

Financial Review

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Management's Discussion and Analysis of Results of Operations and Financial Condition

Consolidated Results

Net Sales

1999 was another record-setting year for USG due to continued strong demand from all sectors of the construction industry in North America. Net sales of \$3.60 billion represented a new record level, the eighth consecutive year of higher sales and a 15% increase from the previous record of \$3.13 billion in 1998. Growth in repair and remodeling and new residential construction resulted in record shipments and selling prices for USG's SHEETROCK brand gypsum wallboard. Increased opportunity from nonresidential construction led to record shipments of DONN brand suspension grid and solid demand for USG's ceiling tile products. Similar market trends resulted in a 9% increase in 1998 net sales as compared with 1997.

Gross Profit

Gross profit as a percentage of net sales increased to 29.7% in 1999, compared with 28.2% in 1998 and 27.4% in 1997. The improved margin in 1999 reflects higher selling prices for SHEETROCK brand gypsum wallboard, which more than offset increased asbestos-related costs and a \$22 million charge related to a plant closing.

Asbestos charges in 1999 totaled \$80.5 million compared with \$26 million in 1998. See "Legal Contingencies" below and "Note 16. Litigation" for additional information on asbestos-related costs.

Selling and Administrative Expenses

Selling and administrative expenses increased to \$338 million in 1999, from \$299 million in 1998 and \$281 million in 1997. However, these expenses as a percentage of net sales improved to 9.4% in 1999, from 9.6% in 1998 and 9.8% in 1997. The increase in expense dollars in 1999 primarily related to incentive compensation and information

technology initiatives. The increase in 1998 versus 1997 was primarily attributable to higher levels of expenses related to marketing programs and information technology initiatives.

Interest Expense

Interest expense amounted to \$53 million in both 1999 and 1998 as the level of total debt remained relatively constant over the two-year period. Interest expense in 1998 was down 12% from \$60 million in 1997 as a result of a lower average level of debt in 1998.

Income Taxes

Income tax expense amounted to \$263 million in 1999, compared with \$202 million in 1998 and \$172 million in 1997. The Corporation's effective tax rates for 1999, 1998 and 1997 were 38.4%, 37.8% and 53.9%, respectively.

In 1997, the Corporation's income tax expense was computed based on pretax earnings excluding the amortization of excess reorganization value, which was not deductible for income tax purposes. Excess reorganization value was established in 1993 in connection with a financial restructuring. Excluding the amortization of excess reorganization value, the Corporation's 1997 effective tax rate was 38.6%. See "Note 14. Income Taxes" for additional information.

Net Earnings

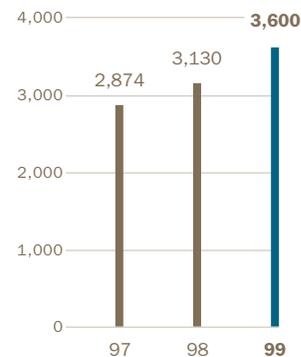
Net earnings in 1999 were a record \$421 million, up 27% from \$332 million in 1998. This increase marked the fifth consecutive year of improved earnings. Diluted earnings per share were \$8.39 in 1999 versus \$6.61 in 1998.

In 1997, net earnings of \$148 million, or \$3.03 per diluted share, were net of the amortization of excess reorganization value of \$127 million, or \$2.60 per diluted share.

USG Corporation

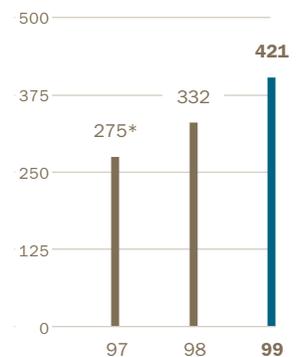
Net Sales

millions of dollars



Net Earnings

millions of dollars



* Excludes amortization of excess reorganization value of \$127 million.

Core Business Results

	<i>millions</i>	Net Sales			Operating Profit (Loss)		
		1999	1998	1997	1999	1998	1997*
North American Gypsum							
U.S. Gypsum Company		\$2,034	\$1,732	\$1,565	\$597	\$494	\$376
CGC Inc. (gypsum)		161	134	124	27	18	2
Other subsidiaries		108	95	95	27	22	24
Eliminations		(122)	(135)	(116)	-	-	-
Total		2,181	1,826	1,668	651	534	402
Worldwide Ceilings							
USG Interiors, Inc.		455	446	425	60	53	(1)
USG International		212	237	229	-	9	(3)
CGC Inc. (ceilings)		39	37	34	3	3	3
Eliminations		(58)	(63)	(54)	-	-	-
Total		648	657	634	63	65	(1)
Building Products Distribution							
L&W Supply Corporation		1,345	1,103	981	87	40	29
Corporate		-	-	-	(64)	(54)	(49)
Eliminations		(574)	(456)	(409)	(7)	-	(2)
Total USG Corporation		3,600	3,130	2,874	730	585	379

*Operating profit (loss) in 1997 includes the amortization of excess reorganization value of \$127 million (\$60 million for North American Gypsum, \$65 million for Worldwide Ceilings and \$2 million for Building Products Distribution).

Effective with this annual report, USG's operations are organized into three operating segments – North American Gypsum, Worldwide Ceilings and Building Products Distribution. Previously, L&W Supply Corporation was a component of North American Gypsum. Because

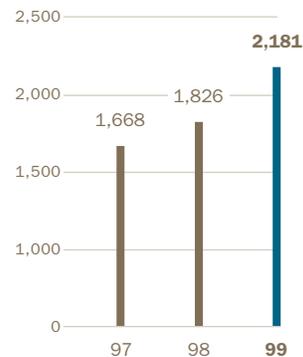
of the growth of L&W Supply, it is now presented as a separate operating segment.

Following is a discussion of the results for each of USG's operating segments beginning with North American Gypsum.

North American Gypsum

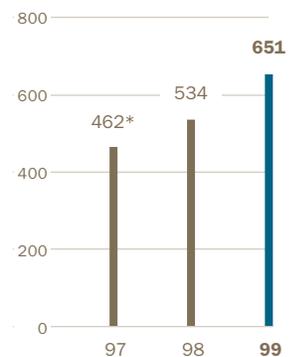
Net Sales

millions of dollars



Operating Profit

millions of dollars



* Excludes amortization of excess reorganization value of \$60 million.

North American Gypsum

Net sales in 1999 were \$2.18 billion, up 19% from 1998. Operating profit in 1999 was \$651 million, up 22% from 1998. Net sales in 1998 increased 9% versus 1997. Operating profit in 1998 rose 33% due in part to the absence of amortization of excess reorganization value of \$60 million recorded in 1997.

United States Gypsum Company: With its plants running at full capacity, shipments of SHEETROCK brand gypsum wallboard totaled a record 9.2 billion square feet in 1999, up 5% from 8.8 billion square feet in 1998. Shipments in 1997 totaled 8.4 billion square feet. The average selling price of SHEETROCK brand gypsum wallboard in 1999 was a record \$153.40 per thousand square feet, up 18% compared with the 1998 average price of \$129.50. The average price in 1997 was \$122.65. These improved results for wallboard were complemented by record shipments of SHEETROCK brand joint compound and DUROCK brand cement board in 1999. U.S. Gypsum's manufacturing costs for SHEETROCK brand gypsum wallboard were higher in 1999 largely due to higher prices for wastepaper, the primary raw material of wallboard paper. Lower unit costs in 1998 versus 1997 were largely due to lower prices for wastepaper. U.S. Gypsum's plants operated at 100% of capacity in 1999, compared with the estimated average rate of 98% for the U.S. wallboard industry.

CGC Inc.: The gypsum business of Canada-based CGC experienced improved net sales and operating profit in both 1999 and 1998. Increased levels of housing starts in eastern Canada resulted in greater demand and higher selling prices for CGC's SHEETROCK brand gypsum wallboard in each year. Improved results in 1998 versus 1997 also reflected a higher level of exports to the United States.

Worldwide Ceilings

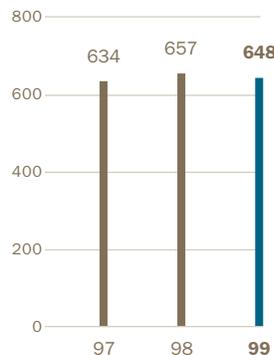
Net sales in 1999 were \$648 million, down slightly from 1998. Operating profit in 1999 was \$63 million, compared with \$65 million in 1998. Record sales and operating profit for USG Interiors, Inc., record domestic shipments of DONN brand suspension grid and solid demand for ceiling tile products were attributable to increased opportunity from the U.S. nonresidential construction market (both new construction and renovation). Operating profit in 1999 for USG Interiors also benefited from reduced manufacturing costs. However, these results were offset by weak economic conditions in Eastern Europe and in the Asia Pacific region.

Comparing 1998 with 1997, net sales increased 4% to \$657 million as sales improved for ceiling tile and DONN brand suspension grid. Operating profit of \$65 million in 1998 was favorably affected by higher volume and selling prices, reduced manufacturing costs and improved international operating efficiencies. An operating loss of \$1 million in 1997 reflected the amortization of excess reorganization value of \$65 million.

Worldwide Ceilings

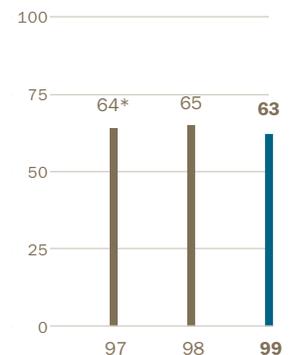
Net Sales

millions of dollars



Operating Profit

millions of dollars



* Excludes amortization of excess reorganization value of \$65 million.

