USG CORP
Form 10-Q
October 26, 2017
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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 September 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 September 30, 2017 was 141,474,530.

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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 September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net sales	$795	$ 767	$2,373	$ 2,283
Cost of products sold	632	586	1,878	1,728
Gross profit	163	181	495	555
Selling and administrative expenses	70	74	215	213
Long-lived asset impairment charges	—	10	—	10
Recovery of receivable	—	—	—	(3)
Operating profit	93	97	280	335
Income from equity method investments	15	14	42	37
Interest expense	(15)	(37)	(54)	(115)
Interest income	1	—	2	3
Loss on extinguishment of debt	—	(1)	(22)	(5)
Other (expense) income, net	(1)	1	(5)	6
Income from continuing operations before income taxes	93	74	243	261
Income tax expense	(27)	(18)	(76)	(78)
Income from continuing operations	66	56	167	183
(Loss) income from discontinued operations, net of tax	—	6	(10)	20
Net income	$66	$ 62	$157	$ 203
Earnings per average common share - basic:				
Income from continuing operations	$0.47	$ 0.39	$1.16	$ 1.26
(Loss) income from discontinued operations	—	0.04	(0.07)	0.13
Net income	$0.47	$ 0.43	$1.09	$ 1.39
Earnings per average common share - diluted:				
Income from continuing operations	$0.46	$ 0.38	$1.14	$ 1.25
(Loss) income from discontinued operations	—	0.04	(0.07)	0.13
Net income	$0.46	$ 0.42	$1.07	$ 1.38
Average common shares	142,103,716	146,043,791	145,054,965	145,892,390
Dilutive awards under long-term incentive plan	2,389,428	2,147,176	2,312,816	1,628,501
Deferred shares for non-employee directors	188,546	196,670	216,242	—
Average diluted common shares	144,681,690	148,387,637	147,584,023	147,520,891

See accompanying Notes to Condensed Consolidated Financial Statements.

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USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(millions)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net income	$66	$62	$157	$203
Other comprehensive (loss) income, net of tax:				
Derivatives qualifying as cash flow hedges:				
Loss on derivatives qualifying as cash flow hedges, net of tax (benefit) of ($2), ($1), ($7) and ($1), respectively	(3)	(2)	(11)	(6)
Less: Reclassification adjustment for loss on derivatives included in net income, net of tax (benefit) of ($1), ($1), ($1) and ($3), respectively	—	(2)	(1)	(6)
Net derivatives qualifying as cash flow hedges	(3)	—	(10)	—
Pension and postretirement benefits:				
Changes in pension and postretirement benefits, net of tax (benefit) of ($10), ($4), ($8) and ($7), respectively	(15)	(3)	(12)	(9)
Less: Amortization of prior service cost included in net periodic pension cost, net of tax (benefit) of ($2), ($1), ($9) and ($2), respectively	(1)	—	(13)	(1)
Net pension and postretirement benefits	(14)	(3)	1	(8)
Foreign currency translation:				
Changes in foreign currency translation, net of tax benefit of $0 in all periods	10	3	58	(9)
Other comprehensive (loss) income, net of tax	$(7)	$—	$49	$(17)
Comprehensive income	$59	$62	$206	$186

See accompanying Notes to Condensed Consolidated Financial Statements.

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USG CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(millions, except share data)	September 30, 2017	December 31, 2016
Assets		
Cash and cash equivalents	$ 347	$ 427
Short-term marketable securities	61	62
Receivables (net of reserves 2017 - $9 and 2016 - $8)	237	183
Inventories	252	236
Other current assets	38	41
Total current assets	935	949
Long-term marketable securities	37	29
Property, plant and equipment (net of accumulated depreciation and depletion - 2017 - $2,046 and 2016 - $1,960)	1,733	1,707
Deferred income taxes	450	492
Equity method investments	676	628
Other assets	61	64
Total assets	$ 3,892	$ 3,869
Liabilities and Stockholders' Equity		
Accounts payable	$ 253	$ 237
Accrued expenses	140	175
Income taxes payable	1	10
Total current liabilities	394	422
Long-term debt	1,077	1,083
Deferred income taxes	4	4
Pension and other postretirement benefits	250	290
Other liabilities	185	184
Total liabilities	1,910	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 - 141,475,000 shares and 2016 - 146,167,000 shares	15	15
Treasury stock at cost; 2017 - 5,038,000 shares and 2016 - 0 shares	(150)	—
Additional paid-in capital	3,053	3,038
Accumulated other comprehensive loss	(336)	(385)
Retained earnings (accumulated deficit)	(600)	(782)
Total stockholders' equity	1,982	1,886
Total liabilities and stockholders' equity	$ 3,892	$ 3,869

See accompanying Notes to Condensed Consolidated Financial Statements.

