$246
Foreign	15	18	10
State	(13)	27	47
	<u>(65)</u>	<u>199</u>	<u>303</u>
<i>Deferred:</i>			
Federal	90	(306)	(38)
Foreign	(5)	-	5
State	16	(54)	(7)
	<u>101</u>	<u>(360)</u>	<u>(40)</u>
Total	36	(161)	263

Differences between actual provisions (benefits) for income taxes and provisions (benefits) for income taxes at the U.S. federal statutory rate (35%) were as follows:

<i>(millions)</i>	2001	2000	1999
Taxes on income (loss)			
at federal statutory rate	\$18	\$(147)	\$ 240
Chapter 11 reorganization expenses	2	-	-
Foreign sales corporation	(1)	(1)	(1)
Foreign earnings subject to different tax rates	16	4	-
State income tax, net of federal benefit	1	(17)	26
Percentage depletion	(2)	(4)	(4)
Other, net	2	4	2
Provision (benefit) for income taxes	<u>36</u>	<u>(161)</u>	<u>263</u>
Effective income tax rate	70.0%	38.4%	38.4%

Significant components of deferred tax assets and liabilities as of December 31 were as follows:

<i>(millions)</i>	2001	2000
<i>Deferred Tax Assets:</i>		
Pension and postretirement benefits	\$ 115	\$ 104
Reserves not deductible until paid	448	550
Other	14	34
	<u>577</u>	<u>688</u>
<i>Deferred Tax Liabilities:</i>		
<u>Property, plant and equipment</u>	<u>268</u>	<u>237</u>
<u>Net deferred tax assets</u>	<u>309</u>	<u>451</u>

The Corporation recognized an income tax receivable of \$76 million in 2001 for federal and state income taxes that it expects to be refunded as a result of the carryback of a net operating loss incurred by the Corporation in the current year.

The Corporation's income tax reserves were reduced by \$103 million in the third quarter of 2000 to reflect the settlement of various tax audits. The benefit realized from the reduction of these reserves was credited to equity in accordance with SOP 90-7. The reduction of these reserves had no impact on the results of operations or cash flows of the Corporation.

The Corporation does not provide for U.S. income taxes on the portion of undistributed earnings of foreign subsidiaries that are intended to be permanently reinvested. The cumulative amount of such undistributed earnings totaled approximately \$211 million as of December 31, 2001. These earnings would become taxable in the United States upon the sale or liquidation of these foreign subsidiaries or upon the remittance of dividends. It is not practicable to estimate the amount of the deferred tax liability on such earnings.

16. Segments

OPERATING SEGMENTS

<i>(millions)</i>	2001	2000	1999
<i>Net Sales:</i>			
North American Gypsum	\$ 1,950	\$ 2,298	\$ 2,416
Worldwide Ceilings	660	705	689
Building Products Distribution	1,152	1,373	1,345
Eliminations	(466)	(595)	(640)
Total	3,296	3,781	3,810

Operating Profit (Loss):

North American Gypsum	80	392	651
Worldwide Ceilings	33	70	63
Building Products Distribution	64	110	87
Corporate	(43)	(44)	(64)
Eliminations	1	3	(7)
Chapter 11 reorganization expenses	(12)	-	-
Provisions for impairment and restructuring	(33)	(50)	-
Provision for asbestos claims	-	(850)	-
Total	90	(369)	730

Depreciation, Depletion and Amortization:

North American Gypsum	81	70	57
Worldwide Ceilings	19	18	19
Building Products Distribution	7	7	6
Corporate	-	1	9
Total	107	96	91

Capital Expenditures:

North American Gypsum	96	354	397
Worldwide Ceilings	11	16	20
Building Products Distribution	2	9	8
Corporate	-	1	1
Total	109	380	426

Assets:

North American Gypsum	1,985	1,924	1,721
Worldwide Ceilings	408	433	425
Building Products Distribution	268	278	309
Corporate	908	639	431
Eliminations	(105)	(60)	(92)
Total	3,464	3,214	2,794

GEOGRAPHIC SEGMENTS

<i>(millions)</i>	2001	2000	1999
<i>Net Sales:</i>			
United States	\$2,947	\$3,428	\$3,449
Canada	279	284	262
Other Foreign	254	259	260
Geographic transfers	(184)	(190)	(161)
Total	3,296	3,781	3,810
<i>Long-Lived Assets:</i>			
United States	1,787	1,750	1,514
Canada	157	188	198
Other Foreign	61	93	61
Total	2,005	2,031	1,773

Transactions between operating and geographic segments are accounted for at transfer prices that are approximately equal to market value. Intercompany transfers between operating segments (shown above as eliminations) largely reflect intercompany sales from U.S. Gypsum to L&W Supply.

No single customer accounted for 10% or more of consolidated net sales. Revenues are attributed to geographic areas based on the location of the assets producing the revenues. Export sales to foreign unaffiliated customers represent less than 10% of consolidated net sales.

Segment operating profit (loss) includes all costs and expenses directly related to the segment involved and an allocation of expenses that benefit more than one segment.

Corporate assets for 2000 and 1999 include the assets of USG Funding, which represent the outstanding balances of receivables purchased from U.S. Gypsum and USG Interiors, net of reserves. As of December 31, 2000 and 1999, such receivables, net of reserves, amounted to \$93 million and \$125 million, respectively, including \$59 million and \$97 million purchased from U.S. Gypsum and \$34 million and \$28 million purchased from USG Interiors as of the respective dates.

Long-lived assets include property, plant and equipment, prepaid expenses, investments in other companies, goodwill and other long-term assets. As of December 31, 2001, goodwill, net of accumulated amortization, for the Corporation's businesses in the United States, Canada and Other Foreign segments was \$63 million, \$49 million and zero, respectively. As of December 31, 2000, goodwill, net of accumulated amortization, for the United States, Canada and Other

Foreign segments was \$66 million, \$53 million and \$1 million, respectively. As of December 31, 1999, goodwill, net of accumulated amortization, for the United States, Canada and Other Foreign segments was \$58 million, \$57 million and \$1 million, respectively. The Corporation believes that including goodwill in long-lived assets provides meaningful disclosure to financial statement users in terms of geographic resource allocation, investment decisions and related risk.