Building Products Distribution

Net sales and operating profit for L&W Supply, the leading specialty building products distributor in the United States, reached record levels in 1999. Net sales exceeded \$1.3 billion, a 22% increase over 1998. Operating profit totaled \$87 million, more than double the 1998 level of \$40 million. This performance reflects record sales of gypsum wallboard and complementary building materials such as drywall metal, ceiling products and joint compound. During 1999, L&W Supply had a net increase of six locations, bringing the total to 193, representing 37 states. Net sales and operating profit in 1998 increased 12% and 38%, respectively, versus 1997. Operating profit in 1997 for L&W Supply was lowered by the amortization of excess reorganization value of \$2 million.

Market Conditions and Outlook

Overall market conditions were robust in 1999, and management is optimistic about key market fundamentals in 2000.

Industry shipments of wallboard in the United States grew in 1999 to an estimated 31.0 billion square feet, a record level and a 10% rise from 1998. This increase was supported by growth in new residential construction and repair and remodel activity. Strong demand from nonresidential construction was also a contributing factor.

Based on preliminary data issued by the U.S. Bureau of the Census, U.S. housing starts in 1999 were an estimated 1.665 million units, up 3% over 1998. Although management believes that new residential construction may not maintain this high level in 2000, housing starts are expected to approximate the healthy pace of the past several years. In addition, demand for larger homes with higher ceilings and more

amenities, and whose purchasers are less affected by interest rate changes, remains strong. Housing starts totaled 1.617 million units in 1998 and 1.474 million units in 1997.

Repair and remodel is the fastest-growing market for USG and accounts for the second-largest portion of its sales. Opportunity from repair and remodel activity continued to grow in 1999, increasing approximately 10%. Sales of existing homes were a record 5.2 million units in 1999. Because many buyers remodel an existing home within two years of purchase, the residential repair and remodel market should be healthy over the next several years. Lease rates, government tax receipts and other factors should support continued renovation of nonresidential space, such as offices and schools. Repair and remodel activity of all types is expected to continue to account for an increasing proportion of USG's sales.

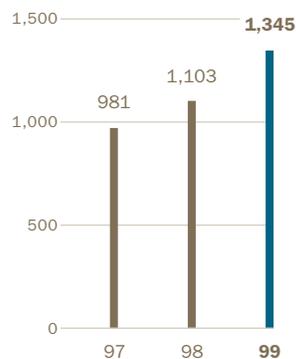
Sales of USG products to the new nonresidential construction market increased in 1999 and are expected to remain strong in 2000. Future demand for USG products from new nonresidential construction is gauged by floor space for which contracts are signed. Installation of gypsum and ceilings products follows signing of the construction contract by about a year. Floor space for which contracts were signed rose 13% in 1998 and increased another 3% in 1999.

While market conditions continue to be good in the United States and Canada, certain international markets remain weak. Most of USG's sales outside of North America come from Western Europe, Latin America and the Asia Pacific region. USG's exposure to the economic problems of Asia and Eastern Europe is small. Business conditions continue to be soft in Asia and parts of Europe, but have remained solid in Latin America.

Building Products Distribution

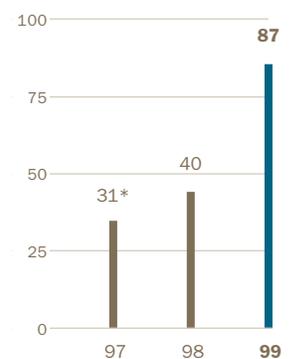
Net Sales

millions of dollars



Operating Profit

millions of dollars



* Excludes amortization of excess reorganization value of \$2 million.

Liquidity and Capital Resources

Financial Strategy

USG is focused on building long-term stockholder value through dividends, share repurchases and the five elements of its strategic growth plan.

Dividends: In 1999, USG paid cash dividends of \$0.10 per share in the first, second and third quarters. Because of record earnings in 1999 and the forecast of a stronger performance in 2000, USG increased its quarterly dividend to \$0.15 in the fourth quarter of 1999.

Share Repurchases: USG has purchased nearly 1.7 million shares since its multiyear share-repurchase program began in the fourth quarter of 1998. Under the program, USG may repurchase up to 5 million shares. Share repurchases are being made in the open market or through privately negotiated transactions and are being funded with available cash from operations.

Strategic Growth Plan: USG is investing in its businesses under five central strategies – building for growth by adding capacity and lowering production costs (see “Capital Expenditures” below), leading in product innovation, expanding its building products distribution business, enhancing customer service and promoting its brand names.

Capital Expenditures

Capital spending amounted to \$426 million in 1999, compared with \$309 million in 1998. As of December 31, 1999, capital expenditure commitments for the replacement, modernization and expansion of operations amounted to \$260 million, compared with \$481 million as of December 31, 1998. USG’s capital expenditures program includes the following projects:

Wallboard Capacity Modernization and Expansion: To meet growing demand, USG is investing in state-of-the-art manufacturing facilities. New production capacity will serve to meet the demands of USG’s customers and improve profitability. Upon completion of the five projects described below, USG will have added more than 2 billion square feet of net new capacity with lower operating costs than those of the old facilities it is replacing.

In the Southeast, construction of a new plant in Bridgeport, Ala., was successfully completed. This facility, which has more than 700 million square feet of SHEETROCK brand gypsum wallboard manufacturing capacity, began operation in the second quarter of 1999.

In the Midwest, U.S. Gypsum completed construction of a new production line for SHEETROCK brand gypsum wallboard at its East Chicago, Ind., plant. This new line replaced an existing high-cost line and began operation in the fourth quarter of 1999.

In the Northeast, U.S. Gypsum is building a new SHEETROCK brand gypsum wallboard plant in Aliquippa, Pa. Construction of this facility is expected to be completed in the second quarter of 2000.

In the Northwest, ground was broken during 1999 for a new SHEETROCK brand gypsum wallboard plant in Rainier, Ore. A significant portion of the new capacity provided by this plant will replace existing USG shipments into the region from plants as far away as Iowa, Texas and Ontario, Canada. This facility is expected to be fully operational in 2001.

In the Southwest, construction began in 1999 on a new production line for SHEETROCK brand gypsum wallboard at U.S. Gypsum’s plant in Plaster City, Calif., which will replace a 41-year-old, high-cost production line. This facility also is expected to be fully operational in 2001.

Gypsum Fiber Project: Construction was completed on a facility to manufacture FIBEROCK brand gypsum fiber panels, USG’s newest product platform. This production line, which is located at the Gypsum, Ohio, wallboard plant, began operation in late 1999.

Acquisition of Sybex, Inc.

On November 30, 1999, USG acquired Sybex, Inc., the holding company of Beadex Manufacturing Company, Inc. and The Synkoloid Company of Canada. Sybex operates joint compound and paper-faced metal corner bead plants in the United States and Canada. With annual sales of approximately \$58 million, Sybex is the leader in joint compound in the Pacific Northwest and western Canada and the leader in paper-faced metal corner bead in North America.

USG continues to evaluate potential acquisitions of companies in the building products industry, as well as divestitures and joint ventures, on an ongoing basis. USG has external sources of capital available and adequate financial resources and liquidity to fund future growth opportunities such as new products, acquisitions and joint ventures.

Shutdown of Plasterco

In the third quarter of 1999, U.S. Gypsum announced the planned shutdown of 350 million square feet of high-cost manufacturing capacity at its 90-year-old Plasterco, Va., plant. In conjunction with the announcement, U.S. Gypsum recorded a \$22 million pretax (\$14 million after-tax; \$0.27 per share) 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.

Working Capital

Working capital (current assets less current liabilities) as of December 31, 1999, amounted to \$382 million, compared with \$368 million as of December 31, 1998. The ratio of current assets to current liabilities was 1.78 to 1 as of December 31, 1999, compared with 1.86 to 1 as of December 31, 1998.

Receivables increased to \$361 million as of December 31, 1999, from \$349 million as of December 31, 1998. Inventories increased to \$256 million from \$234 million, and accounts payable rose to \$172 million from \$157 million. These variations reflect an increased level of business in 1999 as compared with 1998.

Cash and cash equivalents as of December 31, 1999, amounted to \$197 million, up from \$152 million as of December 31, 1998. During 1999, net cash flows from operating activities totaled \$631 million. Net cash flows to investing activities of \$498 million primarily reflect capital spending of \$426 million and the acquisition of Sybex, Inc. Net cash flows to financing activities of \$88 million primarily reflect \$72 million used for stock repurchases and \$22 million used for cash dividends, partially offset by \$12 million received from the exercise of stock options.

Debt

As of December 31, 1999, total debt amounted to \$593 million, down slightly from \$596 million at December 31, 1998. During 1999, USG retired \$25 million of 8.75% debentures due 2017, \$25 million of Canadian credit facility borrowings and \$24 million of old higher-cost industrial revenue bonds ("IRBs"). These retirements were offset by a \$64 million increase in IRBs associated with the Gypsum, Ohio, and East Chicago, Ind., capital projects and a \$7 million increase in short-term and long-term notes payable.

Available Liquidity

USG has additional liquidity available through several financing arrangements. Revolving credit facilities in the United States, Canada and Europe allow the Corporation to borrow up to an aggregate of \$602 million (including a \$125 million letter of credit subfacility in the United States), under which, as of December 31, 1999, outstanding revolving loans totaled \$85 million and letters of credit issued and outstanding amounted to \$15 million, leaving the Corporation with \$502 million of unused and available credit.