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USG CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(millions)	Nine months ended September 30, 2017	2016
Operating Activities		
Net income	$157	$203
Less: (Loss) income from discontinued operations, net of tax	(10)	20
Income from continuing operations	167	183
Adjustments to reconcile net income from continuing operations to net cash:		
Depreciation, depletion and amortization	98	100
Loss on extinguishment of debt	22	5
Long-lived asset impairment charges	—	10
Recovery of receivable	—	(3)
Share-based compensation expense	13	14
Deferred income taxes	75	85
Gain on asset dispositions	—	(10)
Income from equity method investments	(42)	(37)
Dividends received from equity method investments	23	18
Pension settlement	10	3
Change in operating assets and liabilities	(164)	(95)
Other, net	1	12
Net cash provided by operating activities of continuing operations	203	285
Net cash (used for) provided by operating activities of discontinued operations	(1)	12
Net cash provided by operating activities	$202	$297
Investing Activities		
Purchases of marketable securities	(75)	(183)
Sales or maturities of marketable securities	69	310
Capital expenditures	(109)	(44)
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	(112)	105
Net cash provided by (used for) investing activities of discontinued operations	6	(1)
Net cash (used for) provided by investing activities	$(106)	$104
Financing Activities		
Issuance of debt	500	—
Repayment of debt	(520)	(205)
Payment of debt issuance fees	(8)	—
Issuance of common stock	3	3
Repurchase of common stock	(153)	—
Repurchases of common stock to satisfy employee tax withholding obligations	(4)	(2)
Net cash used for financing activities of continuing operations	$(182)	$(204)
Effect of exchange rate changes on cash from continuing operations	6	(3)

Net (decrease) increase in cash and cash equivalents from continuing operations	$(85)	$183
Net increase in cash and cash equivalents from discontinued operations	5	11
Change in cash balance included in discontinued operations	—	(2)
Net (decrease) increase in cash and cash equivalents	(80)	192
Cash and cash equivalents at beginning of period	427	442
Cash and cash equivalents at end of period	$347	$634
Supplemental Cash Flow Disclosures:		
Interest paid, net of capitalized interest	$66	$124
Income taxes paid, net of refunds received	13	6
Noncash Investing and Financing Activities:		
Amount in accounts payable for capital expenditures	12	8
Reversal of USG Boral Building Products earnout	—	(24)

See accompanying Notes to Condensed Consolidated Financial Statements.

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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 nine months ended September 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 balance sheets, we condensed "Income tax receivable" into "Other current assets." 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. 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. 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 August 2017, the Financial Accounting Standards Board, or FASB, issued ASU 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,” which expands and refines hedge accounting for both non-financial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The new standard will be effective for us on January 1, 2019. We do not expect the adoption of ASU 2017-12 to have significant impact to our consolidated financial statements or disclosures.

In March 2017, the FASB issued ASU 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," which will require us to disaggregate and present current service cost along with other current compensation costs for employees while presenting other net benefit

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cost components below operating profit. In addition, 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 nine months ended September 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 September 30, 2017		Nine months ended September 30, 2017		Year ended December 31, 2016	
	After Adoption	As Reported	After Adoption	As Reported	After Adoption	As Reported
Gross profit	$161	$ 163	$485	$ 495	$700	$ 705
Operating profit	90	93	269	280	396	394
Other net periodic postretirement benefit (costs)	3	—	11	—	(2)	—
Net income	66	66	157	157	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 consolidated balance sheets and disclosures. We are currently finalizing our accounting policies and analyzing our lease population and, thus, 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 adopt, via the modified retrospective approach, the standard on January 1, 2018 using practical expedients. The adoption will not have a significant impact to our consolidated financial statements. However, we will expand our disclosure in our notes to include disaggregation of revenue and discussion on the satisfaction of our performance obligations.

