

### Dear Fellow Shareholders

For the third straight year, we faced the uncertainties of our asbestos-driven Chapter 11 bankruptcy. But our performance was strong. And our vision is clear.

Supported by a strong housing market, we shipped a record 10.4 billion square feet of wallboard, as well as record volumes of joint compound and cement board products. L&W, our distribution business, increased its sales to \$1.3 billion. Only our ceilings business reported lower sales, due to weakness in the commercial construction market, but we continued to improve the profitability of the business.

So we once again achieved solid results.

While excess capacity in the wallboard industry limited price increases to a scant 1%, our sales rose 6%, to \$3.7 billion. At the same time, however, our profit margins were pressured by higher market prices for natural gas, which rose more than 65% during the year, and increased employee benefit expenses. We also reported a \$16 million charge related to the adoption of a new accounting standard.

Net earnings for the year were \$122 million, or \$2.82 per diluted share, compared to \$43 million, or \$1.00 per share in 2002, when there was a \$96 million charge related to the adoption of a new accounting standard. Earnings before accounting changes were \$138 million in 2003 and \$139 million in 2002.

### Gaining Strength

Our ability to maintain a solid performance, despite high energy costs, reflects our operational strength. In 2003, we once again had the highest utilization rates in our industry, and we operated more efficiently than ever before. Our manufacturing operations continue to increase production speed and reduce both downtime and waste. We launched new strategic sourcing programs that helped us make our supply chain more efficient. Increased productivity, combined with tight spending controls, helped offset some of the increases in energy and benefit costs we experienced last year.

But we did more than simply cut costs.

Thirty-six of our 66 North American facilities completed 2003 without a single lost-time or restricted-duty injury.

In 2003, U.S. Gypsum introduced two revolutionary moisture-resistant products: SHEETROCK brand HUMITEK gypsum panels and FIBEROCK brand AQUA-TOUGH interior panels.

We also continued to strengthen our enterprise. The two manufacturing facilities we opened in late 2002 are up and running and fully able to meet strong market demand for our DUROCK brand cement board and our SHEETROCK brand joint compounds. We continued to build our line of FIBEROCK products, which promises to become a major new franchise. L&W continued to grow. We also continued to strengthen our safety performance, achieving a safety record that once again far surpassed industry norms. Thirty-six of our North American facilities completed 2003 with no lost-time or restricted-duty injuries.

And, as always, we worked to strengthen relationships with customers by investing in products – and services – that answer their concerns and needs. Our new SHEETROCK brand HUMITEK gypsum panels, for example, offer superior protection against moisture and mold. FIBEROCK brand AQUA-TOUGH™ interior panels combine moisture and mold resistance with the ability to stand up to abuse. In addition to launching new products, we also began implementing new technology that will enable us to provide our customers with better information and service.

### The Challenge of Chapter 11

With leading positions in our markets, increasingly productive operations and strong relationships with customers, our enterprise remains sound and healthy. Yet for our shareholders, the future remains uncertain as we continue to face the challenges of our asbestos-related Chapter 11 restructuring.

At the risk of being redundant, I would remind you once more that USG and its subsidiaries never mined, made or sold raw asbestos. It was never used in our drywall products. However, asbestos was a minor ingredient – typically less than 5 percent – in some plasters and joint compounds that we discontinued by 1978. But even though asbestos was never used in wall-board, and we stopped using it entirely a generation ago, we are among the 70 companies that have been forced into bankruptcy by asbestos litigation.

We have worked hard to address this challenge, both in court and in Congress. Our restructuring team, established when we sought bankruptcy protection in June 2001, has performed with distinction. We have communicated openly with all interested parties, including our customers, shareholders, employees and creditors. We have continued to attempt to obtain a fair hearing on our asbestos liability, and we have actively participated in efforts to develop a legislative solution to the asbestos crisis, which now imperils scores, if not hundreds, of other companies.

### In Court

Our objectives haven't changed. Our goals are to fairly compensate legitimate asbestos claimants, repay in full our suppliers, bankers, bondholders and other creditors and protect the interests of our current shareholders. We continue to maintain that people who are not sick should not receive any payment, that people who are not injured by our asbestos-containing products should not receive compensation from USG and that the amount we pay for claims should take our limited involvement with asbestos into account. No large asbestos-related bankruptcy has ever been settled on terms similar to those we have proposed, but if the court agrees with us, we believe that we have the resources to fairly compensate the people who were injured by our products, pay our other creditors and allow current shareholders to retain some portion of their ownership.