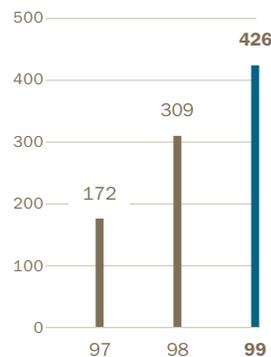
USG had additional borrowing capacity of \$50 million as of December 31, 1999, under a revolving accounts receivable facility. See "Note 10. Financing Arrangements."

A shelf registration statement filed with the Securities and Exchange Commission allows the Corporation to offer from time to time debt securities, shares of preferred and common stock or warrants to purchase shares of common stock, all having an aggregate initial offering price not to exceed \$300 million. As of the filing date of USG's 1999 Annual Report on Form 10-K, no securities had been issued pursuant to this registration.

USG Corporation

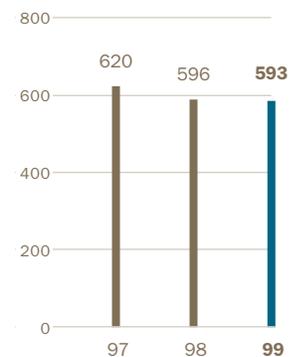
Capital Spending

millions of dollars



Total Debt

as of December 31, millions of dollars



Other Matters

Market Risk

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

Interest Rate Risk: The table below provides information about USG's financial instruments that are sensitive to changes in interest

rates, specifically debt obligations and interest rate swaps. For debt obligations, the table presents principal cash flows and related weighted average interest rates by expected maturity dates. For interest rate swaps, the table presents notional amounts and weighted average interest rates by expected (contractual) maturity dates. Notional amounts are used to calculate the contractual payments to be exchanged under the contract. Weighted average variable rates are based on implied forward rates at the reporting date. The information is presented in U.S. dollar equivalents, which is USG's reporting currency.

	dollars in millions	Maturity Date					Total	Fair Value	
		2000	2001	2002	2003	2004			Thereafter
Debt	U.S. Dollar								
	Fixed rate	-	\$150	-	-	-	\$278	\$428	\$417
	Average interest rate	-	9.3%	-	-	-	5.8%	6.4%	
	Variable rate	\$2	-	\$25	\$40	\$40	-	\$107	\$107
	Average interest rate	8.5 %	-	7.4%	7.3 %	7.4 %	-	7.4 %	
	Canadian Dollar								
	Variable rate	-	-	\$44	-	-	-	\$44	\$44
	Average interest rate	-	-	6.9%	-	-	-	6.9%	
	European Multicurrency Line								
	Variable rate	\$14	-	-	-	-	-	\$14	\$14
Average interest rate	4.7 %	-	-	-	-	-	4.7 %		
Interest Rate Swaps	U.S. Dollar								
	Notional amount	\$25	-	-	-	-	-	\$25	-
	Average pay rate	7.2 %	-	-	-	-	-	7.2 %	
	Average receive rate	6.2 %	-	-	-	-	-	6.2 %	
	Canadian Dollar								
	Notional amount	-	\$28	-	-	-	-	\$28	-
	Average pay rate	-	5.5%	-	-	-	-	5.5%	
	Average receive rate	-	6.3%	-	-	-	-	6.3%	

Foreign Currency Exchange Risk: The table to the right summarizes USG's foreign currency hedge contracts as of December 31, 1999. The table presents the notional amounts (in millions of U.S. dollar equivalents) and weighted average contract rates. Virtually all outstanding foreign currency hedge contracts mature within 12 months.

Currency Sold	Currency Purchased	Notional Value	Contract Rate
Forward Contracts			
U.S. Dollars	Canadian Dollars	\$24	\$1.48
British Pounds	Euros	7	0.68
U.S. Dollars	Euros	3	1.05
Australian Dollars	New Zealand Dollars	2	1.24
Australian Dollars	U.S. Dollars	2	0.65
Singapore Dollars	U.S. Dollars	2	1.65
Option Contracts			
Australian Dollars	U.S. Dollars	1	0.63

Commodity Price Risk: USG uses natural gas swap contracts to manage price exposure on anticipated natural gas purchases. 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 the results of the sensitivity analysis, which may differ from actual results, USG's potential loss in fair value is \$17 million.

See "Note 1. Significant Accounting Policies" and "Note 11. Financial Instruments and Risk Management" for additional information on USG's financial exposures.

Year 2000 Compliance

In 1996, USG began an evaluation of its computer-based systems to determine the extent of the modifications required to make those systems year 2000 compliant and to devise a plan to complete such modifications prior to January 1, 2000. The plan was divided into five phases: identification (a basic inventory of all systems), assessment, remediation, testing and completion. The plan encompassed all of USG's computer systems including mainframe, midrange, client server and desktop systems as well as all specialized control systems for plant operations or other facilities including those that are considered embedded systems. USG's mainframe systems are responsible for most of the information processing done by the Corporation and have received a majority of the efforts dedicated to this project as well as a majority of the budget allocated to it. All plan phases have been completed.

Current Status: USG's computer-based systems did not experience any disruptions on the critical date of January 1, 2000. The USG plan contemplates that the Corporation will continue to monitor its internal operating systems and continue the ongoing contacts regarding year 2000 matters with its critical suppliers at least through early 2000. Furthermore, there may be potential computer problems related to year 2000 that may not surface until after January 2000 (e.g., software applications affected by the leap day, software applications that are run only on a quarterly or annual basis, or automatic shutdown of embedded systems and any related processes based on failure to perform timely maintenance.)

Suppliers and Customers: USG's year 2000 compliance plan also included an analysis and survey of critical third-party suppliers of material and services to determine their year 2000 compliance status. As of the filing date of USG's Annual Report on Form 10-K, no disruption to USG's business has occurred as a result of performance issues affecting suppliers. However, there continues to be a small degree of uncertainty as to whether there will be, or the extent of, any significant disruption due to third-party supplier failures. USG also has been in contact with most of its major customers on the status of each party's year 2000 compliance plans and expects to continue such information exchanges beyond January 1, 2000, in order to maintain those business relationships and to obtain updated information for its own ongoing planning.

Based on the survey responses received to date, these ongoing contacts, internal review of its collection history from major customers, the steps taken to prepare for the critical period and USG's experience since January 1, 2000, USG does not expect to experience any lack of liquidity which would affect its ability to continue business operations in whatever circumstances should come about.

Costs: The cost of carrying out USG's compliance plan is currently estimated at \$11 million, a reduction of \$1 million from the previous estimate. As of December 31, 1999, about 82% of this amount has been incurred. Much of the balance may be expended in early 2000.

Contingency Plans: While USG has not to date experienced any significant systems or other year 2000 problems, it is still possible that USG might later experience significant disruptions due to year 2000 problems that affect the operating environment in which it conducts business. The inability of USG or its critical suppliers and customers to effectuate solutions to their respective year 2000 issues on a timely and cost-effective basis could still have a material adverse effect on USG.

In view of the continuing uncertainty, albeit much reduced, that USG faces with respect to year 2000 issues, it maintains its ability to implement its contingency plan to provide for continuation of its operations in the event of possible year 2000 disruptions. The plan will be continually evaluated and modified as required by developments and circumstances that may emerge through the course of 2000.

USG's contingency plan provides for the continuation of its business and operations in the period following January 1, 2000. The planning process involved detailed reviews by operating personnel of all of the information that has been gathered concerning critical suppliers, customers and internal systems to determine all foreseeable risks to the continuation of business operations. Based on that review process, USG prepared a set of operating procedures for dealing with the identified risks. These procedures provide for flexible responses to conditions, as they may be expected to develop after the critical date of January 1, 2000.

Worst-Case Scenario: In the view of USG's year 2000 contingency planning team, the most reasonably likely worst-case scenario is that there might be a local or regional disruption to its plant production due to disruptions in the supply chain. However, as of the filing date of its Annual Report on Form 10-K, USG has not experienced any local or regional disruption to its plant production due to disruptions in the supply chain.

Conclusion: While USG will continue to maintain its contingency plan even beyond January 1, 2000, management believes that, in terms of the Corporation's internal operating systems, it has been and will be able to continue its operations without material disruption. Based on management's present knowledge, it also does not foresee any significant disruptions to USG's businesses from external causes.

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 is a three-year transition period during which parties may use either the existing currencies or the euro. However, during the transition period, all exchanges between currencies of the participating countries are required to be first converted through the euro.

USG has conducted a comprehensive analysis to address the euro currency issue. USG's efforts are focused on two phases. The first phase addresses USG's European operations during the transition period. The second phase covers full conversion of these operations to the euro. The Corporation was ready for the transition period that began on January 1, 1999, and expects to be ready for full conversion by January 1, 2002, the mandatory conversion date. USG also is prepared to deal with its critical suppliers and customers during the transition period and will communicate with them as appropriate. The Corporation 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

One of the Corporation's subsidiaries, U.S. Gypsum, is a defendant in asbestos lawsuits alleging both property damage and personal injury. Asbestos charges in 1999 totaled \$80.5 million compared with \$26 million in 1998. Although new personal injury cases were filed in 1999 at a significantly lower rate than that at which cases were filed in 1998, asbestos charges to results of operations have been higher in 1999 because the estimated cost of resolving cases pending during 1998 will, when expended, consume all of U.S. Gypsum's remaining insurance. As a result, the estimated liability from new case filings is currently being charged against reported earnings.

U.S. Gypsum expects that periodic charges will continue to be necessary in the future in amounts that could be higher or lower than recent quarters, and which could be material to the period in which they are taken. The amount of future periodic charges will depend upon factors that include, but may not be limited to, the rate at which new asbestos-related claims are filed, the potential imposition of medical criteria, the impact of changes in membership of the Center for Claims Resolution (of which U.S. Gypsum is a member), U.S.