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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 September 30, 2016	Nine months ended September 30, 2016
Net sales	$ 388	$ 1,131
Cost of products sold	370	1,080
Gross profit	18	51
Selling and administrative expenses	7	18
Operating profit	11	33
Income tax expense	(5)	(13)
Income from discontinued operations	$ 6	$ 20

For the nine months ended September 30, 2017, we recorded a net loss of $10 million to "(Loss) income from discontinued operations," which reflected a $9 million loss for L&W primarily due to a pension settlement and a loss of $1 million for our European operations which were sold in December 2012.

Additionally, upon the close of the sale, we entered into a supply agreement with L&W, and for the three and nine months ended September 30, 2017, we recorded sales of $122 million and $387 million, respectively, and cash inflows related to payments on trade receivables during those same periods of $112 million and $364 million, respectively. For the comparable periods in 2016, the sales that were sold by L&W to third party customers were $143 million and $439 million, respectively.

3. Equity Method Investments

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

	September 30, 2017		December 31, 2016	
(dollars in millions)	Carrying Value	Ownership Percentage	Carrying Value	Ownership Percentage
USG Boral Building Products	$ 669	50%	$ 621	50%
Other equity method investments	7	33% - 50%	7	33% - 50%
Total equity method investments	$ 676		$ 628	

Investment in USG Boral Building Products

Through the first nine months 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 September 30, 2017, the amount of our condensed consolidated retained earnings which represents undistributed earnings from UBBP is $62 million. In October, the UBBP Board approved a cash dividend on earnings through September 2017, of which our 50% share is $19 million, to be paid in the fourth quarter of 2017.

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.

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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 September 30,		Nine months ended September 30,	
(millions)	2017	2016	2017	2016
Translation gain	$ 5	$ 13	$ 28	$ —

Summarized financial information is as follows:

	Three months ended September 30,		Nine months ended September 30,	
(millions)	2017	2016(a)	2017	2016(a)
USG Boral Building Products				
Net sales	$324	$ 276	$887	$ 778
Gross profit	98	90	275	241
Operating profit	43	41	118	105
Income from continuing operations before income taxes	47	42	129	112
Net income	32	29	86	78
Net income attributable to USG Boral Building Products	30	28	83	74
USG share of income from investment accounted for using the equity method	15	14	42	37

(a) The results for the three and nine months ended September 30, 2016 include impairment charges of $8 million, net of tax of $0, for certain assets in China.

TRANSACTIONS WITH UBBP

Our Gypsum segment sells products to UBBP. Total sales to UBBP for the three and nine months ended September 30, 2017 and 2016 were immaterial.

In 2014, in connection with the formation of UBBP, we contributed our ownership interest in a joint venture in China to UBBP, but retained our loan receivable from this joint venture. As of September 30, 2017 and December 31, 2016, the loan receivable, including interest, totaled $14 million and $15 million, respectively, and is included in "Other assets" on our accompanying condensed consolidated balance sheets.

4. Segments

Our operations are organized into three reportable segments: Gypsum, Ceilings and UBBP. Results for our Gypsum and Ceilings segments were as follows:

	Three months ended September 30,		Nine months ended September 30,	
(millions)	2017	2016	2017	2016
Net Sales:				
Gypsum	$665	$635	$2,002	$1,899
Ceilings	133	135	379	391
Eliminations	(3)	(3)	(8)	(7)
Total	$795	$767	$2,373	$2,283
Operating Profit (Loss):				
Gypsum	$85	$89	$266	$310

Ceilings	28	33	74	93
Corporate	(20)	(25)	(60)	(68)
Total	$93	$97	$280	$335

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5. Marketable Securities

Marketable securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses excluded from earnings and reported in "Accumulated other comprehensive loss", or AOCI, on our accompanying condensed consolidated balance sheets. Proceeds received from sales or maturities of marketable securities were as follows:

(millions)	Three months ended September 30, 2017	2016	Nine months ended September 30, 2017	2016
Proceeds received	$ 16	$ 123	$ 69	$ 310

Our investments in marketable securities consisted of the following:

(millions)	As of September 30, 2017 Amortized Cost	Fair Value	As of December 31, 2016 Amortized Cost	Fair Value
Corporate debt securities	$ 65	$ 65	$ 69	$ 69
U.S. government and agency debt securities	10	10	14	14
Non-U.S. government debt securities	1	1	—	—
Asset-backed debt securities	12	12	2	2
Certificates of deposit	10	10	6	6
Total marketable securities	$ 98	$ 98	$ 91	$ 91

The realized and unrealized gains and losses for the three and nine months ended September 30, 2017 and 2016 were immaterial. Cost basis for securities sold are determined on a first-in-first-out basis.