Unfortunately, despite our efforts to obtain that fair hearing, we are not there yet. We hope that these issues can be addressed in 2004.

### In Congress

Meanwhile, we have also worked hard on legislation that offers a comprehensive, nationwide solution to the asbestos crisis. We actively supported the Fairness in Asbestos Injury Resolution (FAIR) Act of 2003 that calls for the creation of a privately funded trust fund that would end asbestos litigation in courts, pay fair settlements to people injured by asbestos and quantify defendants' liabilities.

I am gratified to report that the vast majority of USG's employees and a large number of our suppliers, customers, shareholders and friends wrote their legislators in support of the Act, and in July 2003, it was approved by the Judiciary Committee of the U.S. Senate (S.1125). It's a major step in the right direction. If the FAIR Act takes effect, the single most important issue in our bankruptcy would likely be resolved. But there is still a long way to go. Senate Majority Leader Bill Frist has said he will seek a vote by the full Senate in the spring of 2004. There is no certainty, however, that the FAIR Act will be passed, or what the final terms of the Senate bill will be. Even then, it must be acted on by the House of Representatives and signed by the President before it can become law.

So while we are doing everything possible to achieve an equitable resolution, the outcome of Chapter 11 remains uncertain. We expect that the months ahead will clarify our path through

Our goals are unchanged: provide fair compensation for legitimate asbestos claimants, repay our other creditors and protect the interests of current shareholders.

The U.S. Senate is expected to vote on asbestos legislation this year.

The outcome of our Chapter 11 case is uncertain. The risks for investors remain great.

Chapter 11. But the risks for shareholders remain great. As we have cautioned in the past, your stake in USG could be substantially diluted or even wiped out.

### A Clear Vision

While the future is clouded by uncertainty, our vision is clear: to emerge from Chapter 11 free of the burden of asbestos litigation, ready to sustain and extend our leadership. Our ability to do so depends on our performance today. Regardless of the outcome on asbestos, we must achieve profitable growth. It is vital to us, in the most exact sense of the word.

We do not expect an increase in market demand. While the repair and remodeling market is likely to remain strong, we anticipate a modest decline from the record home sales and housing starts reported in 2003. Nor do we expect any growth in non-residential construction. Although demand for wallboard is likely to remain relatively constant, the industry is expected to continue to experience excess capacity in the near term.

We will focus on what we can control. We must, and will, do everything we can to improve our operations, reduce costs and build our enterprise.

We've made a great deal of progress in improving our ceilings business. We need to make more. After we reorganized the business in 2002, our international ceilings business was profitable throughout the past year. In North America, we improved our pricing, consolidated our distribution channels and took advantage of our integrated drywall and ceilings salesforce. In 2004, we'll continue to strengthen our dealer network. Additional improvements in the operating performance at our plants will help to offset any additional increases in energy costs.

SHEETROCK is one of the best-known brands in the country. Our DUROCK, FIBEROCK, LEVELROCK and DONN brands lead their categories. We plan to extend our leadership. Optimizing our manufacturing facilities, improving efficiencies and sharing our best practices will help us meet the challenge of higher energy costs. The new process technologies we are developing today will help reduce energy use – and costs – even more.

L&W has been successful in accelerating its growth, and we expect it to continue to grow. The opportunities for FIBEROCK are just as significant. We're exploring other new opportunities as well. Our business development team is systematically working to identify, research and launch new businesses to help us gain a larger share of every room.

USG garnered five prestigious awards from industry trade publications for its 2003 product innovations.

All of our efforts will be supported by a new enterprise-wide software system, called LINX, that we began to implement in 2002. When it is fully operational in 2006, the new \$115 million system will link every aspect of our operations, reduce costs for USG and our customers and allow us to provide superior transactional and informational services. Despite being in Chapter 11, we are investing to raise service standards and cement our leadership.

Leadership is our tradition and our strength. And leadership begins with people. In highly uncertain, challenging times, the people of this company have stayed focused on our mission of finding a better way. I am proud of their accomplishments, grateful for their support and committed to helping them gain the opportunities and skills they need to lead this company in the future. New programs that are focused on mentoring, manufacturing excellence and advanced leadership skills, together with our ongoing commitment to diversity, will help us prepare the next generation of leaders.

Even as we work through Chapter 11, we are looking ahead. We are responding to the challenges we are facing today, strengthening our operations and building the value of our enterprise. No matter what the future holds, we'll be ready. We will keep moving forward.



William C. Foote  
Chairman, CEO and President  
February 24, 2004

The USG Customer Service Center handles more than 60,000 orders in an average month.