Gypsum's settlement cost and the estimated cost of resolving pending claims, and the necessity of higher-cost settlements in particular jurisdictions. In addition, U.S. Gypsum will continue to evaluate whether its probable liability for future personal injury cases can be reasonably estimated. The ability to make such an estimate will require an assessment of the impact on future case filings and settlement values of a number of uncertainties. When such an estimate can be made, it is probable that an additional charge to results of operations will be necessary. Although the timing and amount of the resulting charge cannot presently be determined, the amount is expected to be material to results of operations in the period in which it is taken. However, the asbestos litigation is not expected to have a significant impact on the Corporation's liquidity or cash flows. See "Note 16. Litigation" for additional information on asbestos 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. 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 "Note 16. Litigation" for additional information on environmental litigation.

Forward-Looking Statements

This report contains forward-looking statements related to management's expectations about future conditions. Actual business or other conditions may differ significantly from management's expectations and accordingly affect the Corporation's sales and profitability or other results. Actual results may differ due to factors over which the Corporation has no control, including economic activity such as new housing construction, interest rates and consumer confidence; competitive activity such as price and product competition; increases in raw material and energy costs; risk of disruption due to year 2000 issues such as those described above; euro currency issues such as the ability and willingness of third parties to convert affected systems in a timely manner and the actions of governmental agencies or other third parties; and the outcome of contested asbestos-related litigation, the rate of new asbestos-related filings and the other factors described herein. The Corporation assumes no obligation to update any forward-looking information contained in this report.

Consolidated Statement of Earnings

<i>dollars in millions, except per share data</i>	Years Ended December 31,		
	1999	1998	1997
Net sales	\$3,600	\$3,130	\$2,874
Cost of products sold	2,532	2,246	2,087
Gross profit	1,068	884	787
<i>% of net sales</i>	29.7	28.2	27.4
Selling and administrative expenses	338	299	281
Amortization of excess reorganization value	-	-	127
Operating profit	730	585	379
Interest expense	53	53	60
Interest income	(10)	(5)	(3)
Other expense, net	3	3	2
Earnings before income taxes	684	534	320
Income taxes	263	202	172
Net earnings	421	332	148
Net Earnings Per Common Share			
Basic	8.48	6.81	3.19
Diluted	8.39	6.61	3.03

The notes to financial statements are an integral part of this statement.

Consolidated Balance Sheet

	<i>As of December 31,</i>	
<i>dollars in millions, except per share data</i>	1999	1998
Assets		
Current Assets		
Cash and cash equivalents	\$ 197	\$ 152
Receivables (net of reserves of \$18 and \$18)	361	349
Inventories	256	234
Current and deferred income taxes	59	62
Total current assets	873	797
Property, plant and equipment, net	1,568	1,214
Other assets	332	346
Total assets	2,773	2,357
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable	172	157
Accrued expenses	303	237
Notes payable	16	10
Current portion of long-term debt	-	25
Total current liabilities	491	429
Long-term debt	577	561
Deferred income taxes	138	169
Other liabilities	700	680
Stockholders' Equity		
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 48,859,531 and 49,524,952 shares (after deducting 1,125,691 and 296,235 shares held in treasury)	5	5
Treasury stock	(56)	(10)
Capital received in excess of par value	316	317
Deferred currency translation	(33)	(30)
Reinvested earnings	635	236
Total stockholders' equity	867	518
Total liabilities and stockholders' equity	2,773	2,357

The notes to financial statements are an integral part of this statement.

Consolidated Statement of Cash Flows

	Years Ended December 31,		
<i>millions</i>	1999	1998	1997
Operating Activities			
Net earnings	\$421	\$332	\$148
Adjustments to Reconcile Net Earnings to Net Cash			
Amortization of excess reorganization value	-	-	127
Depreciation, depletion and amortization	91	81	70
Current and deferred income taxes	(31)	7	(2)
(Increase) Decrease in Working Capital			
Receivables	(4)	(52)	(23)
Inventories	(15)	(26)	(23)
Payables	12	11	5
Accrued expenses	58	17	20
(Increase) decrease in other assets	(20)	6	(10)
Increase in other liabilities	121	-	19
Other, net	(2)	(2)	1
Net cash from operating activities	631	374	332
Investing Activities			
Capital expenditures	(426)	(309)	(172)
Net proceeds from asset dispositions	2	2	2
Acquisition of business, net of acquired cash	(74)	-	-
Net cash to investing activities	(498)	(307)	(170)
Financing Activities			
Issuance of debt	65	78	116
Repayment of debt	(50)	(107)	(265)
Short-term borrowings (repayments), net	(21)	9	(3)
Issuances of common stock	12	48	18
Purchases of common stock	(72)	(10)	-
Cash dividends paid	(22)	(5)	-
Net cash (to) from financing activities	(88)	13	(134)
Net increase in cash and cash equivalents	45	80	28
Cash and cash equivalents at beginning of period	152	72	44
Cash and cash equivalents at end of period	197	152	72
Supplemental Cash Flow Disclosures			
Interest paid	56	56	64
Income taxes paid	281	186	168

The notes to financial statements are an integral part of this statement.

Consolidated Statement of Stockholders' Equity

<i>millions</i>	<i>Years Ended December 31,</i>		
	1999	1998	1997
Common Stock			
Balance at January 1	\$ 5	\$ 5	\$ 5
Balance at December 31	5	5	5
Treasury Stock			
Balance at January 1	(10)	-	-
Purchases of common stock	(72)	(10)	-
Stock option and restricted stock activity, net	26	-	-
Balance at December 31	(56)	(10)	-
Capital Received in Excess of Par Value			
Balance at January 1	317	258	231
Stock option and restricted stock activity, net	(1)	19	25
Warrants exercised	-	40	2
Balance at December 31	316	317	258
Reinvested Earnings (Deficit)			
Balance at January 1	236	(91)	(239)
Net earnings	421	332	148
Cash dividends paid	(22)	(5)	-
Balance at December 31	635	236	(91)
Accumulated Other Comprehensive Income			
Balance at January 1	(30)	(25)	(20)
Other comprehensive income	(3)	(5)	(5)
Balance at December 31	(33)	(30)	(25)
Total stockholders' equity	867	518	147

Consolidated Statement of Comprehensive Income

<i>millions</i>	<i>Years Ended December 31,</i>		
	1999	1998	1997
Net earnings	\$421	\$332	\$148
Other Comprehensive Income (net of tax)			
Foreign currency translation adjustments	(3)	(5)	(15)
Minimum pension liability	-	-	10
	(3)	(5)	(5)
Total comprehensive income	418	327	143

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

Notes to Financial Statements

1. Significant Accounting Policies

Nature of Operations

Through its subsidiaries, USG Corporation (“USG” or “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. USG’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, DONN brand suspension 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. USG’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 financial statements in conformity with generally accepted accounting principles 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’ financial statements and notes thereto have been reclassified to conform with the 1999 presentation.

Revenue Recognition

Revenue is recognized upon the shipment of products to customers.

Earnings per Share

Basic earnings per share is computed by dividing net earnings by the weighted average number of shares of common stock outstanding during the year. Diluted earnings per share includes the dilutive effect of the potential exercise of outstanding stock options and warrants under the treasury stock method.

Comprehensive Income

The components of comprehensive income for USG include net earnings, foreign currency translation gain or loss adjustments and, in 1997, a minimum pension liability adjustment. Taxes related to the minimum pension liability adjustment in 1997 were \$7 million. 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.

Inventory Valuation

Most of the Corporation’s domestic inventories are valued under the last-in, first-out (“LIFO”) method. The remaining inventories are stated at the lower of cost or market 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. Depletion is computed on a basis calculated to spread the cost of gypsum and other applicable resources over the estimated quantities of material recoverable.

Excess Reorganization Value

In the third quarter of 1997, the remaining balance of excess reorganization value was eliminated. The \$83 million balance, which would have been amortized through April 1998, was offset by the elimination of a valuation allowance in accordance with AICPA Statement of Position 90-7, “Financial Reporting by Entities in Reorganization Under the Bankruptcy Code” (“SOP 90-7”). See “Note 14. Income Taxes” for additional information. Excess reorganization value was recorded in 1993 in connection with a comprehensive restructuring of the Corporation’s debt under the principles of fresh start accounting as required by SOP 90-7.

Goodwill

Goodwill is amortized on a straight-line basis over a period of 40 years. On a periodic basis, the Corporation estimates the future undiscounted cash flows of the businesses to which goodwill relates in order to ensure that the carrying value of goodwill has not been impaired. Goodwill is included in other assets on the consolidated balance sheet.

Financial Instruments

The Corporation uses derivative instruments to manage well-defined interest rate, energy cost and foreign currency exposures. The Corporation does not use derivative instruments for trading purposes. The criteria used to determine if hedge accounting treatment is appropriate are (i) the designation of the hedge to an underlying exposure (ii) whether or not overall uncertainty is being reduced and (iii) if there is a correlation between the value of the derivative instrument and the underlying obligation.

Interest Rate Derivative Instruments: The Corporation utilizes interest rate swap agreements to manage the impact of interest rate changes on its underlying floating-rate debt. These agreements are designated as hedges and qualify for hedge accounting. Amounts payable or receivable under these swap agreements are accrued as an increase or decrease to interest expense on a current basis. To the extent the underlying floating-rate debt is reduced, the Corporation terminates swap agreements accordingly so as not to be in an overhedged position. In such cases, the Corporation recognizes gains and/or losses in the period in which the agreement is terminated.