Contractual maturities of marketable securities as of September 30, 2017 were as follows:

(millions)	Amortized Cost	Fair Value
Due in 1 year or less	$ 61	$ 61
Due in 1-5 years	37	37
Total marketable securities	$ 98	$ 98

Actual maturities may differ from the contractual maturities because issuers of the securities may have the right to prepay them.

6. Debt

Total debt consisted of the following:

(millions)	September 30, 2017	December 31, 2016
4.875% senior notes due 2027	$ 500	$ —
5.5% senior notes due 2025	350	350
7.75% senior notes due 2018	—	500
Industrial revenue bonds (due 2028 through 2034)	239	239
Total	$ 1,089	$ 1,089
Less: Unamortized debt issuance costs	12	6
Total	$ 1,077	$ 1,083

ISSUANCE AND REPURCHASE OF SENIOR NOTES

During the second quarter of 2017, we issued $500 million of 4.875% Senior Notes due 2027, referred to as our 4.875% Notes. The net proceeds from the issuance of these notes and cash on hand were used to fund the repurchase of our 7.75% Senior Notes due 2018, referred to as our 7.75% Notes, and all related costs and expenses. We deferred

$7 million of debt issuance costs that are being amortized to interest expense over the term of the 4.875% Notes. Our obligations under the 4.875% Notes are guaranteed on a senior unsecured basis by certain of our domestic subsidiaries. The notes are redeemable in whole or in part at any time at our option prior to June 1, 2022 at the applicable "make-whole" redemption price or on or after June 1, 2022 at stated redemption prices beginning at 102.438% of the principal

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amount of the notes being redeemed plus any accrued and unpaid interest on the principal amount being redeemed through the redemption date.

The 4.875% Notes contain a provision the same as or similar to the provision in our other senior notes that requires us to offer to purchase the notes at 101% of their principal amount (plus accrued and unpaid interest) in the event of a change in control. The indenture governing the 4.875% Notes contains events of default, covenants and restrictions that are substantially the same as those governing our other senior notes, including a limitation on our ability and the ability of certain of our subsidiaries to create or incur secured indebtedness.

We repurchased the 7.75% Notes through both a cash tender offer and a subsequent notice of redemption for aggregate consideration of $536 million, including premiums of $20 million and accrued interest of $16 million. In the nine months ended September 30, 2017, we recorded a pre-tax loss on the early extinguishment of debt of $21 million. In the first nine months of 2016, we repurchased $200 million of our 6.3% Senior Notes due 2016, or our 6.3% Notes, for aggregate consideration of $209 million, including premiums of $5 million and accrued interest of $4 million. We recorded a pre-tax loss on early extinguishment of debt of $5 million, of which $1 million occurred in the third quarter of 2016.

CREDIT FACILITY

In the second quarter of 2017, we amended and restated our credit facility agreement to, among other things, increase the maximum borrowing limit from $180 million to $220 million. As a result, we recorded a pre-tax loss on extinguishment of debt of $1 million in the nine months ended September 30, 2017 and incurred $1 million of debt issuance costs. Our amended and restated agreement requires us to maintain a minimum fixed charge coverage ratio in the event excess availability falls below a minimum threshold. Because our excess borrowing availability as of September 30, 2017 of $189 million exceeds this threshold, the requirement to maintain the minimum fixed charge coverage ratio is not applicable. As of September 30, 2017, we were in compliance with the covenants contained in our credit facility.

As of September 30, 2017 and during the quarter then-ended, there were no borrowings under the facility. Had there been any borrowings as of that date, the applicable interest rate would have been 2.23% for loans in the U.S. and 2.31% for loans in Canada. Outstanding letters of credit totaled $31 million as of September 30, 2017.

