USG CORP
Form 10-Q
July 26, 2017
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 1-8864
USG CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	36-3329400
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
550 West Adams Street, Chicago, Illinois	60661-3676
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code (312) 436-4000
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	þ	Accelerated filer	¨
Non-accelerated filer	¨	(Do not check if a smaller reporting company)	
		Smaller reporting company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
The number of shares of the registrant's common stock outstanding as of June 30, 2017 was 143,409,835.

Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(millions, except per-share and share data)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Net sales	$811	$ 769	$1,578	$ 1,516
Cost of products sold	643	576	1,246	1,142
Gross profit	168	193	332	374
Selling and administrative expenses	72	71	145	139
Recovery of receivable	—	—	—	(3)
Operating profit	96	122	187	238
Income from equity method investments	14	16	27	23
Interest expense	(19)	(38)	(39)	(78)
Interest income	—	1	1	3
Loss on extinguishment of debt	(22)	(2)	(22)	(4)
Other (expense) income, net	(3)	2	(4)	5
Income from continuing operations before income taxes	66	101	150	187
Income tax expense	(20)	(34)	(49)	(60)
Income from continuing operations	46	67	101	127
(Loss) income from discontinued operations, net of tax	(10)	7	(10)	14
Net income	$36	$ 74	$91	$ 141
Earnings per average common share - basic:				
Income from continuing operations	$0.32	$ 0.46	$0.69	$ 0.87
(Loss) income from discontinued operations	(0.07)	0.04	(0.07)	0.09
Net income	$0.25	$ 0.50	$0.62	$ 0.96
Earnings per average common share - diluted:				
Income from continuing operations	$0.31	$ 0.46	$0.68	$ 0.86
(Loss) income from discontinued operations	(0.07)	0.04	(0.07)	0.09
Net income	$0.24	$ 0.50	$0.61	$ 0.95
Average common shares	144,526,9[illegible]	145,933,165	145,753,0[illegible]	145,856,220
Dilutive awards under long-term incentive plan	2,113,19[illegible]	2,060,867	2,317,971	1,465,200
Deferred shares for non-employee directors	220,846	—	220,404	—
Average diluted common shares	146,860,9[illegible]	147,994,032	148,291,4[illegible]	147,321,420

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

(millions)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Net income	$36	$74	$91	$141
Other comprehensive income (loss), net of tax:				
Derivatives qualifying as cash flow hedges:				
(Loss) gain on derivatives qualifying as cash flow hedges, net of tax (benefit) of ($2), $3, ($5) and $0, respectively	(2)	4	(8)	(4)
Less: Reclassification adjustment for loss on derivatives included in net income, net of tax (benefit) of $0, ($1), $0 and ($2), respectively	(1)	(2)	(1)	(4)
Net derivatives qualifying as cash flow hedges	(1)	6	(7)	—
Pension and postretirement benefits:				
Changes in pension and postretirement benefits, net of tax (benefit) of $2, ($2), $2 and ($3), respectively	4	(3)	3	(6)
Less: Amortization of prior service cost included in net periodic pension cost, net of tax (benefit) of ($7), ($1), ($7) and ($1), respectively	(12)	(1)	(12)	(1)
Net pension and postretirement benefits	16	(2)	15	(5)
Foreign currency translation:				
Changes in foreign currency translation, net of tax benefit of $0 in all periods	8	(36)	48	(12)
Other comprehensive income (loss), net of tax	$23	$(32)	$56	$(17)
Comprehensive income	$59	$42	$147	$124