Energy Derivative Instruments: The Corporation uses swap agreements to hedge anticipated purchases of fuel to be utilized in the manufacturing processes for gypsum wallboard and ceiling tile. Under these swap agreements, the Corporation receives or makes payments based on the differential between a specified price and the actual closing price for the current month's energy price contract. These contracts are designated as hedges and qualify for hedge accounting. Amounts payable or receivable under these swap agreements are accrued as an increase or decrease to cost of products sold, along with the actual spot energy cost of the corresponding underlying hedge transaction, the combination of which amounts to the predetermined specified contract price.

Foreign Exchange Derivative Instruments: The Corporation has operations in a number of countries and due to intercompany and third-party transactions is exposed to changes in foreign currency exchange rates. The Corporation manages these exposures on a consolidated basis, which allows netting of certain exposures to take advantage of any natural offsets. To the extent the net exposures are hedged, forward and/or option contracts are used. Gains and/or losses on these foreign currency hedges are included in net earnings in the period in which the exchange rates change.

Research and Development

Research and development expenditures are charged to earnings as incurred and amounted to \$21 million, \$20 million and \$19 million in the years ended December 31, 1999, 1998 and 1997, respectively.

Recent Accounting Pronouncement

In 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") 133, "Accounting for Derivative Instruments and Hedging Activities." The effective date of this statement was delayed under SFAS 137 to fiscal years beginning after June 15, 2000, and cannot be applied retroactively. SFAS 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded on the balance sheet as either an asset or liability measured at its fair value. The statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. The Corporation plans to adopt SFAS 133 effective January 1, 2001, and will determine both the method and impact of adoption prior to that date.

2. Acquisition of Sybex, Inc.

On November 30, 1999, USG acquired Sybex, Inc., the holding company of Beadex Manufacturing Company, Inc. and The Synkoloid Company of Canada. Sybex operates joint compound and paper-faced metal corner bead plants in the United States and Canada and has annual sales of approximately \$58 million.

3. 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 pretax (\$14 million after-tax; \$0.27 per share) 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.

4. 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	Average Shares (000)	Per Share Amount
1999			
Basic earnings	\$421	49,697	\$8.48
<i>Effect of Dilutive Securities</i>			
Options		519	
Diluted earnings	421	50,216	8.39
1998			
Basic earnings	332	48,710	6.81
<i>Effect of Dilutive Securities</i>			
Options		861	
Warrants		613	
Diluted earnings	332	50,184	6.61
1997			
Basic earnings	148	46,269	3.19
<i>Effect of Dilutive Securities</i>			
Options		930	
Warrants		1,528	
Diluted earnings	148	48,727	3.03

5. Common Stock

Changes in outstanding common stock are summarized as follows:

<i>shares in thousands</i>	1999	1998	1997
Common Stock			
Balance at January 1	49,525	46,781	45,725
Stock option and restricted stock activity, net	165	536	973
Warrants exercised	-	2,455	101
Treasury stock	(830)	(247)	(18)
Balance at December 31	48,860	49,525	46,781
Treasury Stock			
Balance at January 1	(296)	(49)	(31)
Purchases of common stock	(1,425)	(225)	-
Stock option and restricted stock activity, net	595	(22)	(18)
Balance at December 31	(1,126)	(296)	(49)

Stock Repurchases

In the fourth quarter of 1998, USG initiated a multiyear stock-repurchase program, under which up to 5 million shares of common stock may be purchased. Stock repurchases are being made in the open market or through privately negotiated transactions and are being financed with available cash from operations.

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 USG's outstanding common stock, the plan allows other stockholders to buy, with each right, additional USG shares at a 50% discount. Second, if USG 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 USG'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 USG's outstanding common stock, the rights are redeemable for \$0.01 per right at the option of the board of directors. 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%.

Warrants

In 1998, the Corporation received cash proceeds of \$40 million from the exercise of 2,455,383 warrants issued in connection with a

financial restructuring implemented in 1993. Each warrant entitled the holder to purchase one share of common stock at a purchase price of \$16.14 per share, subject to adjustment under certain events, at any time prior to the May 6, 1998, expiration date. The proceeds from the exercises were added to the cash resources of the Corporation and used for general corporate purposes.

6. Inventories

As of December 31, 1999 and 1998, the LIFO values of domestic inventories were \$191 million and \$168 million, respectively, and would have been \$3 million higher for 1999 and \$1 million lower for 1998 if they were valued under the FIFO and 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, 1999 and 1998. Inventory classifications as of December 31 were as follows:

<i>millions</i>	1999	1998
Finished goods and work in progress	\$164	\$151
Raw materials	77	69
Supplies	15	14
Total	256	234

7. Property, Plant and Equipment

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

<i>millions</i>	1999	1998
Land and mineral deposits	\$ 79	\$ 63
Buildings and realty improvements	423	331
Machinery and equipment	1,439	1,118
	1,941	1,512
Reserves for depreciation and depletion	(373)	(298)
Total	1,568	1,214

8. 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 \$62 million, \$59 million and \$51 million in the years ended December 31, 1999, 1998 and 1997, respectively. Future minimum lease payments required under operating leases with initial or remaining noncancelable terms in excess of one year as of December 31, 1999, were \$45 million in 2000, \$37 million in 2001, \$31 million in 2002, \$19 million in 2003 and \$15 million in 2004. The aggregate obligation subsequent to 2004 was \$23 million.

9. Debt

Total debt, including debt maturing within one year, as of December 31 consisted of the following:

<i>millions</i>	1999	1998
European line of credit due 2000	\$ 14	\$ 10
9.25% senior notes due 2001	150	150
U.S. revolving credit facility due 2002	25	25
Canadian credit facility due 2002	44	69
Receivables facility due 2003 and 2004	80	80
8.5% senior notes due 2005	150	150
Industrial revenue bonds	124	84
8.75% sinking fund debentures	-	25
Other	6	3
Total	593	596

U.S. Revolving Credit Facility

USG maintains a \$500 million unsecured revolving credit facility, which includes a \$125 million letter of credit subfacility, with a syndicate of banks under a credit agreement. The revolving credit facility expires in 2002 with no required amortization prior to maturity.

As of December 31, 1999, outstanding revolving loans totaled \$25 million, and letters of credit issued and outstanding amounted to \$15 million, leaving the Corporation with \$460 million of available credit under the revolving credit facility.

The revolving loans bear interest at the London Interbank Offered Rate ("LIBOR") as determined from time to time plus an applicable spread based on the Corporation's net debt to EBITDA ratio (as defined in the credit agreement) for the preceding four quarters. As of December 31, 1999, the applicable spread was 0.4%. The average rate of interest on the revolving loans was 5.7% during 1999 and 6.0% during 1998. See "Note 11. Financial Instruments and Risk Management" for information on instruments used by the Corporation to manage the impact of interest rate changes on LIBOR-based bank debt.

The credit agreement contains restrictions on the operation of the Corporation's business, including covenants pertaining to liens, sale and leaseback transactions, and mergers with and acquisitions of businesses not related to the building industry.

Canadian Credit Facility

USG maintains through CGC Inc. a \$76 million (U.S.) (\$110 million Canadian), parent-guaranteed Canadian credit facility due 2002.

As of December 31, 1999, outstanding loans totaled \$44 million (U.S.), leaving \$32 million (U.S.) of available credit under this facility.

The method of calculating interest and the covenants related to this facility are virtually the same as those for the U.S. facility described above. The average rate of interest on the Canadian loans was 5.8% during 1999 and 6.0% during 1998.

European Line of Credit

USG maintains a parent-guaranteed, multicurrency (\$20 million U.S. equivalent) European line of credit. As of December 31, 1999, short-term borrowings outstanding under this line of credit amounted to \$14 million (U.S.). The average rate of interest on these borrowings was 3.3% during 1999 and 4.2% during 1998.

Industrial Revenue Bonds

Industrial revenue bonds reflected in the above table had interest rates ranging from 5.5% to 8.8%, with maturities through 2034.

USG uses industrial revenue bonds to finance certain capital projects. Proceeds from these bonds are deposited into construction escrow accounts. The bonds are recorded incrementally on USG's books as funds are drawn from the escrow accounts throughout the construction process. In 1999, USG issued \$140 million of industrial revenue bonds, of which \$10 million were drawn and recorded. Industrial revenue bonds issued in 1998 totaling \$54 million were also drawn and recorded in 1999.

Other Information

The fair market value of total debt outstanding was \$582 million and \$619 million as of December 31, 1999 and 1998, respectively, based on indicative market prices as of those dates.

Aggregate scheduled maturities of debt during the five years subsequent to December 31, 1999, are \$16 million in 2000, \$150 million in 2001, \$69 million in 2002, \$40 million in 2003 and \$40 million in 2004.

10. Financing Arrangements

Accounts Receivable Facility

The Corporation has an accounts receivable facility in which USG Funding Corporation, a special-purpose subsidiary of the Corporation formed under Delaware law, entered into agreements with U.S. Gypsum and USG Interiors, Inc. These agreements provide that USG Funding purchases trade receivables (excluding intercompany receivables owed by L&W Supply) of U.S. Gypsum and USG Interiors as generated, in a transaction designed to be a “true sale” under applicable law. USG Funding is a party to a Master Trust arrangement (the “Master Trust”) under which the purchased receivables are then transferred to Chase Manhattan Bank as trustee to be held for the benefit of certificate holders in such trust. A residual interest in the Master Trust is owned by USG Funding through subordinated certificates. Under a supplement to the Master Trust, certificates representing an ownership interest in the Master Trust of up to \$130 million have been issued to Citicorp Securities, Inc. Debt issued under the receivables facility has a final maturity in 2004 but may be prepaid at any time. The underlying interest rate on this facility is based on the commercial paper index. However, the interest rate on such debt was fixed at 8.2% through December 31, 1999, through a long-term interest rate swap that expired on that date. Pursuant to the applicable reserve and eligibility requirements, the maximum amount of debt issuable under the receivables facility as of December 31, 1999 and 1998, (including \$80 million outstanding as of each date) was \$108 million and \$112 million, respectively.