17. Litigation

ASBESTOS AND RELATED INSURANCE LITIGATION

One of the Corporation's subsidiaries, U.S. Gypsum, is among many defendants in lawsuits arising out of the manufacture and sale of asbestos-containing materials. On June 25, 2001 (the "*Petition Date*"), U.S. Gypsum, the Parent Company, and other domestic subsidiaries (the "*Debtors*") filed voluntary petitions for relief under chapter 11 of the U.S. Bankruptcy Code (the "*Filing*") to manage the growing costs of resolving asbestos claims and to achieve a fair and final resolution of liability for both pending and future asbestos claims. The Chapter 11 Cases are being jointly administered under Case No. 01-2094 in the United States Bankruptcy Court for the District of Delaware (the "*Bankruptcy Court*").

U.S. Gypsum's asbestos liability derives from its sale of certain asbestos-containing products beginning in the 1930s; in most cases, the products were discontinued or asbestos was removed from the formula by 1972, and no asbestos-containing products were produced after 1977. Certain of the asbestos lawsuits against U.S. Gypsum seek to recover compensatory and, in many cases, punitive damages for costs associated with the maintenance or removal and replacement of asbestos-containing products in buildings (the "*Property Damage Cases*"). Other asbestos lawsuits seek compensatory and, in many cases, punitive damages for personal injury allegedly resulting from exposure to asbestos-containing products (the "*Personal Injury Cases*"). A more detailed description of the Property Damage and Personal Injury Cases is set forth below.

As a result of the Filing, all pending Personal Injury and Property Damage Cases against U.S. Gypsum are stayed, and no party may take any action to pursue or collect on such asbestos lawsuits absent specific authorization of the Bankruptcy Court. Since the Filing, U.S. Gypsum has ceased making both cash

payments and accruals with respect to asbestos lawsuits, including cash payments and accruals pursuant to settlements of asbestos lawsuits. The Bankruptcy Court has approved creditors' committees that represent claimants in Personal Injury and Property Damage Cases. The Bankruptcy Court is expected to appoint a legal representative for the interests of potential future asbestos claimants. As part of the bankruptcy proceeding, it will be determined which asbestos claims should be allowed, or compensated, and the aggregate value of such claims.

U.S. Gypsum anticipates that its liability for pending and future asbestos claims will be addressed in a plan of reorganization developed and approved in the bankruptcy proceeding. The Debtors' exclusive right to propose such a plan of reorganization has been extended by the Bankruptcy Court to May 1, 2002. The Debtors are likely to seek one or more additional extensions of the exclusivity period depending on developments in the bankruptcy case. It is the Debtors' intention that the plan of reorganization will include the creation of a trust under Section 524(g) of the Bankruptcy Code which will be funded to allow payment of present and future asbestos claims, and, as a result of creation of the trust, the Bankruptcy Court will issue a permanent injunction channeling all asbestos-related claims to the trust and barring the assertion of pending or future asbestos-related claims against the reorganized companies. However, there is no assurance that such creation of a trust under Section 524(g), or the issuance of such a permanent injunction, will be approved by the Bankruptcy Court. It is anticipated that the plan or plans of reorganization ultimately approved will include all Debtors in the final resolution of asbestos-related claims that are or might be asserted against U.S. Gypsum, the Corporation and all other Debtor affiliates.

Recent Developments in the Reorganization Proceeding: During the fourth quarter of 2001, the Corporation's bankruptcy proceeding, along with four other asbestos-related bankruptcy proceedings pending in the federal courts in the District of Delaware, were assigned to the Honorable Alfred M. Wolin of the United States District Court for the District of New Jersey. This assignment was accomplished through orders of the United States Court of Appeals for the Third Circuit and the United States District Court for the District of Delaware dated November 27 and November 29, 2001, respectively.

In orders subsequent to the reassignment, Judge

Wolin has indicated that issues relating to asbestos personal injury claims in the foregoing bankruptcy proceedings will be assigned to him and that other bankruptcy claims and issues will remain assigned to the bankruptcy judges in the United States Bankruptcy Court for the District of Delaware. The Corporation has requested Judge Wolin, with the possible assistance of a Special Master appointed by Judge Wolin, to conduct hearings to address key issues relevant to the liability of U.S. Gypsum for asbestos personal injury claims, and the Corporation expects that if Judge Wolin agrees to this proposal, these hearings will begin in 2002.

If the hearings on liability issues do not go forward or a consensual resolution is not reached as a result of the hearings or otherwise, the Corporation will employ other means to resolve its asbestos personal injury liability. These other means may include, but are not limited to, setting a bar date for filing asbestos personal injury claims and determining which of the subsequently filed claims are entitled to vote on and participate in an asbestos trust under 11 U.S.C. §524(g) of the Bankruptcy Code. A bar date proceeding likely would lengthen the bankruptcy case significantly.

The Corporation expects that U.S. Gypsum's liability for asbestos property damage claims will also be included in a §524(g) trust, but resolution of this liability likely will be resolved through different and less time-consuming means than the procedures for resolving the asbestos personal injury liability.

Given the recent assignment of Judge Wolin to these bankruptcy proceedings and the current status of the cases, the Corporation is unable to forecast with any reasonable degree of certainty the timing or substance of the resolution of the Debtors' asbestos-related liability or the reorganization proceeding.

The following is a summary of the Property Damage and Personal Injury Cases pending against U.S. Gypsum as of the Petition Date.

Property Damage Cases: As of the Petition Date, U.S. Gypsum was a defendant in eleven Property Damage Cases, most of which involved multiple buildings. One of the cases is a conditionally certified class action comprising all colleges and universities in the United States, which certification is presently limited to the resolution of certain allegedly "common" liability issues. (*Central Wesleyan College v. W.R. Grace & Co., et al.*, U.S.D.C. S.C.). On June 15, 2001, a Property Damage Case was filed by The County of Orange, Texas, in the district court of Orange County, Texas, naming as defendants U.S. Gypsum and other

manufacturers of asbestos-containing materials. This was the first Property Damage case filed against U.S. Gypsum since June 1998. The Orange County case is a putative class action brought by The County of Orange on behalf of an alleged class comprising the State of Texas, its public colleges and universities, and all political subdivisions of the State of Texas. As to U.S. Gypsum, the putative class also includes all private and/or non-public colleges, universities, junior colleges, community colleges, and elementary and secondary schools in the State of Texas. The Orange County action seeks recovery of the costs of removing and replacing asbestos-containing materials in buildings at issue, as well as punitive damages. The complaint does not specify how many buildings are at issue. As a result of the Filing, all Property Damage Cases, including the Central Wesleyan and Orange County cases, are stayed against U.S. Gypsum. U.S. Gypsum's estimated cost of resolving the Property Damage Cases is discussed below (see "Estimated Cost").

