USG CORP
Form 10-Q
October 25, 2016
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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, 2016
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, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).
Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
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, 2016 was 146,079,429.

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

(millions, except per-share and share data)	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net sales	$767	$ 747	$2,283	$ 2,195
Cost of products sold	586	578	1,728	1,710
Gross profit	181	169	555	485
Selling and administrative expenses	74	75	213	225
Long-lived asset impairment charges	10	—	10	—
Recovery of receivable	—	—	(3)	—
Gain on disposal of shipping operations, net	—	—	—	(1)
Operating profit	97	94	335	261
Income from equity method investments	14	13	37	35
Interest expense	(37)	(40)	(115)	(123)
Interest income	—	—	3	1
Loss on extinguishment of debt	(1)	—	(5)	(19)
Other income, net	1	—	6	—
Income from continuing operations before income taxes	74	67	261	155
Income tax (expense) benefit	(18)	1	(78)	2
Income from continuing operations	56	68	183	157
Income from discontinued operations, net of tax	6	8	20	22
Net income	$62	$ 76	$203	$ 179
Earnings per average common share - basic:				
Income from continuing operations	$0.39	$ 0.46	$1.26	$ 1.08
Income from discontinued operations	0.04	0.06	0.13	0.15
Net income	$0.43	$ 0.52	$1.39	$ 1.23
Earnings per average common share - diluted:				
Income from continuing operations	$0.38	$ 0.46	$1.25	$ 1.07
Income from discontinued operations	0.04	0.06	0.13	0.14
Net income	$0.42	$ 0.52	$1.38	$ 1.21
Average common shares	146,043,791	145,569,692	145,892,396	145,421,798
Average diluted common shares	148,387,637	147,534,779	147,520,891	147,223,897

See accompanying Notes to Consolidated Financial Statements.

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

(millions)	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net income	$62	$76	$203	$179
Other comprehensive income (loss), net of tax:				
Derivatives qualifying as cash flow hedges:				
Loss on derivatives qualifying as cash flow hedges, net of tax expense (benefit) of ($1), $1, ($1), and $1, respectively	(2)	—	(6)	(1)
Less: Reclassification adjustment for loss on derivatives included in net income, net of tax benefit of ($1), $0, ($3), and $0, respectively	(2)	(2)	(6)	(7)
Net derivatives qualifying as cash flow hedges	—	2	—	6
Pension and postretirement benefits:				
Changes in pension and postretirement benefits, net of tax expense (benefit) of ($4), $1, ($7), and $2, respectively	(3)	4	(9)	2
Less: Amortization of prior service cost included in net periodic pension cost, net of tax benefit of ($1), $0, ($2), and ($1), respectively	—	(3)	(1)	(6)
Net pension and postretirement benefits	(3)	7	(8)	8
Foreign currency translation:				
Changes in foreign currency translation, net of tax expense of $0 in all periods	3	(52)	(9)	(91)
Other comprehensive loss, net of tax	$—	$(43)	$(17)	$(77)
Comprehensive income	$62	$33	$186	$102

See accompanying Notes to Consolidated Financial Statements.

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USG CORPORATION
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(millions, except share and per share data)	September 30, 2016	December 31, 2015
Assets		
Cash and cash equivalents	$ 634	$ 442
Short-term marketable securities	102	194
Restricted cash	—	9
Receivables (net of reserves - $13 and $9)	197	184
Inventories	228	219
Income taxes receivable	4	5
Other current assets	37	41
Assets related to discontinued operations	385	306
Total current assets	1,587	1,400
Long-term marketable securities	—	36
Property, plant and equipment (net of accumulated depreciation and depletion - $1,938 and $1,881)	1,700	1,771
Deferred income taxes	636	728
Equity method investments	674	682
Other assets	64	68
Assets related to discontinued operations	—	51
Total assets	$ 4,661	$ 4,736
Liabilities and Stockholders' Equity		
Accounts payable	$ 222	$ 208
Accrued expenses	165	186
Current portion of long-term debt	300	500
Income taxes payable	7	9
Litigation settlement accrual	—	9
Liabilities related to discontinued operations	118	80
Total current liabilities	812	992
Long-term debt	1,677	1,675
Deferred income taxes	3	5
Pension and other postretirement benefits	357	392
Other liabilities	183	216
Liabilities related to discontinued operations	—	20
Total liabilities	3,032	3,300
Preferred stock – $1 par value, authorized 36,000,000 shares; outstanding - none	—	—
Common stock – $0.10 par value; authorized 200,000,000 shares; issued: 2016 - 146,079,000 shares; 2015 - 145,667,000 shares	15	15
Additional paid-in capital	3,034	3,027
Accumulated other comprehensive loss	(331)	(314)
Retained earnings (accumulated deficit)	(1,089)	(1,292)
Total stockholders' equity	1,629	1,436
Total liabilities and stockholders' equity	$ 4,661	$ 4,736

See accompanying Notes to Consolidated Financial Statements.