OTHER

(millions)	September 30, 2017	December 31, 2016
Fair value of debt	$ 1,133	$ 1,129
Accrued interest	14	31

The fair values of our debt were determined utilizing unadjusted prices from independent pricing services and are classified as Level 2. See Note 8 for further discussion on fair value measurements. The vendors' methodologies utilize various forms of market data, including but not limited to, trade data, yield, spreads, bids and offers. We review the values provided by the independent pricing service for reasonableness by comparing the valuations received from the independent pricing service to valuations from at least one other observable source.

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7. Derivative Instruments

We use derivative instruments to manage selected commodity price and foreign currency exposures as described below. We do not use derivative instruments for speculative trading purposes, and we typically do not hedge beyond six years. Cash flows from derivative instruments are included in operating activities in our condensed consolidated statements of cash flows. Gains and losses on contracts designated as cash flow hedges are reclassified into earnings when the underlying forecasted transactions affect earnings. For contracts designated as cash flow hedges, we reassess the probability of the underlying forecasted transactions occurring on a quarterly basis.

Derivative Instruments	Type	Hedged Item	Aggregate Notional Amount	Contracts Maturing Through
Commodity	Natural gas swaps	Purchases of natural gas	36 million mmBTUs*	December 31, 2022
Foreign Exchange	Forward contracts	Purchases of products and services denominated in a foreign currency	$115 million	December 31, 2018

* - millions of British Thermal Units

COUNTERPARTY RISK, MASTER NETTING ARRANGEMENTS AND BALANCE SHEET OFFSETTING

We are exposed to credit losses in the event of nonperformance by the counterparties to our derivative instruments. As of September 30, 2017, our derivatives were in a $13 million net liability position. All of our counterparties have investment grade credit ratings; accordingly, we anticipate that they will be able to fully satisfy their obligations under the contracts.

All of our derivative contracts are governed by master netting agreements negotiated between us and the counterparties that reduce our counterparty credit exposure. The agreements outline the conditions (such as credit ratings and net derivative fair values) upon which we, or the counterparties, are required to post collateral. As required by certain of our agreements, we had $6 million of collateral posted with our counterparties related to our derivatives as of September 30, 2017. Amounts paid as cash collateral are included in "Receivables" on our accompanying condensed consolidated balance sheets.

We have not adopted an accounting policy to offset fair value amounts related to derivative contracts under our master netting arrangements; therefore, individual derivative contracts are reflected on a gross basis, as either assets or liabilities, on our accompanying condensed consolidated balance sheets, based on their fair value as of the balance sheet date.

FINANCIAL STATEMENT INFORMATION

The following are the pretax effects of derivative instruments on the condensed consolidated statements of income for the three months ended September 30, 2017 and 2016.

(millions)	Amount of Gain or (Loss) Recognized in Other Comprehensive Income on Derivatives (Effective Portion) 2017	2016	Location of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion) 2017	2016
Derivatives in Cash Flow Hedging Relationships					
Commodity contracts	$ (2)	$ (4)	Cost of products sold	$ (1)	$ (3)
Foreign exchange contracts	(3)	1	Cost of products sold	—	—
Total	$ (5)	$ (3)		$ (1)	$ (3)

	Location of Gain or (Loss)	Amount of Gain or (Loss) Recognized in

(millions)	Recognized in Income on Derivatives	Income on Derivatives 2017		2016	
Derivatives Not Designated as Hedging Instruments					
Commodity contracts	Cost of products sold	$	—	$	—
Total		$	—	$	—

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The following are the pretax effects of derivative instruments on the condensed consolidated statements of income for the nine months ended September 30, 2017 and 2016.

(millions)	Amount of Gain or (Loss) Recognized in Other Comprehensive Income on Derivatives (Effective Portion) 2017	2016	Location of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion) 2017	2016
Derivatives in Cash Flow Hedging Relationships					
Commodity contracts	$ (12)	$ (2)	Cost of products sold	$ (2)	$ (13)
Foreign exchange contracts	(6)	(5)	Cost of products sold	—	4
Total	$ (18)	$ (7)		$ (2)	$ (9)

(millions)	Location of Gain or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives 2017	2016
Derivatives Not Designated as Hedging Instruments			
Commodity contracts	Cost of products sold	$ (1)	$ —
Total		$ (1)	$ —

For both commodity contracts and foreign exchange contracts, no ineffectiveness was recorded in the three and nine months ended September 30, 2017 and 2016.