Personal Injury Cases: U.S. Gypsum is also a defendant in approximately 106,000 Personal Injury Cases pending as of the Petition Date (the date of the Filing), as well as an additional approximately 52,000 Personal Injury Cases that are the subject of settlement agreements. Filings of new Personal Injury Cases totaled approximately 53,000 claims in 2000, 48,000 claims in 1999, and 80,000 claims in 1998. As a result of the Filing, all Personal Injury Cases are stayed against U.S. Gypsum, and new cases may not be filed due to the automatic stay. In the first half of 2001, up to the Petition Date, approximately 26,200 new Personal Injury Cases were filed against U.S. Gypsum, as compared to 27,800 new filings in the first half of 2000.

Prior to the Filing, U.S. Gypsum managed the handling and settlement of Personal Injury Cases through its membership in the Center for Claims Resolution (the "Center"). From 1988 up to February 1, 2001, costs of defense and settlement of Personal Injury Cases were shared among the members of the Center pursuant to predetermined sharing formulae. Effective February 1, 2001, the Center members, including U.S. Gypsum, ended their prior settlement sharing arrangement, and each Center member, including U.S. Gypsum, was responsible for negotiating and paying its own settlements separately. As of the Petition Date and as a result of the stay of asbestos lawsuits against U.S. Gypsum, U.S. Gypsum no longer negotiates or pays settlements of Personal Injury Cases

and no longer requires the services of the Center in negotiating or defending Personal Injury Cases.

In 2000 and years prior, U.S. Gypsum and other Center members negotiated a number of settlements with plaintiffs' firms that included agreements to resolve over time the firms' pending Personal Injury Cases as well as certain future claims (the "*Long-Term Settlements*"). With regard to future claims, these Long-Term Settlements typically provide that the plaintiffs' firms will recommend to their future clients that they defer filing, or accept nominal payments on, personal injury claims that do not meet established disease criteria, and, with regard to those claims meeting established disease criteria, that the future clients accept specified amounts to settle those claims. These Long-Term Settlements typically resolve claims for amounts consistent with historical per-claim settlement costs paid to the plaintiffs' firms involved. As a result of the Filing, cash payments by U.S. Gypsum under these Long-Term Settlements have ceased, and U.S. Gypsum expects that its obligations under these settlements will be determined in the bankruptcy proceeding and plan of reorganization.

In 2000, U.S. Gypsum closed approximately 57,000 Personal Injury Cases. U.S. Gypsum's cash payments in 2000 to defend and resolve Personal Injury Cases totaled \$162 million, of which \$90 million was paid or reimbursed by insurance. In 2000, the average settlement per case was approximately \$2,600, exclusive of defense costs. U.S. Gypsum made cash payments of \$100 million in 1999 and \$61 million in 1998 to resolve Personal Injury Cases, of which \$85 million and \$45.5 million, respectively, were paid or reimbursed by insurance.

In the first and second quarters of 2001, cash payments to resolve Personal Injury Cases increased dramatically, primarily as a result of the bankruptcy filings of other defendants in asbestos personal injury lawsuits. As a result of these bankruptcy filings, plaintiffs substantially increased their settlement demands to the remaining defendants, including U.S. Gypsum, to replace the expected payments of the bankrupt defendants. In response to these increased settlement demands, U.S. Gypsum attempted to manage its asbestos liability by contesting, rather than settling, a greater number of cases that it believed to be non-meritorious. As a result, in the first and second quarters of 2001, U.S. Gypsum agreed to settle fewer Personal Injury Cases, but at a significantly higher cost per case.

In the first half of 2001 (up to the Petition Date), U.S. Gypsum closed approximately 18,900 Personal

Injury Cases. In the first half of 2001 (up to the Petition Date), U.S. Gypsum's total asbestos-related cash payments, including defense costs, were approximately \$124 million, of which approximately \$10 million was paid or reimbursed by insurance. A portion of these payments were for settlements agreed to in prior periods. As of March 31, 2001, U.S. Gypsum had estimated that cash expenditures for Personal Injury Cases in 2001 would total approximately \$275 million before insurance recoveries of approximately \$37 million.

As a result of these increasing settlement demands and the concern that federal legislation addressing the asbestos litigation problem likely would not be enacted within the necessary timeframe, U.S. Gypsum concluded that it would not be able to manage and resolve its asbestos liability in the tort system, and, on June 25, 2001, the Debtors filed a voluntary petition under chapter 11 of the Bankruptcy Code.

In addition to the asbestos Personal Injury Cases pending against U.S. Gypsum, one of the Corporation's subsidiaries and a Debtor in the bankruptcy proceeding, L&W Supply Corporation, was named as a defendant in approximately 21 pending Personal Injury Cases as of the Petition Date. L&W, a distributor of building products manufactured by U.S. Gypsum and other building products manufacturers, has not made any payments in the past to resolve Personal Injury Cases. It is believed that L&W has been named as a defendant in Personal Injury Cases based on its role as a distributor of U.S. Gypsum products. Therefore, the Corporation expects that any asbestos-related liability of L&W would be derivative of the liability of U.S. Gypsum, and that any plan or plans of reorganization should reflect that L&W's liability, if any, rests with U.S. Gypsum as the manufacturer. However, because of the small number of Personal Injury Cases against L&W to date and the lack of development of the cases against L&W, the Corporation does not have sufficient information at this time to predict as to how any plan or plans of reorganization will address any asbestos-related liability of L&W and whether any such liability will be limited to L&W's role as a distributor of U.S. Gypsum products.

Insurance Coverage: As of the Petition Date, after deducting insurance used to date, U.S. Gypsum had approximately \$76.3 million of insurance remaining to cover asbestos-related costs. After insurance payments to U.S. Gypsum during the third and fourth quarters of 2001, approximately \$52 million remained as of

December 31, 2001. This insurance is scheduled to be paid over a period of approximately three years.

Estimated Cost: In evaluating U.S. Gypsum's estimated asbestos liability prior to the Filing, the Corporation considered numerous uncertainties that made it difficult to estimate reliably U.S. Gypsum's asbestos liability in the tort system for both pending and future asbestos claims.

In the Property Damage Cases, such uncertainties included, but were not limited to, the identification and volume of asbestos-containing products in the buildings at issue in each case, which is often disputed; the claimed damages associated therewith; the viability of statute of limitations, product identification and other defenses, which varies depending upon the facts and jurisdiction of each case; the amount for which such cases can be resolved, which normally (but not uniformly) has been substantially lower than the claimed damages; and the viability of claims for punitive and other forms of multiple damages.