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USG CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(millions)	Nine months ended September 30,	
	2016	2015
Operating Activities		
Net income	$203	$179
Less: income from discontinued operations	20	22
Income from continuing operations	183	157
Adjustments to reconcile net income to net cash:		
Depreciation, depletion and amortization	100	99
Loss on extinguishment of debt	5	19
Long-lived asset impairment charges	10	—
Recovery of receivable	(3)	—
Share-based compensation expense	14	9
Deferred income taxes	85	1
Gain on asset dispositions	(10)	(6)
Income from equity method investments	(37)	(35)
Dividends received from equity method investments	18	18
Pension settlement	3	(1)
(Increase) decrease in working capital:		
Receivables	(10)	(7)
Income taxes receivable	2	(4)
Inventories	(9)	(9)
Other current assets	—	1
Payables	10	(29)
Accrued expenses	(34)	(65)
Decrease in other assets	2	4
Decrease in pension and other postretirement benefits	(47)	(33)
Decrease in other liabilities	(9)	(7)
Other, net	12	15
Net cash provided by operating activities of continuing operations	285	127
Net cash provided by operating activities of discontinued operations	12	26
Net cash provided by operating activities	$297	$153
Investing Activities		
Purchases of marketable securities	(183)	(96)
Sales or maturities of marketable securities	310	132
Capital expenditures	(44)	(67)
Net proceeds from asset dispositions	12	42
Return of capital	1	—
Release (deposit) of restricted cash	9	(8)
Net cash provided by investing activities of continuing operations	105	3
Net cash used for investing activities of discontinued operations	(1)	—

Net cash provided by investing activities	$104	$3
Financing Activities		
Issuance of debt	—	350
Repayment of debt	(205)	(386)
Payment of debt issuance fees	—	(6)
Issuance of common stock	3	6
Repurchases of common stock to satisfy employee tax withholding obligations	(2)	(8)
Net cash used for financing activities of continuing operations	$(204)	$(44)
Effect of exchange rate changes on cash from continuing operations	(3)	(7)
Net increase in cash and cash equivalents from continuing operations	$183	$79
Net increase in cash and cash equivalents from discontinued operations	11	26
Change in cash balance included in discontinued operations	(2)	(1)
Net increase in cash and cash equivalents	192	104
Cash and cash equivalents at beginning of period	442	231
Cash and cash equivalents at end of period	$634	$335
Supplemental Cash Flow Disclosures:		
Interest paid, net of capitalized interest	$124	$128
Income taxes paid, net of refunds received	6	2
Noncash Investing and Financing Activities:		
Amount in accounts payable for capital expenditures	8	6
Reversal of USG Boral Building Products earnout	(24)	—

See accompanying Notes to Consolidated Financial Statements.

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USG CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
In the following Notes to Consolidated Financial Statements, “USG,” “we,” “our” and “us” refer to USG Corporation, a Delaware corporation, and its subsidiaries included in the 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 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, 2016 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 August 29, 2016, we announced the signing of a definitive agreement to sell L&W Supply Corporation, or L&W, our distribution business, to American Builders & Contractors Supply Co., Inc., or ABC Supply, at which time L&W met the criteria to be classified as held for sale and presented as a discontinued operation. L&W's results of operations have been reclassified to "Income from discontinued operations, net of tax" in our consolidated statements of income for all periods presented. The assets and liabilities of L&W have been reclassified to "Assets related to discontinued operations" and "Liabilities related to discontinued operations", respectively, in our consolidated balance sheets as of September 30, 2016 and December 31, 2015. The cash flows associated with L&W have been reclassified to "Net cash provided by operating activities of discontinued operations" and "Net cash used for investing activities of discontinued operations" for all periods presented. The results of L&W, which consists of our Distribution segment, have been excluded from segment results. Additionally, results of our Gypsum and Ceilings segments have been revised to reflect intercompany transactions as a result of L&W's classification as a discontinued operation. 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, our mining operation in Canada, which we indefinitely idled in the third quarter of 2016, and our shipping operations, which we exited in the second quarter of 2015. Gypsum manufactures products throughout the United States, Canada, Mexico and Latin America. 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 structural panel concrete roofing.
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. 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 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, 2015, which we filed with the SEC on February 10, 2016.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In August 2016, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,” which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The standard will be effective for us in

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the first quarter of 2018 and we will adopt the new standard using the retrospective approach. The significant components of this standard are as follows:

- Debt prepayments or extinguishment costs are to be classified as cash outflows for financing activities. Upon adoption we will reclassify these costs to financing activities.
- Equity method investments that are a return on investment should be classified as an operating activity where a return of investment should be classified as an investing activity. As we currently apply this methodology to our cash flow statement, there will be no impact.
- Insurance claims are to be classified based on the nature of the loss. As we currently apply this methodology to our cash flow statement, there will be no impact.

In March 2016, the FASB issued ASU 2016-09, “Improvements to Employee Share-Based Payment Accounting,” which simplifies certain aspects of accounting for employee share-based payments. The standard will be effective for us in the first quarter of 2017 and will be applied in part prospectively and in part using a modified retrospective transition approach. The components of this standard that will impact our financial statements are as follows:

- Excess tax benefits and deficiencies related to stock compensation will be prospectively recognized in income tax expense instead of in equity when the awards vest or are settled. For the nine months ended September 30, 2016 and 2015, we recorded a reduction to tax benefits to equity of $9 million and $0, respectively, that would have been recognized as $8 million net tax expense in 2016 and $4 million net tax benefit in 2015 under the new standard.
- Excess tax benefits that were previously unrecognized because the related tax deduction had not been realized through a reduction in taxes payable will be recorded on a modified retrospective basis. If we had early adopted this standard, we would have recorded a cumulative-effect adjustment to opening retained earnings of $25 million on our September 30, 2016 consolidated balance sheet.
- An accounting policy will be elected to either estimate forfeitures on awards, as previously required, or to recognize forfeitures as they occur. Upon adoption, we will recognize forfeitures as they occur and will record a cumulative-effect change to retained earnings in accordance with the modified retrospective adoption requirements. If we had early adopted this standard, we would have recorded an immaterial cumulative-effect adjustment to opening retained earnings on our September 30, 2016 consolidated balance sheet.

In February 2016, the FASB issued ASU 2016-02, “Leases,” 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. The standard will be effective for us in the first quarter of 2019, and we will adopt the new standard using the modified retrospective approach. While we continue to evaluate the impact of the new standard, we believe the standard will require us to implement a new lease accounting system and related processes. Further, we anticipate the adoption of ASU 2016-02 will have a significant impact to our consolidated balance sheets, consolidated statements of income and disclosures.

