# Management's Discussion and Analysis

## Overview

We intend this discussion to provide information that will assist in understanding our 31 March 2005 consolidated financial statements, the changes in significant items in those consolidated financial statements from year to year, and the primary reasons for those changes. This discussion includes information about our critical accounting policies and how these policies affect our consolidated financial statements and information about the consolidated financial results of each business segment to provide a better understanding of how each segment and its results affect our financial condition and operating results as a whole. Our 31 March 2005 consolidated financial statements and the notes accompanying those consolidated financial statements should be read in conjunction with this discussion. In addition, during fiscal year 2005, we incurred significant costs associated with the Special Commission of Inquiry (the "SCI") and other related matters. We have continued to incur material costs associated with the SCI and other related matters and expect to incur such costs in the short-term. Information regarding the SCI and other related matters can be found in this discussion and in Note 13 of our consolidated financial statements on pages 112 –120.

**The Company and the Building Product Markets**

Based on net sales, we believe we are the largest manufacturer of fibre cement products and systems for internal and external building construction applications in the United States, Australia, New Zealand and the Philippines and the second largest manufacturer of flat sheet products in Chile. Our current primary geographic markets include the United States, Australia, New Zealand, the Philippines, Chile and Europe. Through significant research and development expenditure, we develop key product and production process technologies that we patent or hold as trade secrets. We believe that these technologies give us a competitive advantage in the markets in which we sell our products.

We manufacture numerous types of fibre cement products with a variety of patterned profiles and surface finishes for a range of applications including external siding and soffit lining, trim, roofing, internal linings, facades, floor and tile underlayments, drainage pipes and decorative columns. Our products are used in various market segments, including new residential construction, manufactured housing, repair and remodel and a variety of commercial and industrial construction applications. We believe that in certain construction applications, our fibre cement products and systems provide a combination of distinctive performance, design and cost advantages over competing building products and systems.

Our products are primarily sold to the residential housing markets. Residential construction fluctuates based on the levels of new home construction activity and the repair and remodeling of existing homes. These levels of activity are affected by many factors including home mortgage interest rates, inflation rates, unemployment levels, existing home sales, the average age and the size of housing inventory, consumer home repair and remodel spending, gross domestic product growth and consumer confidence levels. These factors were generally favourable during fiscal year 2005, resulting in healthy levels of residential construction and home repair and remodel activity.

**Fiscal Year 2005 Key Results**

Total net sales increased 23% to US$1,210.4 million in fiscal year 2005, EBIT increased 14% to US$196.2 million, and operating profit from continuing operations increased 2% to US$127.9 million.

Our largest market is North America, where fibre cement is one of the fastest growing segments of the external siding market. During fiscal year 2005, USA Fibre Cement net sales contributed approximately 78% of total net sales, and its EBIT was the primary contributor of total company EBIT. Net sales increased due to increased sales volume and a higher average net selling price. EBIT increased from fiscal year 2004, primarily due to growth in net sales, partly offset by an increase in unit cost of sales, unit freight cost, general liability insurance and selling, general and administrative expenses.

Asia Pacific net sales contributed approximately 20% of total net sales, and its EBIT was the second largest contributor of total company EBIT. Net sales increased in fiscal year 2005 in both our Australia and New Zealand and our Philippines Fibre Cement businesses. In our Australia and New Zealand business, this increase was primarily due to favourable foreign currency exchange rates. EBIT increased primarily due to cost savings and the impact of a cost provision recorded in the fiscal year 2004 that did not recur in fiscal year 2005 related to our Australia and New Zealand business and favourable foreign currency exchange rate differences.