Uncertainties in the Personal Injury Cases included, but were not limited to, the number, disease and occupational characteristics, and venue of Personal Injury Cases that are filed against U.S. Gypsum; the age and level of physical impairment of claimants; the viability of claims for conspiracy or punitive damages; the elimination of indemnity sharing among Center members for future settlements and its negative impact on U.S. Gypsum's ability to continue to resolve claims at historical or acceptable levels; the adverse impact on U.S. Gypsum's settlement costs of recent bankruptcies of co-defendants; the continued solvency of other defendants and the possibility of additional bankruptcies; the possibility of significant adverse verdicts due to recent changes in settlement strategies and related effects on liquidity; the inability or refusal of former Center members to fund their share of existing settlements and its effect on such settlement agreements; the continued ability to negotiate settlements or develop other mechanisms that defer or reduce claims from unimpaired claimants; and the possibility that federal legislation addressing asbestos litigation will be enacted. The Corporation reported that adverse developments with respect to any of these uncertainties could have a material impact on U.S. Gypsum's settlement costs and could materially increase the cost above the estimated range discussed below.

Prior to the fourth quarter of 2000, the Corporation, in the opinion of management, was unable

to reasonably estimate the probable cost of resolving future asbestos claims in the tort system, although the Corporation had estimated and reserved for costs associated with then-pending claims. However, in 1999 and increasingly in 2000, as U.S. Gypsum entered into Long-Term Settlements of Personal Injury Cases (discussed above), the Corporation undertook a detailed, independent study of U.S. Gypsum's current and potential future asbestos liability. This analysis was based on the assumption that U.S. Gypsum's asbestos liability would continue to be resolved in the tort system. The analysis was completed in the fourth quarter of 2000.

As part of this analysis, the Corporation reviewed, among other things, historical case filings and increasing settlement costs; the type of products sold by U.S. Gypsum and the occupations of claimants expected to bring future asbestos-related claims; epidemiological data concerning the incidence of past and projected future asbestos-related diseases; trends in the propensity of persons alleging asbestos-related disease to sue U.S. Gypsum; the adverse effect on settlement costs of historical reductions in the number of solvent defendants available to pay claims, including reductions in membership of the Center; the pre-agreed settlement recommendations in, and the continued viability of, the Long-Term Settlements described above; and anticipated trends in recruitment by plaintiffs' firms of non-malignant or unimpaired claimants. The study attempted to weigh relevant variables and assess the impact of likely outcomes on future case filings and settlement costs. In addition, the Corporation considered future defense costs, as well as allegations that U.S. Gypsum and the other Center members bear joint liability for the share of certain settlement agreements that was to be paid by former members that now have refused or are unable to pay.

In the fourth quarter of 2000, the Corporation concluded that it was possible to provide a reasonable estimate of U.S. Gypsum's liability in the tort system for asbestos cases to be filed through 2003, as well as those currently pending. Based on an independent study, the Corporation determined that, although substantial uncertainty remained, it was probable that asbestos claims currently pending against U.S. Gypsum and future asbestos claims to be filed against it through 2003 (both property damage and personal injury) could be resolved in the tort system for an amount between \$889 million and \$1,281 million, including defense costs, and that within this range the most likely estimate was \$1,185 million. Consistent with this analysis, in the

fourth quarter of 2000, the Corporation recorded a pretax noncash charge of \$850 million to results of operations, which, combined with the previously existing reserve, increased U.S. Gypsum's reserve for asbestos claims to \$1,185 million. Substantially all of this reserve relates to the estimated costs of resolving then-pending asbestos personal injury claims and those expected to be filed through 2003, and the reserve reflected management's expectation that U.S. Gypsum's average payment per asbestos personal injury claim would increase at least in the short term due to distortions caused by the bankruptcy filings of other asbestos personal injury defendants discussed above. Less than 10 percent of the reserve is attributable to defense and administrative costs.

At the time of recording this reserve, it was expected that the reserve amounts would be expended over a period extending several years beyond 2003, because asbestos cases have historically been resolved an average of three years after filing. The Corporation concluded that it did not have adequate information to allow it to reasonably estimate the number of claims to be filed after 2003, or the liability associated with such claims.

During 2001 up to the Filing, U.S. Gypsum's cash payments for asbestos claims and related legal fees totaled approximately \$124 million, reducing its reserve for asbestos claims to \$1,061 million as of December 31, 2001. Insurance recoveries during 2001 totaled approximately \$34 million, leaving U.S. Gypsum with a receivable from insurance carriers (the estimated portion of the reserved amount that is expected to be paid or reimbursed by insurance) of approximately \$52 million as of December 31, 2001. The above amounts are stated before tax benefit and are not discounted to present value.

It is the Corporation's view that, as a result of the Filing, there is even greater uncertainty in estimating the reasonably possible range of asbestos liability for pending and future claims as well as the most likely estimate of liability within this range. There are significant differences in the treatment of asbestos claims in a bankruptcy proceeding as compared to the tort litigation system. Among other things, these uncertainties include how the Long-Term Settlements will be treated in the bankruptcy proceeding and plan of reorganization, and whether those settlements will be set aside; the number of asbestos-related claims that will be filed in the proceeding; the number of future claims that will be estimated in connection with preparing a plan of reorganization; how claims for

punitive damages and claims by persons with no asbestos-related physical impairment will be treated and whether such claims will be allowed; the impact historical settlement values for asbestos claims may have on the estimation of asbestos liability in the bankruptcy proceeding; and the impact any relevant potential federal legislation may have on the proceeding. These factors, as well as the uncertainties discussed above in connection with the resolution of asbestos cases in the tort system, increase the uncertainty of any estimate of asbestos liability.

As a result of the increased uncertainty of estimating asbestos liability due to the Filing, it is the Corporation's view that no change should be made to the previously recorded reserve for asbestos claims (except to reflect obligations incurred prior to the Filing). However, it is possible that the cost of resolving asbestos claims will be greater than that set forth in the high end of the estimated reserve range. As the bankruptcy proceeding continues, it is expected that the Corporation will obtain additional information that may provide greater certainty to the expected range of liability.

When a reasonable estimate can be made of the Debtors' probable liability for asbestos claims and such estimate differs from the existing reserve, the reserve will be adjusted to reflect the estimate, and it is possible that a charge to results of operations will be necessary at that time.