The following are the fair values of derivative instruments and the location on our accompanying condensed consolidated balance sheets as of September 30, 2017 and December 31, 2016.

(millions)	Balance Sheet Location	Fair Value 9/30/17	12/31/16	Balance Sheet Location	Fair Value 9/30/17	12/31/16
Derivatives in Cash Flow Hedging Relationships						
Commodity contracts	Other current assets	$2	$ 8	Accrued expenses	$4	$ 4
Commodity contracts	Other assets	1	3	Other liabilities	7	5
Foreign exchange contracts	Other current assets	—	1	Accrued expenses	4	1
Foreign exchange contracts	Other assets	—	—	Other liabilities	1	—
Total derivatives in cash flow hedging relationships		$3	$ 12		$16	$ 10
Derivatives Not Designated as Hedging Instruments						
Commodity contracts	Other current assets	$—	$1	Accrued expenses	$—	$—

Total derivatives not designated as hedging instruments		$—	$1		$—	$—
Total derivatives	Total assets	$3	$13	Total liabilities	$16	$10

As of September 30, 2017, we had no derivatives designated as fair value hedges or net investment hedges.

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8. Fair Value Measurements

Certain assets and liabilities are required to be recorded at fair value. There are three levels of inputs that may be used to measure fair value which are described below along with how USG derives fair value.

Level	Definition	USG
Level 1	Quoted prices for identical assets and liabilities in active markets	Cash equivalents and equity mutual funds consist of money market funds that are valued based on quoted prices in active markets.
Level 2	Quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable	Marketable securities, including certain cash equivalents, are valued using a "market value" approach. Values are based on quoted prices and other observable market inputs received from data providers. Derivatives are valued using the "income" approach such as discounted-cash-flow models and readily observable market data. The inputs for the valuation models are obtained from data providers and include end-of-period spot and forward natural gas prices, foreign currency exchange rates, natural gas price volatility and LIBOR and swap rates for discounting the cash flows implied from the derivative contracts.
Level 3	Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable	No level 3 investments.

Our assets and liabilities measured at fair value on a recurring basis were as follows:

	Level 1		Level 2		Level 3		Total	
(millions)	9/30/17	12/31/16	9/30/17	12/31/16	9/30/17	12/31/16	9/30/17	12/31/16
Cash equivalents	$116	$ 38	$27	$ 34	$ —	$ —	$143	$ 72
Equity mutual funds	6	5	—	—	—	—	6	5
Marketable securities:								
Corporate debt securities	—	—	65	69	—	—	65	69
U.S. government and agency debt securities	—	—	10	14	—	—	10	14
Non-U.S. government debt securities	—	—	1	—	—	—	1	—
Asset-backed debt securities	—	—	12	2	—	—	12	2
Certificates of deposit	—	—	10	6	—	—	10	6
Derivative assets	—	—	3	13	—	—	3	13
Derivative liabilities	—	—	(16)	(10)	—	—	(16)	(10)

Certain assets and liabilities are measured at fair value on a nonrecurring basis rather than on an ongoing basis, but are subject to fair value adjustments in certain circumstances, such as when there is evidence of impairment or when a new liability is being established that requires fair value measurement. During the third quarter of 2016, we indefinitely idled our mining operations in Little Narrows, Nova Scotia, Canada. We reviewed the property, plant and equipment at Little Narrows for potential impairment by comparing the carrying values of those assets with their fair values as estimated using the future undiscounted cash flows for their remaining useful lives. We measured the fair value of the machinery, equipment and buildings using measurements classified as Level 3, and, as disclosed in Note 14, we recorded long-lived asset impairment charges of $10 million.