Under the foregoing agreements and related documentation, USG Funding is a separate corporate entity with its own separate creditors that will be entitled to be satisfied out of USG Funding’s assets prior to distribution of any value to its shareholder.

As of December 31, 1999 and 1998, the outstanding balance of receivables sold to USG Funding and held under the Master Trust was \$192 million and \$189 million, respectively, and debt outstanding under the receivables facility was \$80 million as of each date. Receivables and debt outstanding in connection with the receivables facility remain in receivables and long-term debt, respectively, on the consolidated balance sheet.

Shelf Registration

In 1996, the Securities and Exchange Commission declared effective a shelf registration statement that allows the Corporation to offer from time to time (i) debt securities (ii) shares of \$1.00 par value preferred stock (iii) shares of \$0.10 par value common stock and/or (iv) warrants to purchase shares of common stock, all having an aggregate initial offering price not to exceed \$300 million. As of the filing date of the Corporation’s 1999 Annual Report on Form 10-K, no securities had been issued pursuant to this registration.

11. Financial Instruments and Risk Management

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.

Interest Rate Risk Management

USG uses interest rate swap agreements to manage the impact of interest rate changes on the underlying floating-rate debt. USG’s swap portfolio consists of pay fixed/receive floating swaps, which effectively convert floating-rate obligations into fixed-rate instruments. As of December 31, 1999 and 1998, USG had swap agreements in place to convert \$53 million and \$131 million, respectively, of notional principal from floating-rate to fixed-rate instruments. As of December 31, 1999, all swap agreements mature within two years. The fair values of these swap agreements as of December 31, 1999 and 1998, were zero and \$(8) million, respectively.

Energy Risk Management

USG uses swap agreements to hedge anticipated purchases of fuel to be utilized in its manufacturing processes. As of December 31, 1999 and 1998, USG had swap agreements to exchange monthly payments on notional amounts of energy amounting to \$53 million and \$57 million, respectively. These agreements mature within three years. The fair values of these swap agreements as of December 31, 1999 and 1998, were zero and \$(6) million, respectively.

Foreign Exchange Risk Management

As of December 31, 1999 and 1998, USG had a number of foreign currency contracts in place (primarily Canadian dollars and euros) to hedge its exposure to exchange rate fluctuations on foreign currency transactions. These foreign exchange contracts mature on the anticipated cash requirement date of the hedged transaction, virtually all within 12 months. The notional amounts of foreign currency contracts as of December 31, 1999 and 1998, were \$41 million and \$60 million, respectively. The fair values of these contracts as of December 31, 1999 and 1998, were zero and \$(1) million, respectively.

Counterparty Risk

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

12. 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 years of service and employees' 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:

Pension Benefits

<i>millions</i>	1999	1998	1997
Service cost of benefits earned	\$19	\$14	\$12
Interest cost on projected benefit obligation	43	39	36
Expected return on plan assets	(49)	(44)	(39)
Net amortization	2	1	-
Net pension cost	15	10	9

Postretirement Benefits

<i>millions</i>	1999	1998	1997
Service cost of benefits earned	7	6	6
Interest cost on projected benefit obligation	15	14	15
Net amortization	-	(1)	-
Net postretirement cost	22	19	21

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

<i>millions</i>	Pension		Postretirement	
	1999	1998	1999	1998
Change in Benefit Obligation				
Benefit obligation as of January 1	\$633	\$528	\$214	\$219
Service cost	19	14	7	6
Interest cost	43	39	15	14
Employee contributions	9	9	2	2
Benefits paid	(49)	(47)	(12)	(13)
Plan amendment	2	3	(7)	-
Actuarial (gain) loss	(28)	90	(24)	(14)
Foreign currency rate change	3	(3)	-	-
Benefit obligation as of December 31	632	633	195	214

<i>millions</i>	Pension		Postretirement	
	1999	1998	1999	1998
Change in Plan Assets				
Fair value as of January 1	\$597	\$554	-	-
Actual return on plan assets	97	79	-	-
Employer contributions	9	7	-	-
Employee contributions	9	9	-	-
Benefits paid	(49)	(47)	-	-
Foreign currency rate change	4	(5)	-	-
Fair value as of December 31	667	597	-	-

Funded Status

	1999	1998	1999	1998
As of December 31	35	(36)	\$(195)	\$(214)
Unrecognized prior service cost	7	4	(6)	1
Unrecognized net (gain) loss	(65)	14	(48)	(23)
Net balance sheet liability	(23)	(18)	(249)	(236)

Assumptions as of December 31

	1999	1998	1999	1998
Discount rate	7.75%	6.75%	7.75%	6.75%
Pension plans expected return	9%	9%	-	-
Compensation increase rate	5%	5%	5%	5%

The assumed health-care-cost trend rate used in measuring the accumulated postretirement benefit obligation was 6% as of December 31, 1999, and 7% as of December 31, 1998, with a rate gradually declining to 5% by 2000 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 Point Increase	One Percentage Point Decrease
Effect on total service and interest cost components	\$ 4	\$(3)
Effect on postretirement benefit obligation	34	(27)

13. 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:

	1999	1998	1997
Expected life (years)	7.4	7.4	7.4
Risk-free interest rate	6.5%	5.7%	6.8%
Expected volatility	31.4%	30.7%	29.6%
Dividend yield	.88%	-	-

The weighted average fair value of options granted on January 2, 1999, was \$22.05. The weighted average fair values of options granted on January 2 and January 19, 1998, were \$22.32 and \$24.53, respectively. The weighted average fair value of options granted during 1997 was \$15.61.

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 and net earnings per common share would have changed to the following pro forma amounts:

<i>millions, except per share data</i>		1999	1998	1997
Net Earnings	As reported	\$421	\$332	\$148
	Pro forma	416	328	144
Basic EPS	As reported	8.48	6.81	3.19
	Pro forma	8.38	6.73	3.12
Diluted EPS	As reported	8.39	6.61	3.03
	Pro forma	8.29	6.54	2.96

Stock option activity was as follows:

<i>options in thousands</i>	1999	1998	1997
Options			
Outstanding, January 1	2,034	2,049	2,565
Granted	316	413	378
Exercised	(553)	(388)	(882)
Canceled	(7)	(40)	(12)
Outstanding, December 31	1,790	2,034	2,049
Exercisable, December 31	1,087	1,292	1,339
Available for grant, December 31	566	1,122	1,671

Weighted Average Exercise Price

	1999	1998	1997
Outstanding, January 1	\$30.43	\$25.54	\$21.71
Granted	50.87	48.44	34.60
Exercised	22.29	22.72	18.20
Canceled	48.99	40.53	32.00
Outstanding, December 31	36.49	30.43	25.54
Exercisable, December 31	28.05	23.80	22.06

The following table summarizes information about stock options outstanding as of December 31, 1999:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options (000)	Weighted Average Remaining Contractual Life (yrs.)	Weighted Average Exercise Price	Options (000)	Weighted Average Exercise Price
\$ 5 - 15	157	3.4	\$10	157	\$10
15 - 25	121	4.6	22	121	22
25 - 35	809	5.7	32	809	32
35 - 55	703	8.5	50	-	-
Total	1,790	6.5	36	1,087	28

14. Income Taxes

Earnings before income taxes consisted of the following:

<i>millions</i>	1999	1998	1997
U.S.	\$633	\$487	\$301
Foreign	51	47	19
Total	684	534	320

Income taxes consisted of the following:

<i>millions</i>	1999	1998	1997
Current			
Federal	\$246	\$165	\$147
Foreign	10	12	10
State	47	29	26
	303	206	183
Deferred			
Federal	(38)	(3)	(12)
Foreign	5	(1)	2
State	(7)	-	(1)
	(40)	(4)	(11)
Total	263	202	172

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

<i>millions</i>	1999	1998	1997
Taxes on income at federal statutory rate	\$240	\$187	\$112
Excess reorganization value amortization	-	-	44
Foreign sales corporation	(1)	(1)	-
Foreign earnings subject to different tax rates	-	(1)	2
State income tax, net of federal benefit	26	19	16
Percentage depletion	(4)	(3)	(3)
Other, net	2	1	1
Provision for income taxes	263	202	172
Effective income tax rate	38.4%	37.8%	53.9%

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

<i>millions</i>	1999	1998
Property, plant and equipment	\$189	\$173
Other	-	1
Deferred tax liabilities	189	174
Pension and postretirement benefits	(93)	(87)
Reserves not deductible until paid	(178)	(137)
Other	(7)	-
Deferred tax assets	(278)	(224)
Net deferred tax assets	(89)	(50)

A valuation allowance of \$90 million, which had been provided for deferred tax assets relating to pension and postretirement benefits prior to the Corporation's financial restructuring in 1993, was eliminated in the third quarter of 1997. The elimination of this allowance reflected a change in management's judgment regarding the realizability of these assets in future years as a result of the Corporation's pre-tax earnings levels and improved capital structure over the prior three years. In accordance with SOP 90-7, the benefit realized from the elimination of this allowance was used to reduce the balance of excess reorganization value to zero in the third quarter of 1997.

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 \$196 million as of December 31, 1999. 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.