In our emerging businesses of Chile Fibre Cement, Europe Fibre Cement and USA Hardie Pipe, we continued to make good progress. Our Chilean business recorded a small positive EBIT in each quarter of fiscal year 2005. Our USA Hardie Pipe business significantly reduced its EBIT loss compared to fiscal year 2004. Our Europe Fibre Cement Business incurred an EBIT loss for fiscal year 2005 as expected as we continued to build awareness of our products among distributors, builders and contractors, and added further distribution outlets in both the UK and French markets. In addition, our Artisan™ Roofing business is continuing to prove its business model and remains focused on market testing, refining the manufacturing operation and improving productivity.

| (Millions of US dollars) | 2005 | 2004 | % Change |
|---|---|---|---|
| Net Sales | | | |
| USA Fibre Cement | **$ 939.2** | $ 738.6 | 27 |
| Asia Pacific Fibre Cement | **236.1** | 219.8 | 7 |
| Other Fibre Cement | **35.1** | 23.5 | 49 |
| Total Net Sales | **$1,210.4** | $ 981.9 | 23 |
| Net Sales | **$1,210.4** | $ 981.9 | 23 |
| Cost of goods sold | **(784.0)** | (623.0) | 26 |
| Gross profit | **426.4** | 358.9 | 19 |
| Selling, general and administrative expenses | **(174.5)** | (162.0) | 8 |
| Research and development expenses | **(21.6)** | (22.6) | (4) |
| Special Commission of Inquiry and other related expenses | **(28.1)** | – | – |
| Other operating expenses | **(6.0)** | (2.1) | – |
| EBIT | **196.2** | 172.2 | 14 |
| Net interest expense | **(5.1)** | (10.0) | (49) |
| Other (expense) income | **(1.3)** | 3.5 | – |
| Operating profit from continuing operations before income taxes | **189.8** | 165.7 | 15 |
| Income tax expense | **(61.9)** | (40.4) | 53 |
| Operating Profit From Continuing Operations | **$ 127.9** | $ 125.3 | 2 |
| Net Operating Profit Including Discontinued Operations | **$ 126.9** | $ 129.6 | (2) |
| Effective tax rate from continuing operations | **32.6%** | 24.4% | |
| Volume (mmsf) | | | |
| USA Fibre Cement | **1,855.1** | 1,519.9 | 22 |
| Asia Pacific Fibre Cement* | **376.9** | 362.1 | 4 |
| Average net sales price per unit (per msf) | | | |
| USA Fibre Cement | **US$ 506** | US$ 486 | 4 |
| Asia Pacific Fibre Cement* | **A$ 846** | A$ 862 | (2) |

*See **Endnotes** on page 58
All results are for continuing operations unless otherwise stated.

## Total Net Sales

Total net sales increased 23% compared to the same period of the previous year, from US$981.9 million to US$1,210.4 million.

Net sales from USA Fibre Cement increased 27% from US$738.6 million to US$939.2 million due to continued strong growth in sales volumes and a higher average net sales price.

Net sales from Asia Pacific Fibre Cement increased 7% from US$219.8 million to US$236.1 million due to increased sales volumes and favourable foreign currency movements.

Net sales from Other Fibre Cement increased 49% from US$23.5 million to US$35.1 million as the Chilean flat sheet business, the USA Hardie Pipe business and Europe Fibre Cement business continued to grow.

## USA Fibre Cement

Net sales increased 27% from US$738.6 million to US$939.2 million due to increased sales volumes and a higher average net sales price.

Sales volume increased 22% from 1,519.9 million square feet to 1,855.1 million square feet, primarily due to continued strong growth in primary demand for fibre cement and a favourable housing construction market.

New residential housing construction remained buoyant during the year due to strong consumer demand and low inventories of houses for sale, fuelled by low interest rates, solid house prices and a strengthening domestic economy.

We continued to grow sales in both our emerging and established geographic markets and in our exterior and interior product markets.

Further market share was gained in our emerging geographic markets as our exterior products continued to penetrate against alternative materials, primarily wood-based and vinyl siding. There continued to be growth in sales of higher-priced, differentiated products such as vented soffits, Heritage® panels, the ColorPlus™ Collection of pre-painted siding and Harditrim® XLD® Planks.

There were further market share gains in the interior products market, with sales of Hardibacker® 500 half-inch backerboard up strongly compared to the previous year.