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

USG CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(millions, except share data)	June 30, 2017	December 31, 2016
Assets		
Cash and cash equivalents	$371	$ 427
Short-term marketable securities	59	62
Receivables (net of reserves 2017 - $8 and 2016 - $8)	234	183
Inventories	249	236
Income taxes receivable	1	1
Other current assets	35	40
Total current assets	949	949
Long-term marketable securities	33	29
Property, plant and equipment (net of accumulated depreciation and depletion - 2017 - $2,026 and 2016 - $1,960)	1,718	1,707
Deferred income taxes	469	492
Equity method investments	656	628
Other assets	62	64
Total assets	$3,887	$ 3,869
Liabilities and Stockholders' Equity		
Accounts payable	$242	$ 237
Accrued expenses	133	175
Income taxes payable	4	10
Total current liabilities	379	422
Long-term debt	1,077	1,083
Deferred income taxes	4	4
Pension and other postretirement benefits	272	290
Other liabilities	187	184
Total liabilities	1,919	1,983
Preferred stock – $1 par value, authorized 36,000,000 shares; outstanding - none	—	—
Common stock – $0.10 par value; authorized 200,000,000 shares; issued: 2017 - 143,410,000 shares and 2016 - 146,167,000 shares	15	15
Treasury stock at cost; 2017 - 3,103,000 shares and 2016 - 0 shares	(95)	—
Additional paid-in capital	3,043	3,038
Accumulated other comprehensive loss	(329)	(385)
Retained earnings (accumulated deficit)	(666)	(782)
Total stockholders' equity	1,968	1,886
Total liabilities and stockholders' equity	$3,887	$ 3,869

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(millions)	Six months ended June 30, 2017	2016
Operating Activities		
Net income	$91	$141
Less: (Loss) income from discontinued operations, net of tax	(10)	14
Income from continuing operations	101	127
Adjustments to reconcile net income from continuing operations to net cash:		
Depreciation, depletion and amortization	65	67
Loss on extinguishment of debt	22	4
Recovery of receivable	—	(3)
Share-based compensation expense	9	9
Deferred income taxes	48	58
Gain on asset dispositions	(1)	(10)
Income from equity method investments	(27)	(23)
Dividends received from equity method investments	23	18
Pension settlement	7	2
Change in operating assets and liabilities	(117)	(86)
Other, net	(1)	(12)
Net cash provided by operating activities of continuing operations	129	151
Net cash (used for) provided by operating activities of discontinued operations	(1)	13
Net cash provided by operating activities	$128	$164
Investing Activities		
Purchases of marketable securities	(54)	(167)
Sales or maturities of marketable securities	53	187
Capital expenditures	(72)	(26)
Net proceeds from asset dispositions	2	12
Return of capital	—	1
Insurance proceeds	1	—
Return of restricted cash	—	9
Net cash (used for) provided by investing activities of continuing operations	(70)	16
Net cash provided by (used for) investing activities of discontinued operations	6	(2)
Net cash (used for) provided by investing activities	$(64)	$14
Financing Activities		
Issuance of debt	500	—
Repayment of debt	(520)	(141)
Payment of debt issuance fees	(8)	—
Issuance of common stock	3	2
Repurchase of common stock	(97)	—
Repurchases of common stock to satisfy employee tax withholding obligations	(4)	(2)
Net cash used for financing activities of continuing operations	$(126)	$(141)
Effect of exchange rate changes on cash from continuing operations	6	—
Net (decrease) increase in cash and cash equivalents from continuing operations	$(61)	$26
Net increase in cash and cash equivalents from discontinued operations	5	11

Net (decrease) increase in cash and cash equivalents	(56)	37
Cash and cash equivalents at beginning of period	427	442
Cash and cash equivalents at end of period	$371	$479
Supplemental Cash Flow Disclosures:		
Interest paid, net of capitalized interest	$48	$76
Income taxes paid, net of refunds received	9	5
Noncash Investing and Financing Activities:		
Amount in accounts payable for capital expenditures	7	4
Reversal of USG Boral Building Products earnout	—	(24)

See accompanying Notes to Condensed Consolidated Financial Statements.

6

Table of Contents

USG CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

In the following Notes to Condensed Consolidated Financial Statements, “USG,” “we,” “our” and “us” refer to USG Corporation, a Delaware corporation, and its subsidiaries included in the condensed consolidated financial statements, except as otherwise indicated or as the context otherwise requires.