15. Segments

Operating Segments

<i>millions</i>	1999	1998	1997
Net Sales			
North American Gypsum	\$2,181	\$1,826	\$1,668
Worldwide Ceilings	648	657	634
Building Products Distribution	1,345	1,103	981
Eliminations	(574)	(456)	(409)
Total	3,600	3,130	2,874
Amortization of Excess Reorganization Value			
North American Gypsum	-	-	60
Worldwide Ceilings	-	-	65
Building Products Distribution	-	-	2
Total	-	-	127
Operating Profit (Loss)			
North American Gypsum	651	534	402
Worldwide Ceilings	63	65	(1)
Building Products Distribution	87	40	29
Corporate	(64)	(54)	(49)
Eliminations	(7)	-	(2)
Total	730	585	379
Depreciation, Depletion and Amortization			
North American Gypsum	57	50	44
Worldwide Ceilings	19	18	17
Building Products Distribution	6	5	4
Corporate	9	8	5
Total	91	81	70
Capital Expenditures			
North American Gypsum	397	260	121
Worldwide Ceilings	20	39	45
Building Products Distribution	8	9	5
Corporate	1	1	1
Total	426	309	172
Assets			
North American Gypsum	1,721	1,350	1,085
Worldwide Ceilings	425	434	398
Building Products Distribution	309	258	213
Corporate	410	383	289
Eliminations	(92)	(68)	(59)
Total	2,773	2,357	1,926

Geographic Segments

<i>millions</i>	1999	1998	1997
Net Sales			
United States	\$3,262	\$2,829	\$2,570
Canada	240	206	184
Other Foreign	246	256	251
Geographic transfers	(148)	(161)	(131)
Total	3,600	3,130	2,874
Long-Lived Assets			
United States	1,473	1,094	869
Canada	198	155	156
Other Foreign	102	83	71
Total	1,773	1,332	1,096

Effective with this annual report, USG's operations are organized into three operating segments—North American Gypsum, Worldwide Ceilings and Building Products Distribution. Previously, L&W Supply Corporation was a component of North American Gypsum. Because of the growth of L&W Supply, it is now presented as a separate operating segment.

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. Segment operating profit (loss) for 1997 also includes the noncash amortization of excess reorganization value, which had the impact of reducing operating profit for North American Gypsum, Worldwide Ceilings and Building Products Distribution.

Corporate assets 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, 1999, 1998 and 1997, such receivables, net of reserves, amounted to \$125 million, \$141 million and \$128 million, respectively, including \$97 million, \$106 million and \$95 million purchased from U.S. Gypsum and \$28 million, \$35 million and \$33 million purchased from USG Interiors as of the respective dates.

16. Litigation

Asbestos and Related Insurance Litigation

One of the Corporation's subsidiaries, U.S. Gypsum (or "the Company"), is among many defendants in lawsuits arising out of the manufacture and sale of asbestos-containing materials. U.S. Gypsum sold 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. Some of these lawsuits 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"). Others seek compensatory and in many cases punitive damages for personal injury allegedly resulting from exposure to asbestos-containing products (the "Personal Injury Cases").

Property Damage Cases: U.S. Gypsum is a defendant in 11 Property Damage Cases, most of which involve multiple buildings. One of the cases is a conditionally certified class action comprised of 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.). The Company anticipates that few additional Property Damage Cases will be filed, as a result of the operation of statutes of limitations and the impact of certain other factors, although if the class action referred to above is decertified, as sought by the Company, it is likely that some colleges and universities will file individual Property Damage Cases against U.S. Gypsum. It is possible that any cases that are filed will seek substantial damages.

In total, U.S. Gypsum has settled approximately 115 Property Damage Cases involving 245 plaintiffs, in addition to four class action settlements. Twenty-four cases have been tried to verdict, 16 of which were won by U.S. Gypsum and five lost; three other cases, one won at the trial level and two lost, were settled during appeals. In the cases lost, compensatory damage awards against U.S. Gypsum totaled \$11.5 million. Punitive damages totaling \$5.5 million were entered against U.S. Gypsum in four trials. Two of the punitive damage awards, totaling \$1.45 million, were paid, and two were settled during the appellate process.

In 1999, no new Property Damage Cases were filed against U.S. Gypsum, one case was settled, and 11 were pending at year end. U.S. Gypsum expended \$5 million for the defense and resolution of Property Damage Cases and received insurance payments of \$24 million. In 1998, two Property Damage Cases were filed against U.S. Gypsum, two cases were dismissed before trial, four were settled, and 12 were pending at year end. U.S. Gypsum expended \$29.5 million for the defense and resolution of Property Damage Cases (most of which consisted of payments for settlements agreed to in the prior year) and received insurance payments of \$22.0 million in 1998.

In 1997, one Property Damage Case was filed against U.S. Gypsum, three cases were dismissed before trial, six were settled, one closed case was reopened, and 16 were pending at year end. U.S. Gypsum expended \$7.8 million for the defense and resolution of Property Damage Cases and received insurance payments of \$15.5 million in 1997. A substantial portion of the insurance payments received during the years 1997-1999 constituted reimbursement for amounts expended in connection with Property Damage Cases in prior years.

U.S. Gypsum's estimated cost of resolving pending Property Damage Cases is discussed below (see "Estimated Cost").

Personal Injury Cases: U.S. Gypsum is also a defendant in approximately 93,000 Personal Injury Cases pending at December 31, 1999, as well as an additional approximately 59,000 cases that have been settled but will be closed over time. Filings of new Personal Injury Cases totaled approximately 48,000 claims in 1999, compared to 80,000 claims in 1998, and 23,500 claims in 1997. The Company believes that the higher rate of personal injury case filings in 1998 resulted, at least in part, from a Supreme Court ruling striking down a class action settlement that included an injunction against the filing of certain Personal Injury Cases from September 1994 until July 1997. It is anticipated that Personal Injury Cases will continue to be filed in substantial numbers for the foreseeable future, although the percentage of such cases filed by claimants with little or no physical impairment is expected to remain high.

U.S. Gypsum's average settlement cost for Personal Injury Cases over the past several years has been approximately \$1,800 per claim, exclusive of defense costs. In 1999, U.S. Gypsum (through the Center for Claims Resolution, discussed below) agreed to settlements of approximately 76,000 Personal Injury Cases, including 39,000 cases that will be closed in future years at an average cost of approximately \$1,250 per case, and 37,000 claims closed during 1999 for an average settlement of approximately \$2,500 per case. The higher cost of settlements of those cases actually closed in 1999 was due primarily to more costly settlements in particular jurisdictions, and an increase in the number of such claims that came from individuals alleging serious illness, due in part to the courts' accelerated treatment of such claims. Management anticipates that the average settlement cost for most pending claims will continue to be moderated by opportunities for block settlements of large numbers of claims and the apparently high percentage of claims that appear to have been brought by individuals with little or no physical impairment. However, other factors, including the litigation strategies of certain co-defendants and an increasingly adverse litigation environment in particular jurisdictions, are expected to have an adverse impact on settlement costs for some pending and future cases and, therefore, on U.S. Gypsum's overall settlement costs.

U.S. Gypsum is a member, together with 14 other former producers of asbestos-containing products, of the Center for Claims Resolution (the "Center"), which has assumed the handling of all

Personal Injury Cases pending against U.S. Gypsum and the other members of the Center. Costs of defense and settlement are shared among the members of the Center pursuant to predetermined sharing formulae. Most of U.S. Gypsum's personal injury liability and defense costs have been paid by its insurance carriers. Punitive damages have never been awarded against U.S. Gypsum in a Personal Injury Case; whether such an award would be covered by insurance would depend on state law and the terms of the individual policies.

During 1999, three companies left the Center and the membership of another company was terminated by the Center's Board. U.S. Gypsum and other Center members have stated their intention to pursue alternatives to the current tort system, including settlements with plaintiffs' firms that include agreements to resolve over time the firms' pending claims, as well as the firms' agreement to recommend to their future clients that they defer filing, or accept nominal payments on, personal injury claims that do not meet established disease criteria. The Center reached several such agreements in 1999 and will continue to attempt to negotiate similar agreements in the future. The impact of such agreements, and of the changes in the Center's membership, cannot be determined at this time.

During 1999, approximately 48,000 Personal Injury Cases were filed against U.S. Gypsum, and approximately 37,000 were settled or dismissed. U.S. Gypsum incurred expenses of \$100 million in 1999 with respect to the settlement and defense of Personal Injury Cases, of which approximately \$85 million was paid by insurance. During 1998, approximately 80,000 Personal Injury Cases were filed against U.S. Gypsum, and 21,000 were settled or dismissed. U.S. Gypsum incurred expenses of \$61.1 million in 1998 with respect to the resolution and defense of Personal Injury Cases, of which \$45.5 million was paid by insurance. During 1997, approximately 23,500 Personal Injury Cases were filed against U.S. Gypsum, approximately 5,000 claims were refiled or amended to add U.S. Gypsum as a defendant, and approximately 14,000 were settled or dismissed. U.S. Gypsum incurred expenses of \$31.6 million in 1997 with respect to Personal Injury Cases, of which \$27.2 million was paid by insurance.

U.S. Gypsum's estimated cost of resolving the pending Personal Injury Cases is discussed below (see "Estimated Cost").

Insurance Coverage Action: U.S. Gypsum sued its insurance carriers in 1983 to obtain coverage for asbestos cases (the "Coverage Action") and has settled all disputes with its solvent carriers. As of December 31, 1999, after deducting insolvent coverage and insurance paid out to date, and taking into account recent settlements, approximately \$142 million of insurance remained with 8 carriers, all of which have agreed, subject to certain limitations and conditions, to cover asbestos-related costs.