The average net sales price increased 4% from US$486 per thousand square feet to US$506 per thousand square feet. The increase was due to proportionally stronger growth of differentiated, higher priced products, including Harditrim®, vented soffit and the ColorPlus™ Collection, and price increases for some products that became effective on 1 July 2004 and 1 January 2005.

Our West Coast manufacturing capacity increased during the year with the addition of our new fibre cement plant in Reno, Nevada. The plant began producing product in the fourth quarter and its ramp-up is progressing well. At year end, we were in pre-production with our new 160 million square foot trim line in Peru, Illinois. Also during the year, we added pre-finishing capacity in Peru, Illinois and began construction of our tenth plant in Pulaski, Virginia.

## Asia Pacific Fibre Cement*

Net sales increased 7% from US$219.8 million to US$236.1 million. Net sales increased 1% in Australian dollars. Sales volume increased 4% from 362.1 million square feet to 376.9 million square feet.

**Australia and New Zealand Fibre Cement**
Net sales increased 8% from US$195.5 million to US$210.1 million due to a higher average net sales price and favourable foreign currency movements. In Australian dollars, net sales increased 1%.

Sales volumes decreased from 284.2 million square feet to 283.3 million square feet primarily due to weaker market conditions in Australia and the impact of product bans and boycotts in Australia connected with the SCI and release of the SCI report.

In Australia, new residential housing activity improved early in the year, led by buoyant activity in Queensland, and the renovation and commercial segments also remained strong early. However, both new residential housing and renovations activity softened over the year.

In New Zealand, new residential housing activity was robust in the first half year but softened slightly during the second half. Sales of our Linea® weatherboards continued to grow strongly. The average net sales price increased 1% in Australian dollars.

During the year, we launched Eclipsa™ Eaves Lining, a new pre-painted eave product, across Australia. Eclipsa™ offers cost benefits and construction advantages over non-painted eave products and we expect that it will be received favourably by builders.

**Philippines Fibre Cement**
Net sales increased 25% from US$20.8 million to US$26.0 million. In local currency, net sales increased 27%. This increase was due to a 20% increase in sales volume and a 5% increase in the average net sales price.

The increase in the average net sales price was due to a change in sales mix between domestic and export sales and higher domestic prices in the second half of the year.

Increased market penetration and regional exports resulted in significantly stronger demand during the year.

## Other Fibre Cement

**Chile Fibre Cement**
Our Chilean business continued to increase its penetration of the domestic flat sheet market and increased sales of higher-priced, differentiated products, and increased regional exports.

Net sales increased compared to the previous year, due to growth in sales volume and a higher average net sales price. In local currency, the average net sales price decreased primarily due to the impact of a weaker US dollar on export prices, partly offset by higher domestic prices and a change in the sales mix.

Construction activity in Chile continued to show signs of improvement during the year.

**USA Hardie Pipe**
Our USA Hardie Pipe business continued to penetrate the Florida market of the United States and to improve its manufacturing efficiency.

Net sales for the year increased strongly due to increased sales volumes and higher prices despite severe weather in Florida that adversely affected sales in the first half of the year. The increase in sales volume was due to market share gains and buoyant construction activity in Florida.

The average net sales price improved strongly during the year, reflecting favourable market conditions and improved customer focus by the business.

The manufacturing performance of our plant also improved significantly during the year, but operating costs remain above our targets.

* See **Endnotes** on page 58

### Europe Fibre Cement

Our European business continued to grow demand during the year by building awareness of our products among distributors, builders and contractors, and by adding further distribution outlets in both the UK and French markets.

Sales have continued to build steadily since commencement of operations in the first quarter of the previous fiscal year. Progress on creating primary demand in Europe for fibre cement siding products and converting tile applications from drywall and wood to fibre cement products, remains in line with management expectations.

### Artisan™ Roofing

In June 2003, we completed construction and began production trials at our pilot roofing plant in Fontana, California. The pilot plant, which has a design capacity of 25 million square feet, was built to test our proprietary manufacturing technology and to provide product for market testing in Southern California.