Bond to Secure Certain CCR Obligations: In January 2001, U.S. Gypsum obtained a performance bond from Safeco Insurance Company of America ("*Safeco*") in the amount of \$60.3 million to secure certain obligations of U.S. Gypsum for extended payout settlements of Personal Injury Cases and other obligations owed by U.S. Gypsum to the Center. The bond is secured by an irrevocable letter of credit obtained by the Corporation in the amount of \$60.3 million and issued by Chase Manhattan Bank to Safeco. After the Filing, by letter dated July 6, 2001, the Center stated that certain amounts allegedly covered by the bond, totaling approximately \$15.7 million, were overdue from U.S. Gypsum to the Center. In subsequent letters dated November 19, 2001, and December 11, 2001, the Center stated that additional amounts allegedly covered by the bond totaling approximately \$14 million and \$113 million, respectively, were also overdue from U.S. Gypsum. The amounts for which the Center made demand were for the payment of, among other things, settlements of

Personal Injury Cases that were entered into pre-petition. By letter dated November 16, 2001, the Center made a demand to Safeco for payment of \$15.7 million under the bond, and by letter dated December 28, 2001, the Center made a demand to Safeco for payment of approximately \$127 million under the bond. The total amount demanded by the Center under the bond, approximately \$143 million, exceeds the original penal sum of the bond, which is \$60.3 million. Safeco has not made any payment under the bond, but, to the extent that Safeco were to pay any portion of the bond, it is likely that Safeco would draw down the Chase letter of credit to cover the bond payment and Chase would assert a pre-petition claim in a corresponding amount against the Corporation in the bankruptcy proceeding.

On November 30, 2001, the Corporation and U.S. Gypsum filed an Adversary Complaint in the bankruptcy proceeding to, among other things, enjoin the Center from drawing on the bond and enjoin Safeco from paying on the bond during the pendency of these bankruptcy proceedings. This Adversary Proceeding is pending in the United States Bankruptcy Court for the District of Delaware and is captioned *USG Corporation and United States Gypsum Company v. Center for Claims Resolution, Inc. and Safeco Insurance Company of America*, No. 01-08932. The Corporation cannot predict whether or when any portion of the bond proceeds will be paid, what amount, if any, will be paid, and whether the letter of credit will be drawn.

Conclusion: There are many uncertainties associated with the resolution of asbestos liability in the bankruptcy proceeding. These uncertainties include, among others, the number of asbestos-related claims that will be filed against the Debtors in the proceeding; the number of future claims that will be estimated in connection with preparing a plan of reorganization; how the Long-Term Settlements will be treated in the bankruptcy proceeding and plan of reorganization, and whether those settlements will be set aside; how claims for punitive damages and claims by persons with no asbestos-related physical impairment will be treated and whether such claims will be allowed; the impact historical settlement values for asbestos claims may have on the estimation of asbestos liability in the bankruptcy proceeding; and the impact any relevant potential federal legislation may have on the proceeding. The Corporation has not revised its previously recorded reserve for asbestos liability, except by reducing the reserve in accordance with obligations incurred prior to the Filing. The

Corporation will continue to review its asbestos liability as the bankruptcy proceeding progresses. When a reasonable estimate can be made of the Debtors' probable liability for asbestos claims and such estimate differs from the existing reserve, the reserve will be adjusted to reflect the estimate, and it is possible that a charge to results of operations will be necessary at that time. It is possible that the Corporation's asbestos liability may vary significantly from the recorded estimate of liability and that this difference could be material to the results of operations in the period recorded.

ENVIRONMENTAL LITIGATION

The Corporation and certain of its subsidiaries have been notified by state and federal environmental protection agencies of possible involvement as one of numerous "potentially responsible parties" in a number of so-called "Superfund" sites in the United States. In most of these sites, the involvement of the Corporation or its subsidiaries is expected to be minimal. The Corporation believes that appropriate reserves have been established for its potential liability in connection with all Superfund sites but is continuing to review its accruals as additional information becomes available. Such reserves take into account all known or estimated costs associated with these sites, including site investigations and feasibility costs, site cleanup and remediation, legal costs, and fines and penalties, if any. In addition, environmental costs connected with site cleanups on Corporation-owned property also are covered by reserves established in accordance with the foregoing. The Corporation believes that neither these matters nor any other known governmental proceeding regarding environmental matters will have a material adverse effect upon its results of operations or financial position.

REPORT OF MANAGEMENT

Management of USG Corporation is responsible for the preparation, integrity and fair presentation of the financial information included in this report. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States and necessarily include certain amounts that are based on management's estimates and judgment.

Management is responsible for maintaining a system of internal accounting controls to provide reasonable assurance as to the integrity and reliability of the financial statements, the proper safeguarding and use of assets, and the accurate execution and recording of transactions. Such controls are based on established policies and procedures and are implemented by trained personnel. The system of internal accounting controls is monitored by the Corporation's internal auditors to confirm that the system is proper and operating effectively. The Corporation's policies and procedures prescribe that the Corporation and its subsidiaries are to maintain ethical standards and that its business practices are to be consistent with those standards.

The Corporation's financial statements have been audited by Arthur Andersen LLP, independent public accountants. Their audit was conducted in accordance with auditing standards generally accepted in the United States and included consideration of the Corporation's internal control system. Management has made available to Arthur Andersen LLP all the Corporation's financial records and related data, as well as minutes of the meetings of the Board of Directors. Management believes that all representations made to Arthur Andersen LLP were valid and appropriate.

The Board of Directors, operating through its Audit Committee composed entirely of nonemployee directors, provides oversight to the financial reporting process. The Audit Committee meets periodically with management, the internal auditors and Arthur Andersen LLP, jointly and separately, to review accounting, auditing, internal control and financial reporting matters. Both Arthur Andersen LLP and the internal auditors have unrestricted access to the Audit Committee.

William C. Foote
Chairman, President and Chief Executive Officer

Richard H. Fleming
Executive Vice President and Chief Financial Officer

Raymond T. Belz
Senior Vice President and Controller

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Stockholders and Board of Directors of USG Corporation:

We have audited the accompanying consolidated balance sheets of USG Corporation (a Delaware corporation) and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of earnings, cash flows and stockholders' equity for the years ended December 31, 2001, 2000 and 1999. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of USG Corporation and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for the years ended December 31, 2001, 2000 and 1999, in conformity with accounting principles generally accepted in the United States.

The accompanying consolidated financial statements have been prepared assuming that the Corporation will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Corporation voluntarily filed for Chapter 11 bankruptcy protection on June 25, 2001. Management's plans in regard to these matters are also described in Note 2. This action, which was taken primarily as a result of asbestos litigation as discussed in Note 17 to the consolidated financial statements, raises substantial doubt about the Corporation's ability to continue as a going concern. Such doubt includes, but is not limited to, a possible change in control of the Corporation as well as a potential change in the composition of the Corporation's business portfolio. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Our audit was made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. Schedule II is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the consolidated financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the consolidated financial statements taken as a whole.