Insurance payments to U.S. Gypsum for all asbestos-related matters, including property damage, personal injury, insurance coverage litigation and related expenses, exceeded asbestos-related expenses by \$6 million for 1999 and \$0.7 million in 1997 due primarily to

nonrecurring reimbursement for amounts expended in prior years. However, U.S. Gypsum's total asbestos-related expenditures exceeded aggregate insurance payments by \$24 million in 1998.

Insolvent Carriers: Four of U.S. Gypsum's domestic insurance carriers, as well as underwriters of portions of various policies issued by Lloyds and other London market companies, providing a total of approximately \$106 million of coverage, are insolvent. Because these policies would already have been consumed by U.S. Gypsum's asbestos expenses to date if the carriers had been solvent, the insolvencies will not adversely affect U.S. Gypsum's coverage for future asbestos-related costs. However, U.S. Gypsum is pursuing claims for reimbursement from the insolvent estates and other sources and expects to recover a presently indeterminable portion of the policy amounts from these sources.

Estimated Cost: The asbestos litigation involves numerous uncertainties that affect U.S. Gypsum's ability to estimate reliably its probable liability in the Personal Injury and Property Damage Cases. In the Property Damage Cases, such uncertainties include 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 include the number, characteristics and venue of Personal Injury Cases that are filed against U.S. Gypsum; the Center's ability to continue to resolve claims at historical or acceptable levels; the level of physical impairment of claimants; the viability of claims for punitive damages; the effect of recent changes in membership in the Center and any future changes in Center membership; and the ability to negotiate settlements or develop other mechanisms that defer or reduce claims from unimpaired claimants. As a result, any estimate of U.S. Gypsum's liability, while based upon the best information currently available, may not be an accurate prediction of actual costs and is subject to revision as additional information becomes available and developments occur.

Subject to the above uncertainties, and based in part on information provided by the Center, U.S. Gypsum estimates that it is probable that Property Damage and Personal Injury Cases pending at December 31, 1999, can be resolved for an amount totaling between \$342 million and \$485 million, including defense costs. Most of these amounts are expected to be expended over the next three to five years, although settlements of some Personal Injury Cases will be consummated over periods as long as seven years. Significant insurance funding is available for these costs, as detailed below, although resolution of the pending cases will consume U.S. Gypsum's remaining insurance. At this

time, U.S. Gypsum does not believe that the number and severity of asbestos-related cases that ultimately will be filed in the future can be predicted with sufficient accuracy to provide the basis for a reasonable estimate of the liability that will be associated with such cases, although, as noted below, the Company is actively engaged in examining the feasibility of such an estimate with the objective of providing such information when possible.

Accounting for Asbestos Liability: As of December 31, 1999, U.S. Gypsum had reserved \$342 million for liability from pending Property Damage and Personal Injury Cases (equaling the lower end of the estimated range of costs provided above). U.S. Gypsum had a corresponding receivable from insurance carriers of approximately \$142 million, the estimated portion of the reserved amount that is expected to be paid or reimbursed by insurance. As of December 31, 1999, U.S. Gypsum had an additional \$32 million reserved for asbestos liabilities and asbestos-related expenses.

U.S. Gypsum compares its estimates of liability to then-existing reserves and available insurance assets and from time to time adjusts its reserves as appropriate. The Company historically has accrued \$18 million annually (\$4.5 million per quarter) for asbestos costs. In view of the increased level of personal injury filings beginning in 1998, U.S. Gypsum accrued an additional \$8 million (or a total of \$12.5 million) in both the fourth quarter of 1998 and the first quarter of 1999. U.S. Gypsum charged results of operations a total of \$30 million in the second quarter of 1999, \$20 million in the third quarter, and \$18 million in the fourth quarter, based largely on new filings in those quarters. Although new Personal Injury Cases were filed in 1999 at a rate significantly below the rate at which cases were filed in 1998, asbestos charges to results of operations have been higher in 1999 because the estimated cost of resolving cases pending during 1998 will, when expended, consume all of U.S. Gypsum's remaining insurance; as a result, the estimated liability from new case filings is currently being charged against reported earnings. Accordingly, the Company expects that additional periodic charges will be necessary in the future, in amounts that could be higher or lower than recent quarters, and which could be material to the period in which they are taken. The amount of future periodic charges will depend upon factors that include, but may not be limited to, the rate at which new asbestos-related claims are filed, the potential imposition of medical criteria, the impact of changes in membership of the Center, changes in U.S. Gypsum's settlement cost and the estimated cost of resolving pending claims, and the necessity of higher-cost settlements in particular jurisdictions.

In addition, U.S. Gypsum will continue to evaluate whether its probable liability for future Personal Injury Cases can be reasonably estimated. The ability to make such an estimate will require an assessment of the impact on future case filings and settlement values of the uncertainties identified above, including the outcome of negotiations currently underway between the Center and certain plaintiffs' firms concerning settlements that would, among other things, apply medical criteria to the firms' future Personal Injury Cases. When such an estimate can be made, it is probable that an additional charge to results of operations will be necessary. Although the timing and amount of the resulting charge cannot presently be determined, the amount is expected to be material to results of operations in the period in which it is taken.

Conclusion: The above estimates and reserves are re-evaluated periodically as additional information becomes available. Additional charges to results of operations are expected to be necessary in light of future events, and such charges could be material to results of operations in the period in which they are taken. However, it is management's opinion, taking into account all of the above information and uncertainties, including currently available information concerning U.S. Gypsum's liabilities, reserves and probable insurance coverage, that the asbestos litigation will not have a material adverse effect on the liquidity or financial position of the Corporation.

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 continuously reviews 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 USG-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 generally accepted accounting principles 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 generally accepted auditing standards 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 financial reporting matters, internal accounting controls and audit results to assure that all parties are properly fulfilling their responsibilities. Both Arthur Andersen LLP and the internal auditors have unrestricted access to the Audit Committee.



William C. Foote
Chairman, Chief Executive Officer and President



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, 1999 and 1998, and the related consolidated statements of earnings, cash flows, stockholders' equity and comprehensive income for the years ended December 31, 1999, 1998 and 1997. 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 generally accepted auditing standards. 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, 1999 and 1998, and the results of their operations and their cash flows for the years ended December 31, 1999, 1998 and 1997, in conformity with generally accepted accounting principles.



ARTHUR ANDERSEN LLP
Chicago, Illinois

January 27, 2000

Selected Quarterly Financial Data (unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
millions, except per share data					
1999					
Net sales	\$823	\$895	\$952	\$930	\$3,600
Gross profit	231	265	283	289	1,068
Operating profit	154	183	198	195	730
Net earnings	86	104	116	115	421
Per Common Share					
Net earnings (a) - basic	1.73	2.09	2.34	2.34	8.48
- diluted	1.71	2.07	2.32	2.32	8.39
Price range (b) - high	58.375	64.500	60.750	52.375	64.500
- low	44.750	51.438	46.438	41.125	41.125
Cash dividends paid	0.10	0.10	0.10	0.15	0.45
1998					
Net sales	\$735	\$775	\$814	\$806	\$3,130
Gross profit	196	221	233	234	884
Operating profit	124	147	158	156	585
Net earnings	67	82	91	92	332
Per Common Share					
Net earnings (a) - basic	1.42	1.68	1.83	1.85	6.81
- diluted	1.35	1.63	1.80	1.83	6.61
Price range (b) - high	56.750	58.000	58.750	51.625	58.750
- low	47.000	49.500	41.375	35.500	35.500
Cash dividends paid	-	-	-	0.10	0.10

(a) Basic earnings per share is calculated using average shares outstanding during the period. Diluted earnings per share is calculated using average shares and common stock equivalents outstanding during the period. Consequently, the sum of the four quarters is not necessarily the same as the total for the year.

(b) 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, 2000: Common - 4.463; Preferred - none.

Five-Year Summary *(unaudited)*

		Years Ended December 31,					
<i>dollars in millions, except per share data</i>		1999	1998	1997	1996	1995	
Earnings Statement Data	Net sales	\$3,600	\$3,130	\$2,874	\$2,590	\$2,444	
	Gross profit	1,068	884	787	645	603	
	Selling and administrative expenses	338	299	281	268	244	
	Amortization of excess reorganization value	-	-	127	169	169	
	Operating profit	730	585	379	208	190	
	Interest expense	53	53	60	75	99	
	Interest income	(10)	(5)	(3)	(2)	(6)	
	Other expense, net	3	3	2	3	32	
	Income taxes	263	202	172	117	97	
	Net earnings (loss)	421	332	148	15	(32)	
	Net Earnings (Loss) Per Common Share						
	Basic	8.48	6.81	3.19	0.32	(0.71)	
	Diluted	8.39	6.61	3.03	0.31	(0.71)	
Balance Sheet Data <i>as of the end of the period</i>	Working capital	382	368	264	159	167	
	Current ratio	1.78	1.86	1.70	1.41	1.46	
	Property, plant and equipment, net	1,568	1,214	982	887	842	
	Total assets	2,773	2,357	1,926	1,864	1,927	
	Total debt (a)	593	596	620	772	926	
	Total stockholders' equity (deficit)	867	518	147	(23)	(37)	
Other Information	Capital expenditures	426	309	172	120	147	
	Gross margin %	29.7	28.2	27.4	24.9	24.7	
	Stock price (per common share) (b)	47.13	50.94	49.00	33.88	30.00	
	Cash dividends paid (per common share)	0.45	0.10	-	-	-	
	Average number of employees	14,300	13,700	13,000	12,500	12,400	

(a) Total debt is shown at principal amounts for all periods presented. The carrying amounts of total debt (net of unamortized reorganization discount) as reflected on the consolidated balance sheets as of December 31, 1996 and 1995, were \$755 million and \$907 million, respectively.

(b) Stock price per common share reflects the closing price on December 31.