The business is continuing to prove its business model and remains focused on market testing, refining the manufacturing operation and improving productivity.

Our Artisan™ Roofing product, made from a new lightweight concrete roofing technology, has now been launched in all our targeted markets in California.

## Gross Profit

Gross profit increased 19% from US$358.9 million to US$426.4 million due to improvements in our major businesses. The gross profit margin decreased 1.4 percentage points to 35.2%.

USA Fibre Cement gross profit increased 19% due to higher net sales, partly offset by an increase in unit cost of sales and increased freight costs. The higher unit cost of sales resulted primarily from increased sales of higher-priced, differentiated products, higher pulp and cement costs, maintenance expenses and a temporary reduction in manufacturing efficiency at some plants that occurred during the second quarter. Higher freight costs were primarily related to an increase in length of haul of some products due to supply issues associated with a temporary reduction in plant manufacturing efficiency in the second quarter, and higher fuel costs and general liability insurance. The gross profit margin decreased 2.6 percentage points.

Asia Pacific Fibre Cement gross profit increased 11% following improvements from Australia and New Zealand Fibre Cement and Philippines Fibre Cement, which increased 8% and 53%, respectively. The improved result was due to manufacturing efficiency gains in both Australia and New Zealand and increased net sales in New Zealand, partly offset by reduced net sales in Australia attributable to weaker market conditions and product bans and boycotts in Australia connected with the SCI and release of its report. In the Philippines, increased sales accounted for the stronger gross profit performance. The Asia Pacific Fibre Cement gross profit margin increased 1.2 percentage points.

## Selling, General and Administrative (SG&A) Expenses

SG&A expenses increased 8% compared to the previous year, from US$162.0 million to US$174.5 million. The increase in SG&A expenses was due mainly to increased sales and marketing, information technology and other expenses associated with growth initiatives in the United States. As a percentage of sales, SG&A expenses for the year were 2.1 percentage points lower at 14.4%.

## Research and Development Expenses

Research and development expenses include costs associated with "core" research projects that are designed to benefit all fibre cement business units. These costs are recorded in the Research and Development segment rather than being attributed to individual business units. These costs decreased 15% for the year, to US$12.0 million.

Other research and development costs associated with commercialisation projects in business units are included in the business related unit segment results. In total, these costs increased 13% to US$9.6 million for the year.

## SCI and Other Related Expenses

In February 2004, the NSW Government, Australia, established a SCI to investigate, among other matters, the circumstances in which the Medical Research and Compensation Foundation (the "Foundation") was established. Shortly after release of the SCI report on 21 September 2004, we commenced negotiations with the NSW Government, the Australian Council of Trade Unions, UnionsNSW and a representative of asbestos claimants in relation to our offer made to the SCI on 14 July 2004 to provide funds voluntarily for proven Australian-based asbestos-related injury and death claims against certain former James Hardie Australian subsidiaries. On 21 December 2004, we entered into a Heads of Agreement with the above parties to establish and fund a special purpose fund to provide funding for these claims on a long-term basis. We have subsequently entered into negotiations with the NSW Government on an agreement that, when completed, we expect to be put to shareholders for approval.

Costs incurred during the year associated with the SCI and other related matters totalled US$28.1 million and included: US$6.8 million related to the SCI; US$4.9 million related to the internal investigation conducted by independent legal advisers, consistent with US securities regulations, of the impact on our financial statements of allegations of illegal conduct raised during the SCI and any potential impacts on the financial statements (the investigation found there was no adverse impact on our 2004 financial statements); US$1.2 million related to the Australian Securities and Investments Commission (the "ASIC") investigation into the circumstances surrounding the creation of the Foundation; US$6.4 million for resolution advisory services; US$6.0 million in severance and consulting payments to former executives; and US$2.8 million for other matters.

Further information on the SCI and other related matters can be found in Note 13 to the consolidated financial statements on pages 112 – 120 and in *Special Commission of Inquiry and Asbestos Compensation* on pages 12 – 17 of this Annual Report.