In January 2016, the FASB issued ASU 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities,” which requires that most equity instruments be measured at fair value, with subsequent changes in fair value recognized in net income. The pronouncement also impacts the financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. The ASU does not apply to equity method investments or investments in consolidated subsidiaries. The standard will be effective for us in the first quarter of 2018 and will be applied as a cumulative-effect adjustment to the balance sheet in the year of adoption. We do not expect the adoption of ASU 2016-01 will have a significant impact to our consolidated financial statements or disclosures.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory," which changes the measurement principle for inventory from the lower of cost or market to the lower of cost or net realizable value for entities that measure inventory using the first-in, first-out (FIFO) or average cost method. The ASU defines net realizable value as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The standard will be effective for us in the first quarter of 2017 and will be applied prospectively. We do not expect the adoption of ASU 2015-11 will have a significant impact to our consolidated financial statements or disclosures.

In May 2015, the FASB issued ASU 2015-07, "Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)," which updates the disclosure requirements for investments that are measured at net asset value using the practical expedient. These investments are to be removed from the fair value hierarchy and shown as a reconciling item. The standard was effective for us in the first quarter of 2016 and will be applied retrospectively. The update will be reflected in our disclosure for our December 31, 2016 Annual Report on Form 10-K.

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In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers,” 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. In March 2016, the FASB issued ASU 2016-08, “Revenue from Contracts with Customers - Principal versus Agent Considerations (Reporting revenue gross versus net),” which clarifies gross versus net revenue reporting when another party is involved in the transaction. In April 2016, the FASB issued ASU 2016-10, “Identifying Performance Obligations and Licensing,” and in May 2016, ASU 2016-12, “Revenues from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients” both of which provide supplemental adoption guidance and clarification to ASU 2014-09. The standard will be effective for us in the first quarter of 2018, and we will adopt the new standard using the retrospective approach with practical expedients. We do not expect that the adoption of ASU 2014-09, ASU 2016-08, ASU 2016-10 or ASU 2016-12 will have a significant impact to our consolidated financial statements or disclosures.

2. Discontinued Operations

On August 29, 2016, we announced the signing of a definitive agreement to sell our L&W business to ABC Supply for total cash consideration of $670 million, subject to a working capital adjustment. The sale is expected to close on October 31, 2016.

For the quarter ended September 30, 2016, L&W met the criteria to be classified as held for sale and to be presented as a discontinued operation. Accordingly, we reclassified the results of operations and the cash flows of L&W to discontinued operations in our consolidated statements of income and consolidated statements of cash flows for all periods presented. Additionally, we reclassified the assets and liabilities of L&W to discontinued operations in our consolidated balance sheets.

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,		Nine months ended September 30,	
	2016	2015	2016	2015
Net sales	$388	$378	$1,131	$1,076
Cost of products sold	370	364	1,080	1,043
Gross profit	18	14	51	33
Selling and administrative expenses [(a)]	7	6	18	11
Operating profit	11	8	33	22
Income tax expense	(5)	—	(13)	—
Income from discontinued operations	$6	$8	$20	$22

(a) The three and nine months ended September 30, 2016 include transaction costs of $3 million and $8 million, respectively. Prior to the third quarter of 2016, these costs were reported in Corporate selling and administrative expenses.

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The assets and liabilities related to discontinued operations are as follows:

(millions)	September 30, 2016	December 31, 2015
Cash	$ 2	$ —
Accounts receivable, net	231	207
Inventories	104	95
Other current assets	3	4
Property, plant and equipment, net [a]	17	17
Intangible assets [a]	25	31
Other assets [a]	3	3
Total assets related to discontinued operations	$ 385	$ 357
Accounts payable	$ 71	$ 51
Accrued expenses	29	29
Other liabilities [a]	18	20
Total liabilities related to discontinued operations	$ 118	$ 100

(a) As of December 31, 2015, these balances are reflected as long-term in our consolidated balance sheet.

After the completion of the sale of L&W to ABC Supply, we will retain responsibility for the benefits payable to employees of L&W from the USG pension and postretirement plans for the benefits accrued while employed by USG. As such, these liabilities are not reflected in liabilities related to discontinued operations. See Note 17 for discussion of the liability associated with the pricing lawsuit.

Additionally, upon closing of the sale of L&W, we will enter into a supply agreement with L&W and a transition services agreement with ABC Supply to provide certain transition services.

3. Long-Lived Asset Impairment Charges

In the third quarter of 2016, we indefinitely idled our mining operations in Little Narrows, Nova Scotia, Canada after completing a review of our gypsum sourcing needs. As a result, we recorded impairment charges of $10 million, which are included in our consolidated statements of income in "Long-lived asset impairment charges" for the three and nine months ended September 30, 2016. We recorded severance and other charges of $2 million for the termination of employees at the Little Narrows location, which are included in "Costs of products sold". Both the impairment and severance charges relate to our Gypsum segment.

4. Equity Method Investments

Equity method investments as of September 30, 2016 and December 31, 2015, were as follows:

	September 30, 2016		December 31, 2015	
(dollars in millions)	Carrying Value	Ownership Percentage	Carrying Value	Ownership Percentage
USG Boral Building Products	$ 667	50%	$ 675	50%
Other equity method investments	7	33% - 50%	7	33% - 50%
Total equity method investments	$ 674		$ 682	

Investment in USG Boral Building Products

UBBP is our 50/50 joint ventures with Boral Limited, or Boral, and consists of USG Boral Building Products Pte. Limited, a company organized under the laws of Singapore, and USG Boral Building Products Pty Limited, a company organized under the laws of Australia. It manufactures, distributes and sells certain building products, mines raw gypsum and sells natural and synthetic gypsum throughout Asia, Australasia and the Middle East (the Territory). The products that UBBP manufactures and distributes include products for wall, ceiling, floor lining and exterior systems that utilize gypsum, gypsum wallboard, referred

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to as plasterboard in the Territory, mineral fiber ceiling tiles, steel grid and joint compound. We account for our investment in UBBP using the equity method of accounting. Through the first nine months of 2016, UBBP paid cash dividends on earnings through March 2016 of which our 50% share totaled $18 million. We recorded the cash dividend in operating activities on our statements of cash flows. As of September 30, 2016, the amount of our consolidated retained earnings which represents undistributed earnings from UBBP is $60 million.