/s/ Arthur Andersen LLP

ARTHUR ANDERSEN LLP
Chicago, Illinois

January 30, 2002

USG CORPORATION
SELECTED QUARTERLY FINANCIAL DATA (unaudited)

<i>(millions, except per-share data)</i>	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
2001					
Net sales	\$ 826	\$ 806	\$ 842	\$ 822	\$3,296
Operating profit (loss)	32	(5)	49 (a)	14 (b)	90
Net earnings (loss)	11	(13)	27 (a)	(9) (b)	16
<i>Per Common Share:</i>					
Net earnings (loss) (c) - basic	0.25	(0.29)	0.61	(0.21)	0.36
- diluted	0.25	(0.29)	0.61	(0.21)	0.36
Price range (d) - high	24.75	15.28	6.40	6.31	24.75
- low	14.51	2.80	3.66	3.60	2.80
Cash dividends paid	0.025	-	-	-	0.025
2000					
Net sales	989	995	956	841	3,781
Operating profit (loss)	184	165	122	(840) (e)	(369)
Net earnings (loss)	106	93	65	(523) (e)	(259)
<i>Per Common Share:</i>					
Net earnings (loss) (c) - basic	2.19	2.06	1.48	(12.05)	(5.62)
- diluted	2.18	2.04	1.48	(12.05)	(5.62)
Price range (d) - high	48.00	45.56	33.56	25.50	48.00
- low	30.75	30.36	24.63	13.13	13.13
Cash dividends paid	0.15	0.15	0.15	0.15	0.60

(a) Includes reversals of restructuring reserves of \$9 million pretax (\$5 million after-tax) and restructuring-related inventory reserves of \$3 million pretax (\$2 million after-tax).

(b) Includes charges for impairment of \$30 million pretax (\$25 million after-tax) and restructuring of \$12 million pretax (\$10 million after-tax).

(c) The sum of the four quarters is not necessarily the same as the total for the year.

(d) Stock price ranges are for transactions on the New York Stock Exchange (trading symbol USG), which is the principal market for these securities. Stockholders of record as of January 31, 2002: Common - 4,443; Preferred - none.

(e) Includes charges for asbestos claims of \$850 million pretax (\$524 million after-tax), restructuring of \$50 million pretax (\$31 million after-tax) and a restructuring-related inventory writedown of \$4 million pretax (\$2 million after-tax).

USG CORPORATION
FIVE-YEAR SUMMARY

(dollars in millions, except per-share data)

	Years Ended December 31,				
	2001	2000	1999	1998	1997
Statement of Earnings Data:					
Net sales	\$3,296	\$3,781	\$3,810	\$3,342	\$3,066
Cost of products sold	2,882	2,941	2,742	2,458	2,279
Selling and administrative expenses	279	309	338	299	281
Chapter 11 reorganization expenses	12	-	-	-	-
Provisions for impairment and restructuring	33	50	-	-	-
Provision for asbestos claims	-	850	-	-	-
Amortization of excess reorganization value (a)	-	-	-	-	127
Operating profit (loss)	90	(369)	730	585	379
Interest expense	33	52	53	53	60
Interest income	(5)	(5)	(10)	(5)	(3)
Other expense, net	10	4	3	3	2
Income taxes (benefit)	36	(161)	263	202	172
Net earnings (loss)	16	(259)	421	332	148
<i>Net Earnings (Loss) Per Common Share:</i>					
Basic	0.36	(5.62)	8.48	6.81	3.19
Diluted	0.36	(5.62)	8.39	6.61	3.03
Balance Sheet Data (as of the end of the year):					
Working capital	876	(20)	319	410	199
Current ratio	3.73	0.98	1.50	1.79	1.43
Property, plant and equipment, net	1,800	1,830	1,568	1,214	982
Total assets	3,464	3,214	2,794	2,366	1,926
Total debt (b)	1,007	711	593	596	620
Liabilities subject to compromise	2,311	-	-	-	-
Total stockholders' equity	491	464	867	518	147
Other Information:					
Capital expenditures	109	380	426	309	172
Stock price (per common share) (c)	5.72	22.50	47.13	50.94	49.00
Cash dividends paid (per common share)	0.025	0.60	0.45	0.10	-
Average number of employees	14,300	14,900	14,300	13,700	13,000

(a) Excess reorganization value was established in connection with a financial restructuring in May 1993 and was subsequently amortized through September 30, 1997.

(b) Total debt as of December 31, 2001, includes \$1,005 million of debt classified as liabilities subject to compromise.

(c) Stock price per common share reflects the final closing price of the year.

USG CORPORATION
SCHEDULE II
VALUATION AND QUALIFYING ACCOUNTS
(Dollars in millions)

	<u>Beginning Balance</u>	<u>Additions (a)</u>	<u>Deductions (b)</u>	<u>Ending Balance</u>
Year ended December 31, 2001:				
Doubtful accounts	\$14	\$ 3	\$ (4)	\$13
Cash discounts	4	51	(51)	4
Provisions for restructuring	34	10	(32)	12
Year ended December 31, 2000:				
Doubtful accounts	14	4	(4)	14
Cash discounts	4	57	(57)	4
Provision for restructuring	-	35	(1)	34
Year ended December 31, 1999:				
Doubtful accounts	14	4	(4)	14
Cash discounts	4	59	(59)	4

(a) Reflects provisions charged to earnings.

(b) Reflects receivables written off as related to doubtful accounts, discounts allowed as related to cash discounts, and payments and reversals made against the restructuring reserve.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information regarding directors is included in the Corporation's definitive Proxy Statement, which is incorporated herein by reference.