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9. Employee Retirement Plans

The components of net pension and postretirement benefit costs are summarized in the following table:

(millions)	Three months ended September 30, 2017	Three months ended September 30, 2016	Nine months ended September 30, 2017	Nine months ended September 30, 2016
Pension:				
Service cost of benefits earned	$11	$11	$32	$34
Interest cost on projected benefit obligation	15	17	46	51
Expected return on plan assets	(23)	(22)	(69)	(66)
Settlement [(a)]	3	1	23	3
Net amortization	6	5	16	14
Net pension cost [(b)]	$12	$12	$48	$36
Postretirement:				
Service cost of benefits earned	$—	$1	$2	$2
Interest cost on projected benefit obligation	2	1	4	4
Net amortization	(6)	(7)	(18)	(21)
Net postretirement benefit[(c)]	$(4)	$(5)	$(12)	$(15)

(a) During 2017, lump sum benefits paid exceeded the settlement threshold primarily driven by payments to former L&W employees as a result of the disposition of L&W, which resulted in settlement charges recorded for the three and nine months ended September 30, 2017.

(b) Net pension cost, excluding settlement costs, includes amounts allocated to (loss) income from discontinued operations for L&W totaling a benefit of $1 million for the three and nine months ended September 30, 2017 and expense of $2 million and $6 million for the three and nine months ended September 30, 2016, respectively.

(c) Net postretirement benefit includes a net benefit allocated to (loss) income from discontinued operations for L&W totaling $1 million and $3 million for the three and nine months ended September 30, 2016, respectively.

For the three and nine months ended September 30, 2017, we recorded settlement expense of $3 million and $23 million, respectively, as the total lump sum distributions paid by the USG Corporation pension plan to both L&W employees and former USG employees during the first nine months of 2017 exceeded the settlement threshold. Upon termination of their employment from USG, all L&W employees had the option to receive a lump sum benefit payment from the USG Corporation pension plan. For the benefits paid to terminated employees of L&W, we recorded a pre-tax loss of $13 million to "(Loss) income from discontinued operations" for the nine months ended September 30, 2017. For the benefits paid to USG retirees, we recorded a pre-tax loss of $3 million and $8 million to "Costs of products sold" for the three and nine months ended September 30, 2017, respectively, and of $0 million and $2 million to "Selling and administrative expenses" for the three and nine months ended September 30, 2017, respectively.

During the first nine months of 2017, we made cash contributions of $50 million to the USG Corporation Retirement Plan Trust, $16 million to our domestic supplemental pension plan and $3 million to our pension plans in Canada. We expect to make total contributions to our pension plans in 2017 of approximately $71 million.

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10. Share-Based Compensation

During the first nine months of 2017, we granted share-based compensation in the form of market share units, or MSUs, performance shares, and restricted stock units, or RSUs, to eligible participants under our 2016 Long-Term Incentive Plan. We recognize expense on all share-based grants over the service period, which is the shorter of the period until the employees' retirement eligibility dates and the service period of the award for awards expected to vest. We record forfeitures as they occur. Awards granted during the first nine months of 2017, weighted average fair value, and assumptions used to determine fair value were as follows:

	MSUs	Performance Shares	RSUs
Awards granted	371,346	112,732	93,000
Weighted average fair value [(a)]	$35.79	$ 39.42	$30.14
Expected volatility [(b)]	32.10 %	32.10 %	N/A
Risk-free rate [(c)]	1.39 %	1.39 %	N/A
Expected term (in years) [(d)]	2.96	2.96	N/A
Expected dividends	—	—	N/A

(a) Fair value of MSUs and Performance Shares is estimated on the date of grant using the Monte Carlo simulation using the assumptions outlined above. Fair value of RSUs is equal to the closing price of our common stock on the date of grant.

(b) The expected volatility rate is based on stock price history immediately prior to grant for a period commensurate with the expected term.

(c) The risk-free rate is based on zero coupon U.S. government issues at the time of grant.

(d) The expected term represents the period from the valuation date to the end of the performance period.

Terms of the awards granted during the first nine months of 2017 were as follows:

	MSUs	Performance Shares	RSUs
Maximum shares/units earned	Varies from 0% to 150% of the number of MSUs awarded depending on the actual performance of our stock price	Varies from 0% to 200% of the number of performance shares awarded depending on the performance of our total stockholder return relative to the performance of the Dow Jones U.S. Construction and Materials Index [(a)]	100%
Vesting Provisions	Three-year performance period	Three-year performance period	Specified number of years from the grant date