We formed the joint ventures with Boral on February 27, 2014. In the second quarter of 2016, we received $1 million from Boral for final customary working capital adjustments which resulted in a reduction of our investment. We recorded the working capital payment in investing activities on our statement of cash flows. In the event certain U.S. Dollar denominated performance targets are satisfied by UBBP, we will be obligated to pay Boral scheduled earnout payments in an aggregate amount up to $75 million, comprised first of $25 million based on performance during the first three years after closing and then up to $50 million based on performance during the first five years after closing. Upon inception of the joint ventures, we recorded a liability representing the present value of the first earnout payment which was reversed in the second quarter of 2016 as we concluded that it was no longer probable that the three-year performance target will be achieved. We have not recorded a liability for the second 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 was to change, we will record a liability representing the present value of the earnout payments with a corresponding increase to our investment. As of September 30, 2016 and December 31, 2015, our liability for the earnout payments was $0 and $24 million, respectively. As of December 31, 2015, the liability is included in "Other liabilities" on our accompanying consolidated balance sheet.

All of our investments accounted for under the equity method of accounting are initially recorded at cost, and subsequently adjusted for our share of the net income or loss and cash contributions and distributions to or from these entities. Because the underlying net assets in our investments are denominated in a foreign currency, translation gains or losses will impact the recorded value of our investments. Translation gains or losses recorded in other comprehensive income were as follows:

(millions)	Three months ended September 30, 2016	2015	Nine months ended September 30, 2016	2015
Translation gain (loss)	$13	$(35)	$ —	$(54)

Summarized financial information for our equity method investments is as follows:

(millions)	Three months ended September 30, 2016	2015	Nine months ended September 30, 2016	2015
USG Boral Building Products:				
Net sales	$276	$250	$778	$742
Gross profit [(a)]	90	69	241	200
Operating profit	41	30	105	87
Income from continuing operations before income taxes	42	32	112	94
Net income	29	25	78	71
Net income attributable to USG Boral Building Products	28	24	74	66
USG share of income from investment accounted for using the equity method	14	12	37	33
Other equity method investments:				
USG share of income from investments accounted for using the equity method	—	1	—	2

Total income from equity method investments	$14	$13	$37	$35

(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.

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Transactions with UBBP

Our Gypsum segment sells products to UBBP. Total sales to UBBP for the three and nine months ended September 30, 2016 and September 30, 2015 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, 2016 and December 31, 2015, the loan receivable, including interest, totaled $15 million and $14 million, respectively, and is included in "Other assets" on our accompanying consolidated balance sheets.

5. Segments

Our operations are organized into three reportable segments: Gypsum, Ceilings and UBBP. As discussed in Note 2, the results of our Distribution segment have been reclassified to discontinued operations. Additionally, as a result of the presentation of L&W as a discontinued operation, the 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 have been sold by L&W outside the consolidated group. See Note 4 for segment results for UBBP. Segment results for our Gypsum and Ceilings segments were as follows:

	Three months ended September 30,		Nine months ended September 30,	
(millions)	2016	2015	2016	2015
Net Sales:				
Gypsum	$635	$617	$1,899	$1,818
Ceilings	135	132	391	384
Eliminations	(3)	(2)	(7)	(7)
Total	$767	$747	$2,283	$2,195
Operating Profit (Loss):				
Gypsum	$89	$93	$310	$262
Ceilings	33	25	93	70
Corporate [(a)]	(25)	(24)	(68)	(71)
Total	$97	$94	$335	$261

(a) Transaction costs of $3 million and $8 million associated with the sale of L&W have been reclassified to discontinued operations for the three and nine months ended September 30, 2016, respectively.

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6. Earnings Per Share

Basic earnings per share is based on the weighted average number of common shares outstanding. Diluted earnings per share is based on the weighted average number of common shares outstanding plus the dilutive effect, if any, of market share units, or MSUs, performance shares, restricted stock units, or RSUs, stock options, and deferred shares associated with our deferred compensation program for non-employee directors.

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

	Three months ended September 30,		Nine months ended September 30,	
(millions, except per-share data)	2016	2015	2016	2015
Income from continuing operations	$56	$68	$183	$157
Income from discontinued operations, net of tax	6	8	20	22
Net income	$62	$76	$203	$179
Average common shares	146.0	145.6	145.9	145.4
Dilutive RSUs, MSUs, performance shares and stock options	2.2	1.8	1.6	1.6
Deferred shares associated with a deferred compensation program for non-employee directors	0.2	0.1	—	0.2
Average diluted common shares	148.4	147.5	147.5	147.2
Basic earnings per average common share:				
Income from continuing operations	$0.39	$0.46	$1.26	$1.08
Income from discontinued operations	0.04	0.06	0.13	0.15
Net income	$0.43	$0.52	$1.39	$1.23
Diluted earnings per average common share:				
Income from continuing operations	$0.38	$0.46	$1.25	$1.07
Income from discontinued operations	0.04	0.06	0.13	0.14
Net income	$0.42	$0.52	$1.38	$1.21

MSUs, performance shares, RSUs, and stock options and deferred shares associated with our deferred compensation program for non-employee directors that were not included in the computation of diluted earnings per share for those periods because their inclusion would be anti-dilutive were as follows:

	Three months ended September 30,		Nine months ended September 30,	
(millions, common shares)	2016	2015	2016	2015
MSUs, performance shares, RSUs and stock options	1.0	1.8	1.6	1.9
Deferred shares associated with a deferred compensation program for non-employee directors	—	—	0.2	—

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7. 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" on our accompanying consolidated balance sheets. Proceeds received from sales or maturities of marketable securities were as follows:

(millions)	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Proceeds received	$ 123	$ 29	$ 310	$ 132

Our investments in marketable securities consisted of the following:

(millions)	As of September 30, 2016		As of December 31, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Corporate debt securities	$ 65	$ 65	$ 134	$ 134
U.S. government and agency debt securities	32	32	57	57
Asset-backed debt securities	—	—	21	21
Certificates of deposit	5	5	15	15
Municipal debt securities	—	—	3	3
Total marketable securities	$ 102	$ 102	$ 230	$ 230

The realized and unrealized gains and losses for the three and nine months ended September 30, 2016 and 2015 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, 2016 were as follows:

(millions)	Amortized Cost	Fair Value
Due in 1 year or less	$ 102	$ 102
Due in 1-5 years	—	—
Total marketable securities	$ 102	$ 102

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

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8. Intangible Assets

Intangible assets are included in "Other assets" on our accompanying consolidated balance sheets. As discussed in Note 2, we signed a definitive agreement to sell our L&W business and reclassified its results to discontinued operations and reclassified assets and liabilities to discontinued operations on our consolidated balance sheets. The intangible assets attributable to L&W are excluded from the tables below.

Intangible assets with definite lives are amortized. These assets are summarized as follows:

	As of September 30, 2016			As of December 31, 2015		
(millions)	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Intangible assets with definite lives	$7	$ (6)	$ 1	$7	$ (6)	$ 1

Total amortization expense was immaterial for all periods presented. Estimated amortization expense for the remainder of 2016 and for future years is as follows:

(millions)	2016	2017	2018 and thereafter
Estimated future amortization expense	$ —	$ —	$ 1

Intangible assets with indefinite lives are not amortized. The gross carrying amount of these assets was $8 million as of both September 30, 2016 and December 31, 2015.

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9. Debt

Total debt, including the current portion of long-term debt, consisted of the following:

(millions)	September 30, 2016	December 31, 2015
5.5% senior notes due 2025	$ 350	$ 350
5.875% senior notes due 2021	350	350
6.3% senior notes due 2016	300	500
7.75% senior notes due 2018	500	500
7.875% senior notes due 2020, net of discount	249	249
Industrial revenue bonds (due 2028 through 2034)	239	239
Total	$ 1,988	$ 2,188
Less: Unamortized debt issuance costs	11	13
Total	$ 1,977	$ 2,175

REPURCHASE OF SENIOR NOTES

In the first nine months of 2016, we repurchased $200 million of our 6.3% Senior Notes due in 2016, referred to as the 6.3% Notes, on the open market. The transaction included premiums of $5 million and accrued interest of $4 million for aggregate consideration of $209 million. As a result of the repurchases, we recorded a loss on early extinguishment of debt, before tax, of $5 million including premiums, write-off of deferred financing fees and broker fees, of which $1 million occurred in the third quarter.

In the first quarter of 2015, we repurchased $350 million of our 8.375% Senior Notes due in 2018, referred to as the 8.375% Notes, through both a cash tender offer and a subsequent notice of redemption of the remaining 8.375% Notes. We completed a cash tender offer pursuant to which we repurchased $126 million of the 8.375% Notes for aggregate consideration, including tender offer premium and accrued and unpaid interest, of $135 million. We repurchased the remaining $224 million of the 8.375% Notes for aggregate consideration, including premiums and accrued and unpaid interest, of $242 million. As a result of the repurchases, we recorded a loss on early extinguishment of debt of $19 million including premiums and write-off of deferred financing fees.

Also in the first quarter of 2015, we issued $350 million of 5.5% Senior Notes due March 1, 2025. The net proceeds from the issuance of these notes and cash on hand were used to fund the repurchases of the 8.375% Notes and all related costs and expenses. We deferred approximately $6 million of debt issuance costs that are being amortized to interest expense over the term of the notes. As of September 30, 2016 and December 31, 2015, these notes, net of unamortized debt issuances costs, were recorded on our accompanying consolidated balance sheets at $345 million and $344 million, respectively.

CREDIT FACILITY

Taking into account the most recent borrowing base calculation delivered under the credit facility, which reflects trade receivables and inventory as of September 30, 2016, and outstanding letters of credit, borrowings available under the credit facility were approximately $337 million, including $50 million for CGC. As of September 30, 2016 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 2.10% for loans in the US and 2.15% for loans in Canada. Outstanding letters of credit totaled $46 million as of September 30, 2016.

The fair value of our debt was approximately $2.091 billion as of September 30, 2016 and $2.295 billion as of December 31, 2015. The fair values were based on quoted prices for identical or similar liabilities in markets that are not active or valuation models in which all significant inputs are observable and, as a result, are classified as Level 2 inputs. See Note 11 for further discussion on fair value measurements and classifications.

As of September 30, 2016, we were in compliance with the covenants contained in our credit facilities.

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10. 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 four years. Cash flows from derivative instruments are included in net cash provided by operating activities in the consolidated statements of cash flows.