Executive Officers of the Registrant (as of March 1, 2002)

Name, Age and Present Position	Business Experience During the Last Five Years	Present Position Held Since
William C. Foote, 50 Chairman, President and Chief Executive Officer	Chairman, President and Chief Executive Officer from April 1996 to June 1997; Chairman and Chief Executive Officer from June 1997 to August 1999.	August 1999
Richard H. Fleming, 54 Executive Vice President and Chief Financial Officer	Senior Vice President and Chief Financial Officer to February 1999.	February 1999
Raymond T. Belz, 61 Senior Vice President and Controller	Vice President and Controller, USG Corporation, from January 1994 to February 1999; Vice President Financial Operations, North American Gypsum and Worldwide Ceilings, from September 1996 to February 1999.	February 1999
Edward M. Bosowski, 47 Senior Vice President, Corporate Strategy and Marketing; President, USG International	Executive Vice President – Marketing, United States Gypsum Company, to February 1999; President and Chief Executive Officer, United States Gypsum Company, to November 2000; President, Growth Initiatives and International, to February 2001.	February 2001
Stanley L. Ferguson, 49 Senior Vice President and General Counsel	Associate General Counsel to May 2000; Vice President and General Counsel to May 2001.	May 2001
James S. Metcalf, 44 Senior Vice President; President, Building Systems	Vice President, Sales, USG Interiors, Inc., to June 1998; Senior Vice President, Sales and Marketing, USG Interiors, Inc., to March 1999; Executive Vice President and Chief Operating Officer, L&W Supply Corporation, to March 2000; President and Chief Executive Officer, L&W Supply Corporation, to March 2002.	March 2002
Brian W. Burrows, 62 Vice President, Research and Technology	Same position	March 1987

Name, Age and Present Position	Business Experience During the Last Five Years	Present Position Held Since
Brian J. Cook, 44 Vice President, Human Resources	Director, Human Resources Planning and Development and Corporate Employee Counsel, to December 1997; Director, Human Resources – Operations, to December 1998.	December 1998
Jean K. Holley, 42 Vice President and Chief Information Officer	Senior Director, Information Technology, Waste Management Corporation, to August 1998.	August 1998
Marcia S. Kaminsky, 43 Vice President, Communications	Vice President, U.S. Communications, Bank of Montreal/Harris Bank, to January 1997; Senior Vice President, Public Affairs, Bank of Montreal/Harris Bank, to October 1998.	October 1998
Michael C. Lorimer, 62 Vice President; President and Chief Operating Officer, L&W Supply Corporation	Vice President Operations, L&W Supply Corporation, to March 2002.	March 2002
D. Rick Lowes, 47 Vice President and Treasurer	Vice President and Chief Financial Officer, CGC Inc., to January 1999.	January 1999
Peter K. Maitland, 60 Vice President, Compensation, Benefits and Administration	Director, Employee Benefits and Office Facilities, to June 1997; Director, Employee Benefits and Office Management, to February 1999.	February 1999
Clarence B. Owen, 53 Vice President, International and Technology	Vice President Operations, USG Interiors, Inc., to June 1997; Senior Vice President, Technical Services, North American Gypsum and Worldwide Ceilings, to April 1998; President and Managing Director, Europe, USG Interiors, Inc., to March 1999; Senior Vice President, International, USG Interiors, Inc., to May 2001; Vice President to May 2001.	May 2001
Robert B. Sirgant, 61 Vice President, Corporate Customer Relations	Vice President, Corporate Accounts, to August 1999.	August 1999
John Eric Schaal, 58 Associate General Counsel and Corporate Secretary	Assistant General Counsel to August 2000; Associate General Counsel to February 2002.	February 2002

Item 11. EXECUTIVE COMPENSATION

Information required by Item 11 is included in the Corporation’s definitive Proxy Statement, which is incorporated herein by reference.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information required by Item 12 is included in the Corporation’s definitive Proxy Statement, which is incorporated herein by reference.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information required by Item 13 is included in the Corporation’s definitive Proxy Statement, which is incorporated herein by reference.

PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) 1. and 2. The consolidated financial statements and supplemental financial statement schedule

See Part II, Item 8. Financial Statements and Supplementary Data for an index of the Corporation’s consolidated financial statements and supplementary data schedule.

3. *Exhibits (Reg. S-K, Item 601):*

**Exhibit
No.**

Page

3 Articles of incorporation and by-laws:

- (a) Restated Certificate of Incorporation of USG Corporation (incorporated by reference to Exhibit 3.1 of USG Corporation’s Form 8-K, dated May 7, 1993).
- (b) Certificate of Designation of Junior Participating Preferred Stock, series D, of USG Corporation (incorporated by reference to Exhibit A of Exhibit 4 to USG Corporation’s Form 8-K dated March 27, 1998).
- (c) Amended and Restated By-Laws of USG Corporation, dated as of November 14, 2001.

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Instruments defining the rights of security holders, including indentures:

- (a) Indenture dated as of October 1, 1986, between USG Corporation and National City Bank of Indiana, successor Trustee to Bank One, which was successor Trustee to Harris Trust and Savings Bank (incorporated by reference to Exhibit 4(a) of USG Corporation's Registration Statement No. 33-9294 on Form S-3, dated October 7, 1986).
- (b) Rights Agreement dated March 27, 1998, between USG Corporation and Harris Trust and Savings Bank, as Rights Agent (incorporated by reference to Exhibit 4 of USG Corporation's Form 8-K, dated March 27, 1998).
- (c) Form of Common Stock certificate (incorporated by reference to Exhibit 4.4 to USG Corporation's Form 8-K, dated May 7, 1993).

The Corporation and certain of its consolidated subsidiaries are parties to long-term debt instruments under which the total amount of securities authorized does not exceed 10% of the total assets of the Corporation and its subsidiaries on a consolidated basis. Pursuant to paragraph (b)(4)(iii)(A) of Item 601 of Regulation S-K, the Corporation agrees to furnish a copy of such instruments to the Securities and Exchange Commission upon request.

10 Material contracts:

- (a) Management Performance Plan of USG Corporation (incorporated by reference to Annex C of Amendment No. 8 to USG Corporation's Registration Statement No. 33-40136 on Form S-4, dated February 3, 1993).
- (b) First Amendment to Management Performance Plan, effective November 15, 1993, and dated February 1, 1994 (incorporated by reference to Exhibit 10(aq) of Amendment No. 1 of USG Corporation's Registration Statement No. 33-51845 on Form S-1).
- (c) Second Amendment to Management Performance Plan, dated June 27, 2000 (incorporated by reference to Exhibit 10(a) of USG Corporation's Form 10-Q, dated November 6, 2000).
- (d) Amendment and Restatement of USG Corporation Supplemental Retirement Plan, effective July 1, 1997, and dated August 25, 1997 (incorporated by reference to Exhibit 10(c) of USG Corporation's Annual Report on Form 10-K, dated February 20, 1998).
- (e) First Amendment to Supplemental Retirement Plan, effective July 1, 1997 (incorporated by reference to Exhibit 10(d) of USG Corporation's Annual Report on Form 10-K, dated February 26, 1999).