1. Organization, Consolidation and Presentation of Financial Statements

PREPARATION OF FINANCIAL STATEMENTS

We prepared the accompanying unaudited condensed consolidated financial statements of USG Corporation in accordance with applicable United States Securities and Exchange Commission, or SEC, guidelines pertaining to interim financial information. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ materially from those estimates. In the opinion of our management, the financial statements reflect all adjustments, which are of a normal recurring nature, necessary for a fair presentation of our financial results for the interim periods. The results of operations for the three and six months ended June 30, 2017 are not necessarily indicative of the results of operations to be expected for the entire year.

Certain reclassifications have been made to prior year amounts in order to conform with current year presentation. On our condensed consolidated statements of cash flows, we condensed the increase/decrease in working capital, other assets, pension and postretirement benefits, and other liabilities into "Change in operating assets and liabilities".

In conjunction with the sale of L&W Supply Corporation, or L&W, which was completed on October 31, 2016 to American Builders & Contractors Supply Co., Inc., or ABC Supply, L&W is presented as discontinued operations. The results of L&W, which consisted of our Distribution segment, have been excluded from segment results. The 2016 results of our Gypsum and Ceilings segments have been revised to reflect only the sales of USG products from Gypsum and Ceilings to L&W that were sold by L&W to third party customers prior to June 30, 2016. All sales to L&W subsequent to the close of the transaction are included in net sales on our condensed consolidated statements of income. See Note 2 for further discussion.

Our segments are structured around our key products and business units: Gypsum, Ceilings and USG Boral Building Products, or UBBP.

Our Gypsum reportable segment is an aggregation of the operating segments of the gypsum businesses in the United States, Canada, Mexico, and Latin America and our mining operation in Canada, which we indefinitely idled in the third quarter of 2016. Gypsum manufactures products throughout the United States, Canada and Mexico. These products include USG Sheetrock® brand gypsum wallboard, Sheetrock® brand joint compound, Durock® brand cement board, Levelrock® brand gypsum underlayment, Fiberock® brand backerboard, Securock® brand glass mat sheathing used for building exteriors, Securock® brand gypsum fiber and glass mat panels used as roof cover board and USG Structural Panels.

Our Ceilings reportable segment is an aggregation of the operating segments of the ceilings businesses in the United States, Canada, Mexico, and Latin America. Ceilings manufactures ceiling tile in the United States and ceiling grid in the United States and Canada.

UBBP is our 50/50 joint ventures with Boral Limited, or Boral. UBBP manufactures, distributes and sells certain building products, mines raw gypsum and sells natural and synthetic gypsum throughout Asia, Australasia and the Middle East.

These condensed consolidated financial statements and notes are to be read in conjunction with the financial statements and notes included in USG’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016, which we filed with the SEC on February 8, 2017.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

We adopted Accounting Standards Update, or ASU, 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting,” on January 1, 2017. This ASU simplifies certain aspects of accounting for employee share-based payments. Upon adoption, we recorded to retained earnings a $25 million cumulative-effect adjustment for previously unrecognized excess tax benefits and an immaterial cumulative-effect adjustment for the reversal of cumulative forfeiture estimates to record forfeitures as they occur.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In March 2017, the Financial Accounting Standards Board, or FASB, issued ASU, 2017-07, “Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost,”

Table of Contents

which will require us to disaggregate and present current service cost along with other current compensation costs for employees while presenting other net benefit cost components below operating profit. In addition, under the new ASU, only the service cost component of net benefit cost is eligible for capitalization in our inventory and fixed assets. We will retrospectively adopt the standard on January 1, 2018 for the presentation of service cost and prospectively adopt the capitalization of only service cost into inventory and fixed assets. Select line items from our condensed consolidated statements of income for the three and six months ended June 30, 2017 and the year ended December 31, 2016 which reflect the changes in presentation of net benefit costs are as follows.