COMMODITY DERIVATIVE INSTRUMENTS

As of September 30, 2016, we had outstanding natural gas swap contracts to hedge forecasted purchases with an aggregate notional amount of 31 million mmBTUs (millions of British Thermal Units). All of these contracts mature by December 31, 2020. For contracts designated as cash flow hedges, the pre-tax net unrealized loss that remained in accumulated other comprehensive income (loss), or AOCI, as of September 30, 2016 was $7 million and as of December 31, 2015 was $19 million. No ineffectiveness was recorded on contracts designated as cash flow hedges in the first nine months of both 2016 and 2015. 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. Changes in fair value on contracts not designated as cash flow hedges are recorded to earnings. The fair value of those contracts not designated as cash flow hedges was immaterial as of September 30, 2016 and a $2 million unrealized loss as of December 31, 2015.

FOREIGN EXCHANGE DERIVATIVE INSTRUMENTS

We have foreign exchange forward contracts to hedge forecasted purchases of products and services denominated in foreign currencies. The notional amount of these contracts was $101 million as of September 30, 2016, and they mature by December 31, 2017. These forward contracts are designated as cash flow hedges and no ineffectiveness was recorded in the first nine months of both 2016 and 2015. Gains and losses on the contracts are reclassified into earnings when the underlying forecasted transactions affect earnings. The fair value of these contracts that remained in AOCI was an unrealized net pre-tax loss of $1 million as of September 30, 2016 and an unrealized net pre-tax gain of $8 million as of December 31, 2015.

In the third quarter of 2015, we entered into foreign exchange forward contracts to hedge a portion of our net investment in our Knauf-USG joint venture which we sold in the fourth quarter of 2015. The notional amount of these contracts was $35 million as of September 30, 2015, and they matured on November 16, 2015. These forward contracts were designated as net investment hedges and no ineffectiveness was recorded in the third quarter of 2015. Gains and losses on derivatives designated as net investment hedges, to the extent they are effective as hedges, remain in AOCI until such point when the investment is either sold or liquidated. The fair value of these contracts that remained in AOCI was an immaterial gain as of September 30, 2015.

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, 2016, our derivatives were in a $8 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 $8 million of collateral posted with our counterparties related to our derivatives as of September 30, 2016. Amounts paid as cash collateral are included in "Receivables" on our accompanying 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 consolidated balance sheets, based on their fair value as of the balance sheet date.

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FINANCIAL STATEMENT INFORMATION

The following are the pretax effects of derivative instruments on the consolidated statements of income for the three months ended September 30, 2016 and 2015.

(millions)	Amount of Gain or (Loss) Recognized in Other Comprehensive Income on Derivatives (Effective Portion)		Location of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	
	2016	2015		2016	2015
Derivatives in Cash Flow Hedging Relationships					
Commodity contracts	$ (4)	$ (5)	Cost of products sold	$ (3)	$ (4)
Foreign exchange contracts	1	6	Cost of products sold	—	2
Derivatives in Net Investment Hedging Relationships					
Foreign exchange contracts	—	—	Other income, net	—	—
Total	$ (3)	$ 1		$ (3)	$ (2)

(millions)	Location of Gain or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives	
		2016	2015
Derivatives Not Designated as Hedging Instruments			
Commodity contracts	Cost of products sold	$ —	$ (1)
Total		$ —	$ (1)

The following are the pretax effects of derivative instruments on the consolidated statements of income for the nine months ended September 30, 2016 and 2015.

(millions)	Amount of Gain or (Loss) Recognized in Other Comprehensive Income on Derivatives (Effective Portion)		Location of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from AOCI into Income (Effective Portion)	
	2016	2015		2016	2015
Derivatives in Cash Flow Hedging Relationships					
Commodity contracts	$ (2)	$ (9)	Cost of products sold	$(13)	$(11)

Foreign exchange contracts	(5)	9	Cost of products sold	4	4
Derivatives in Net Investment Hedging Relationships					
Foreign exchange contracts	—	—	Other income, net	—	—
Total	$ (7)	$ —		$(9)	$(7)

(millions)	Location of Gain or (Loss) Recognized in Income on Derivatives	Amount of Gain or (Loss) Recognized in Income on Derivatives 2016	2015
Derivatives Not Designated as Hedging Instruments			
Commodity contracts	Cost of products sold	$ —	$ (1)
Total		$ —	$ (1)

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The following are the fair values of derivative instruments and the location on our accompanying consolidated balance sheets as of September 30, 2016 and December 31, 2015.

	Balance Sheet Location	Fair Value		Balance Sheet Location	Fair Value	
(millions)		9/30/16	12/31/15		9/30/16	12/31/15
Derivatives in Cash Flow Hedging Relationships						
Commodity contracts	Other current assets	$ 2	$ 1	Accrued expenses	$6	$ 15
Commodity contracts	Other assets	2	—	Other liabilities	5	5
Foreign exchange contracts	Other current assets	1	8	Accrued expenses	2	—
Foreign exchange contracts	Other assets	—	—	Other liabilities	—	—
Total derivatives in cash flow hedging relationships		$ 5	$ 9		$13	$ 20
Derivatives Not Designated as Hedging Instruments						
Commodity contracts	Other current assets	$—	$—	Accrued expenses	$—	$2
Total derivatives not designated as hedging instruments		$—	$—		$—	$2
Total derivatives	Total assets	$5	$9	Total liabilities	$13	$22

As of September 30, 2016, we had no derivatives designated as fair value hedges or net investment hedges.

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11. 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. Level 1 is defined as observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities that a company has the ability to access. Level 2 is defined as inputs, other than the quoted prices included in Level 1, which are observable for the asset or liability, either directly or indirectly. Level 3 is defined as unobservable inputs for the asset or liability which is typically based on a company's own assumptions where there is little, if any, related market data available.

The cash equivalents and equity mutual funds shown in the table below primarily consist of money market funds that are valued based on quoted prices in active markets and, as a result, are classified as Level 1. We use quoted prices, other readily observable market data and internally developed valuation models when valuing our marketable securities and derivatives and have classified them as Level 2. Marketable securities are valued using income and market value approaches and values are based on quoted prices or other observable market inputs received from data providers. The valuation process may include pricing matrices, or prices based upon yields, credit spreads or prices of securities of comparable quality, coupon, maturity and type. Derivatives are valued using the income approach including discounted-cash-flow models or a Black-Scholes option pricing model 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.