- (f) Second Amendment to Supplemental Retirement Plan, effective November 8, 2000 (incorporated by reference to Exhibit 10(e) of USG Corporation's Annual Report on Form 10-K, dated March 5, 2001).
- (g) Third Amendment to Supplemental Retirement Plan, effective November 8, 2000 (incorporated by reference to Exhibit 10(e) of USG Corporation's Annual Report on Form 10-K, dated March 5, 2001).
- (h) Fourth Amendment to Supplemental Retirement Plan of USG Corporation, effective April 11, 2001 (incorporated by reference to Exhibit 10(a) of USG Corporation's Form 10-Q, dated March 31, 2001).
- (i) Fifth Amendment of USG Corporation Supplemental Retirement Plan, effective December 21, 2001.
- (j) Form of Termination Compensation Agreement dated January 1, 2000 (incorporated by reference to Exhibit 10(e) of USG Corporation's Annual Report on Form 10-K, dated February 29, 2000).
- (k) Form of Indemnification Agreement (incorporated by reference to Exhibit 10(g) of Amendment No. 1 to USG Corporation's Registration No. 33-51845 on Form S-1).
- (l) Form of Employment Agreement dated January 1, 2000 (incorporated by reference to Exhibit 10(g) of USG Corporation's Annual Report on Form 10-K, dated February 29, 2000).
- (m) Five Year Credit Agreement dated as of June 30, 2000, among USG Corporation and the banks listed on the signature pages thereto and The Chase Manhattan Bank as Administrative Agent (incorporated by reference to Exhibit 10(a) of USG Corporation's Form 10-Q, dated August 7, 2000).
- (n) 364-Day Credit Agreement dated as of June 30, 2000, among USG Corporation and the banks listed on the signature pages thereto and The Chase Manhattan Bank as Administrative Agent (incorporated by reference to Exhibit 10(b) of USG Corporation's Form 10-Q, dated August 7, 2000).
- (o) 1995 Long-Term Equity Plan of USG Corporation (incorporated by reference to Annex A to USG Corporation's Proxy Statement and Proxy, dated March 31, 1995).

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(p)	First Amendment to 1995 Long-Term Equity Plan of USG Corporation, dated June 27, 2000 (incorporated by reference to Exhibit 10(b) of USG Corporation's Form 10-Q, dated November 6, 2000).	
(q)	2001 Annual Management Incentive Program - USG Corporation.	81
(r)	Omnibus Management Incentive Plan (incorporated by reference to Annex A to USG Corporation's Proxy Statement and Proxy, dated March 28, 1997).	
(s)	First Amendment to Omnibus Management Incentive Plan, dated November 11, 1997 (incorporated by reference to Exhibit 10(p) of USG Corporation's Annual Report on Form 10-K, dated February 20, 1998).	
(t)	Second Amendment to Omnibus Management Incentive Plan of USG Corporation, dated as of June 27, 2000 (incorporated by reference to Exhibit 10(c) of USG Corporation's Form 10-Q, dated November 6, 2000).	
(u)	Amended and Restated Stock Compensation Program for Non-Employee Directors of USG Corporation, dated July 1, 1997 (incorporated by reference to Exhibit 10(q) of USG Corporation's Annual Report on Form 10-K, dated February 20, 1998).	
(v)	Key Employee Retention Plan, dated May 16, 2001, as amended September 20, 2001.	90
(w)	Senior Executive Severance Plan, dated May 16, 2001, as amended September 20, 2001.	93
(x)	Revolving Credit and Guaranty Agreement, dated as of June 25, 2001, among USG Corporation and certain of its subsidiaries, as debtors, USG Foreign Investments, Ltd., as guarantor, and The Chase Manhattan Bank, as agent and lender, and the other lenders named therein.	98
(y)	First Amendment to Revolving Credit and Guaranty Agreement, dated August 2, 2001.	185
(z)	Second Amendment to Revolving Credit and Guaranty Agreement, dated August 24, 2001.	212
(aa)	Third Amendment to Revolving Credit and Guaranty Agreement, dated December 10, 2001.	221

	(ab)	Security and Pledge Agreement, dated June 25, 2001, among USG Corporation and each of its direct and indirect subsidiaries party to the Credit Agreement, other than USG Foreign Investments, Ltd., and The Chase Manhattan Bank.	229
	(ac)	Second Amendment of USG Corporation Retirement Plan, dated December 21, 2001.	254
21		Subsidiaries	255
23		Consents of Experts and Counsel	256
24		Power of Attorney	257

(b) Reports on Form 8-K:

None.

**Index to exhibits filed
with the Annual Report on Form 10-K
for the year ended December 31, 2001**

<u>Exhibit</u>	<u>Page</u>
3(c) Amended and Restated By-Laws of USG Corporation	63
10(i) Fifth Amendment of USG Corporation Supplemental Retirement Plan	80
10(q) 2001 Annual Management Incentive Program - USG Corporation	81
10(v) Key Employee Retention Plan	90
10(w) Senior Executive Severance Plan	93
10(x) Revolving Credit and Guaranty Agreement	98
10(y) First Amendment to Revolving Credit and Guaranty Agreement	185
10(z) Second Amendment to Revolving Credit and Guaranty Agreement	212
10(aa) Third Amendment to Revolving Credit and Guaranty Agreement	221
10(ab) Security and Pledge Agreement	229
10(ac) Second Amendment of USG Corporation Retirement Plan	254
21 Subsidiaries	255
23 Consent of Experts and Counsel	256
24 Power of Attorney	257

If you wish to receive a copy of any exhibit, it may be obtained, upon payment of reasonable expenses, by writing to:

J. Eric Schaal
Associate General Counsel and Corporate Secretary
USG Corporation
P.O. Box 6721
Chicago, IL 60680-6721

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

March 1, 2002

USG CORPORATION

By: /s/ Richard H. Fleming
Richard H. Fleming
Executive Vice President and
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

/s/ William C. Foote
WILLIAM C. FOOTE
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

March 1, 2002

/s/ Richard H. Fleming
RICHARD H. FLEMING
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

March 1, 2002

/s/ Raymond T. Belz
RAYMOND T. BELZ
Senior Vice President and Controller
(Principal Accounting Officer)

March 1, 2002

ROBERT L. BARNETT, KEITH A. BROWN,)
JAMES C. COTTING, LAWRENCE M. CRUTCHER,)
W. DOUGLAS FORD, DAVID W. FOX,)
VALERIE B. JARRETT, MARVIN E. LESSER,)
JOHN B. SCHWEMM, JUDITH A. SPRIESER)
Directors)
)

By: /s/ Richard H. Fleming
Richard H. Fleming
Attorney-in-fact
Pursuant to Power of Attorney
(Exhibit 24 hereto)
March 1, 2002