(millions)	Three months ended June 30, 2017		Six months ended June 30, 2017		Year ended December 31, 2016	
	After Adoption	As Reported	After Adoption	As Reported	After Adoption	As Reported
Gross profit	$166	$ 168	$324	$ 332	$700	$ 705
Operating profit	95	96	179	187	396	394
Other net periodic postretirement benefit (costs)	1	—	8	—	(2)	—
Net income	36	36	91	91	510	510

We do not expect the adoption of ASU 2017-07 to have a significant impact on our other financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” which supersedes existing lease guidance to require lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by long-term leases and to disclose additional quantitative and qualitative information about leasing arrangements. We will adopt the new standard on January 1, 2019 using the modified retrospective approach. As a result of the new standard, we will implement a new lease accounting system, new processes and accounting policies. Further, we anticipate the adoption of ASU 2016-02 will have a significant impact to our condensed consolidated balance sheets, condensed consolidated statements of income and disclosures; however, we are unable to quantify the financial statement impact at this time.

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” which supersedes the revenue recognition requirements in “Revenue Recognition (Topic 605),” and requires entities to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Subsequently, the FASB has issued various ASUs to provide further clarification around certain aspects of Topic 606. We will retrospectively adopt the standard on January 1, 2018 using practical expedients. The adoption will not have a significant impact to our condensed consolidated financial statements. However, the ASU will require us to include robust and disaggregated disclosures of revenue and how we satisfy our performance obligations in our notes.

2. Discontinued Operations

The sale of L&W was completed on October 31, 2016. The summarized financial information related to L&W that has been excluded from continuing operations and reported as a discontinued operation is as follows:

(millions)	Three months ended June 30, 2016	Six months ended June 30, 2016
Net sales	$ 386	$ 743
Cost of products sold	367	710
Gross profit	19	33
Selling and administrative expenses	8	11
Operating profit	11	22
Income tax expense	(4)	(8)
Income from discontinued operations	$ 7	$ 14

For the three and six months ended June 30, 2017, we recorded a loss of $9 million for L&W and a loss of $1 million for our European operations which were sold in December 2012 to "Loss (income) from discontinued operations". The loss for L&W primarily reflected a pension settlement charge, net of tax, related to lump sum benefits paid to former employees of L&W.

Table of Contents

Additionally, upon the close of the sale, we entered into a supply agreement with L&W, and for the three and six months ended June 30, 2017, we recorded sales of $134 million and $265 million, respectively, and cash inflows related to payments on trade receivables of $143 million and $252 million, respectively. For the comparable periods in 2016, the sales that were sold by L&W to third party customers through June 30, 2016 were $151 million and $296 million, respectively.

3. Equity Method Investments

Equity method investments as of June 30, 2017 and December 31, 2016, were as follows:

	June 30, 2017		December 31, 2016	
(dollars in millions)	Carrying Value	Ownership Percentage	Carrying Value	Ownership Percentage
USG Boral Building Products	$ 649	50%	$ 621	50%
Other equity method investments	7	33% - 50%	7	33% - 50%
Total equity method investments	$ 656		$ 628	

Investment in USG Boral Building Products

During the second quarter of 2017, UBBP paid cash dividends on its earnings through March 2017 of which our 50% share totaled $23 million. We recorded the cash dividend in operating activities on our statements of cash flows. As of June 30, 2017, the amount of our condensed consolidated retained earnings which represents undistributed earnings from UBBP is $47 million.

In the event certain U.S. Dollar denominated performance targets are satisfied by UBBP, we will be obligated to pay Boral an earnout payment of up to $50 million based on performance during the first five years after the closing on February 27, 2014. We have not recorded a liability for this earnout payment as we have concluded that it is currently not probable that the five-year performance target will be achieved. If our conclusion on the probability of achievement changes, we will record a liability representing the present value of the earnout payment with a corresponding increase to our investment. In the second quarter of 2016, we reversed a liability with a corresponding reduction to our investment for an earn-out payment that was based on a three-year performance target.

Our underlying net assets in our investments are denominated in a foreign currency, and translation gains or losses will impact the recorded value of our investments. Translation gains or losses recorded in other comprehensive income were as follows:

	Three months ended June 30,		Six months ended June 30,
(millions)	2017	2016	