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

	Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)		Total	
(millions)	9/30/16	12/31/15	9/30/16	12/31/15	9/30/16	12/31/15	9/30/16	12/31/15
Cash equivalents	$ 153	$ 223	$ 134	$ 25	$ —	$ —	$ 287	$ 248
Equity mutual funds	5	4	—	—	—	—	5	4
Marketable securities:								
Corporate debt securities	—	—	65	134	—	—	65	134
U.S. government and agency debt securities	—	—	32	57	—	—	32	57
Asset-backed debt securities	—	—	—	21	—	—	—	21
Certificates of deposit	—	—	5	15	—	—	5	15
Municipal debt securities	—	—	—	3	—	—	—	3
Derivative assets	—	—	5	9	—	—	5	9
Derivative liabilities	—	—	(13)	(22)	—	—	(13)	(22)

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 3, we recorded long-lived asset impairment charges of $10 million.

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12. Employee Retirement Plans

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

	Three months ended September 30,		Nine months ended September 30,	
(millions)	2016	2015	2016	2015
Pension:				
Service cost of benefits earned	$11	$12	$34	$37
Interest cost on projected benefit obligation	17	16	51	50
Expected return on plan assets	(22)	(20)	(66)	(62)
Settlement	1	1	3	1
Net amortization	5	10	14	29
Net pension cost	$12	$19	$36	$55
Postretirement:				
Service cost of benefits earned	$1	$1	$2	$2
Interest cost on projected benefit obligation	1	1	4	4
Net amortization	(7)	(8)	(21)	(24)
Net postretirement benefit\	$(5)	$(6)	$(15)	$(18)

The amounts in the table above include the costs associated with the employees of L&W that are presented in discontinued operations. After the completion of the sale of L&W to ABC Supply, we will retain responsibility for the benefits payable to employees of L&W for the benefits accrued while employed by USG from the USG pension and postretirement plans.

During the first nine months of 2016, we made cash contributions of $50 million to the USG Corporation Retirement Plan Trust, $6 million to our pension plan in Canada, and $8 million, in aggregate, to certain other domestic pension plans. We expect to make total contributions to our pension plans in 2016 of approximately $65 million. Subsequent to the sale of L&W, we may make an incremental contribution to the USG Corporation Retirement Plan.

In the third quarter of 2016, management approved an amendment to the USG Corporation Retirement Plan to allow retirees and terminated vested participants to take a lump-sum payment at any time without restriction upon departure from USG. The amendment is effective on November 1, 2016 and is expected to reduce the projected benefit obligation and pension costs.

13. Share-Based Compensation

During the first nine months of 2016, 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 Long-Term Incentive Plan and 2016 Long-Term Incentive Plan that was approved at our 2016 annual meeting of stockholders. 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. Expense is generally reduced for estimated forfeitures. Awards granted during the first nine months of 2016, weighted average fair value, and assumptions used to determine fair value were as follows:

	MSUs	Performance Shares	RSUs
Awards granted	800,834	213,626	66,000
Weighted average fair value	$19.59	$ 21.10	$23.47
Expected volatility	34.02 %	34.02 %	N/A
Risk-free rate (a)	0.86 %	0.86 %	N/A
Expected term (in years) (b)	2.95	2.95	N/A
Expected dividends	—	—	N/A

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

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

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MARKET SHARE UNITS

The MSUs granted during the first nine months of 2016 generally vest after a three-year period based on our actual stock price performance during such period. The number of MSUs earned will vary from zero to 150% of the number of MSUs awarded depending on the actual performance of our stock price. In the case of termination of employment due to death, disability or retirement during the performance period, vesting will be pro-rated based on the number of full months employed in 2016. Each MSU earned will be settled in common stock at the end of the three-year period. MSUs may vest earlier in the case of a change in control in most circumstances only if there is also a related loss of employment or diminution of duties.

We estimated the fair value of each MSU granted on the date of grant using a Monte Carlo simulation that used the assumptions noted in the table above. Volatility was based on stock price history immediately prior to grant for a period commensurate with the expected term.

PERFORMANCE SHARES

The performance shares granted during the first nine months of 2016 generally vest after a three-year period based on our total stockholder return relative to the performance of the Dow Jones U.S. Construction and Materials Index, with adjustments to that index in certain circumstances, for the three-year period. The number of performance shares earned will vary from zero to 200% of the number of performance shares granted depending on that relative performance. Generally, vesting will be pro-rated based on the number of full months employed during the performance period in the case of death, disability, or retirement. Each performance share earned will be settled in common stock at the end of the three-year period.

We estimated the fair value of each performance share granted on the date of grant using a Monte Carlo simulation that used the assumptions noted in the table above. Volatility was based on stock price history immediately prior to grant for a period commensurate with the expected term.

RESTRICTED STOCK UNITS

The RSUs granted during the first nine months of 2016 vest after a specified number of years from the date of grant or at a specified date, subject to cliff vesting. Generally, RSUs may vest earlier in the case of death, disability, or a change in control, provided that RSUs will vest upon a change in control in most circumstances only if there is also a related loss of employment or diminution of duties. Each RSU is settled in a share of our common stock after the vesting period. The fair value of each RSU granted is equal to the closing price of our common stock on the date of grant.

OTHER

Expense for share-based arrangements on grants to employees of L&W has been included in discontinued operations. Upon the close of the sale of L&W to ABC Supply, all unvested awards granted to L&W employees will be forfeited.

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14. Supplemental Balance Sheet Information

INVENTORIES

Total inventories consisted of the following:

(millions)	September 30, 2016	December 31, 2015
Finished goods	$ 124	$ 115
Work in progress	35	36
Raw materials	69	68
Total	$ 228	$ 219

ASSET RETIREMENT OBLIGATIONS

Changes in the liability for asset retirement obligations consisted of the following:

	Nine months ended September 30,	
(millions)	2016	2015
Balance as of January 1	$119	$123
Accretion expense	6	6
Liabilities incurred	—	1
Changes in estimated cash flows [a]	(11)	(4)
Liabilities settled [b]	(2)	(2)
Foreign currency translation	1	(4)
Balance as of September 30	$113	$120

(a) Changes in estimated cash flows for the nine months ended September 30, 2016 includes a $8 million reduction related to one of our quarries.

(b) Liabilities settled for the nine months ended September 30, 2016 includes a $2 million liability that was relieved in conjunction with the sale of a surplus property.

ACCRUED INTEREST

Interest accrued on our debt as of September 30, 2016 and December 31, 2015 was $31 million and $45 million, respectively, and is included in "Accrued expenses" on our accompanying consolidated balance sheets.

ASSET DISPOSITIONS

In the second quarter of 2016, we recorded a gain of $11 million, or $7 million net of tax, on the sale of a surplus property. The sale relieved the Company of an asset retirement obligation, as noted in the above table, and included the sale of raw material inventory on hand at the surplus location. The pre-tax gain was recorded in cost of products sold within our Gypsum segment.

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15. Accumulated Other Comprehensive Income (Loss)

Changes in the balances of each component of AOCI for the nine months ended September 30, 2016 and 2015 were as follows:

	Derivatives		Defined Benefit Plans		Foreign Currency Translation		AOCI	
(millions)	2016	2015	2016	2015	2016	2015	2016	2015
Balance as of January 1	$20	$16	$(221)	$(302)	$(113)	$(52)	$(314)	$(338)
Other comprehensive income (loss) before reclassifications, net of tax	(6)	(1)	(9)	2	(9)	(91)	(24)	(90)
Less: Amounts reclassified from AOCI, net of tax	(6)	(7)	(1)	(6)	—	—	(7)	(13)
Net other comprehensive income (loss)	—	6	(8)	8	(9)	(91)	(17)	(77)
Balance as of September 30	$20	$22	$(229)	$(294)	$(122)	$(143)	$(331)	$(415)

Amounts reclassified from AOCI, net of tax, for the three and nine months ended September 30, 2016 and 2015, were as follows:

	Three months ended September 30,		Nine months ended September 30,	
(millions)	2016	2015	2016	2015
Derivatives				
Net reclassification from AOCI for cash flow hedges included in cost of products sold	$(3)	$(2)	$(9)	$(7)
Less: Income tax benefit on reclassification from AOCI included in income tax (expense) benefit	(1)	—	(3)	—
Net amount reclassified from AOCI	$(2)	$(2)	$(6)	$(7)
Defined Benefit Plans				
Net reclassification from AOCI for amortization of prior service benefit included in cost of products sold [(a)]	$(2)	$(1)	$(5)	$(3)
Net reclassification from AOCI for amortization of prior service cost included in selling and administrative expenses [(a)]	1	(2)	2	(4)
Less: Income tax benefit on reclassification from AOCI included in income tax (expense) benefit	(1)	—	(2)	(1)
Net amount reclassified from AOCI	$—	$(3)	$(1)	$(6)

(a) Includes immaterial amounts related to L&W employees that are recorded to "Income from discontinued operations".

We estimate that we will reclassify a net $3 million after-tax loss on derivatives from AOCI to earnings within the next 12 months.

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16. Income Taxes

In the third quarter of 2016, we recorded income tax expense of approximately $18 million. The income tax expense for the three months reflects taxes from federal, foreign, state and local jurisdictions. Our effective tax rate was 24.3%. Our effective tax rate was lower than the U.S. statutory rate primarily because of earnings realized in countries that had lower statutory tax rates, because of our equity method income, which is recorded net of tax, and because of our allocation of income taxes to discontinued operations. Our effective tax rate in the future will depend on the portion of our profits earned within and outside the United States.

In the nine months ended September 30, 2016, we recorded income tax expense of $78 million reflecting taxes from federal, foreign, state and local jurisdictions. Our effective tax rate for the first nine months was 29.9%.

As of September 30, 2016, we had federal net operating loss, or NOL, carryforwards of approximately $1.525 billion that are available to offset future federal taxable income and will expire in the years 2026 through 2032, none of which are subject to Internal Revenue Code limitations under Section 382. In addition, as of that date, we had federal AMT credit carryforwards of approximately $40 million that are available to reduce future regular federal income taxes over an indefinite period. In order to fully realize these U.S. federal net deferred tax assets, taxable income of approximately $1.64 billion would need to be generated during the period before their expiration.

As of September 30, 2016, we had a gross deferred tax asset related to our state NOLs and tax credit carryforwards of $220 million, of which $27 million will expire in 2016. The remainder will expire if unused in years 2017 through 2035. We also had NOL and tax credit carryforwards in various foreign jurisdictions in the amount of $1 million as of September 30, 2016, against which we have maintained a valuation allowance.

A reduction of the carrying amounts of deferred tax assets by a valuation allowance is required if, based on all available evidence, it is more likely than not that such assets will not be realized. The need to establish valuation allowances for deferred tax assets is assessed at each reporting date. In assessing the requirement for, and amount of, a valuation allowance in accordance with the more-likely-than-not standard, we give appropriate consideration to all positive and negative evidence related to the realization of the deferred tax assets. This assessment considers, among other matters, the nature, frequency and severity of current and cumulative losses, forecasts of future profitability, the duration of statutory carryforward periods, our experience with operating loss and tax credit carryforwards not expiring unused a