## Other Operating Expense

Other operating expense of US$6.0 million in the current year relates to a settlement loss of US$5.3 million for an employee retirement plan and loss on the sale of land in Sacramento, California. The retirement of a significant number of participants in the employee retirement plan resulted in a requirement under SFAS No. 88 to recognise and accelerate the amortising of an actuarial loss for the plan. Other operating expense in fiscal year 2004 of US$2.1 million mainly reflects an increase in cost provisions for our Australia and New Zealand business.

## EBIT

EBIT increased 14% from US$172.2 million to US$196.2 million. The EBIT margin decreased 1.3 percentage points to 16.2%. EBIT includes SCI and other related expenses of US$28.1 million.

USA Fibre Cement EBIT increased 24% from US$195.6 million to US$241.5 million. The increase was due to growth in net sales, partly offset by an increase in unit cost of sales, unit freight cost, general liability insurance and SG&A expenses. The increase in unit cost of sales was due to increased sales of higher cost differentiated products, higher pulp and cement costs, increased maintenance expenses and a temporary reduction in manufacturing efficiency at some plants that occurred during the second quarter. Higher freight costs were primarily related to an increase in length of haul of some products due to supply issues associated with the temporary reduction in plant manufacturing efficiency and higher fuel costs. The EBIT margin decreased 0.8 of a percentage point to 25.7%.

Asia Pacific Fibre Cement EBIT increased 25% from US$37.6 million to US$46.8 million. The EBIT margin increased 2.7 percentage points to 19.8%.

Australia and New Zealand Fibre Cement EBIT increased 20% from US$35.4 million to US$42.4 million. In Australian dollars, EBIT increased 12%. The increase in EBIT in Australian dollars was mainly due to cost savings and the impact of a cost provision recorded in the prior year that did not recur in the current year. The EBIT margin increased 2.1 percentage points to 20.2%.

Philippines Fibre Cement business more than doubled its positive EBIT performance compared to the previous year due to increased net sales.

The Chile Fibre Cement business recorded a small positive EBIT in each quarter of the year.

Our USA Hardie Pipe business significantly reduced its EBIT loss compared to the previous year due to increased sales volumes, higher selling prices and manufacturing cost savings.

Our Europe Fibre Cement business incurred an EBIT loss for the year as expected.

General corporate costs increased US$35.3 million from US$27.5 million to US$62.8 million. This increase was primarily due to US$28.1 million of SCI and other related expenses, a settlement loss of US$5.3 million related to an employee retirement plan, a US$0.7 million loss on sale of land owned in Sacramento, California and a net increase in other general corporate costs. Additionally, in the prior fiscal year, we booked a reversal of an excess provision of US$1.6 million related to a vendor dispute that we settled favourably and that did not recur this year. These increases were partially offset by a US$2.5 million decrease in employee bonus plan expense and a US$3.0 million decrease in employee share based compensation expense from stock appreciation rights primarily caused by a decrease in our share price.

### Net Interest Expense

Net interest expense decreased by US$4.9 million from US$10.0 million to US$5.1 million, primarily due to a higher amount of interest expense capitalised on construction projects in the current year compared to the previous year, higher interest income due to higher average cash balances and lower interest expense due to lower average debt balances.

### Other (Expense) Income

During the current year, other expense consisted primarily of a US$2.1 million impairment charge that we recorded on an investment in a company that filed a voluntary petition for reorganisation under Chapter 11 of the US bankruptcy code, partially offset by a US$0.8 million gain on a separate investment. In the prior year, we realised a gain before income tax of US$4.5 million on the sale of property formerly owned by one of our New Zealand subsidiaries. Additionally, a previously recorded liability related to potential contingent legal claims was reversed, resulting in income of US$4.3 million. We also realised US$0.1 million in net investment income. These income items were partially offset by an impairment charge of US$2.2 million that we recorded on an investment in a company that filed a voluntary petition for reorganisation under Chapter 11 of the US bankruptcy code. Additionally, we incurred an expense of US$3.2 million primarily due to a capital duty fee paid in conjunction with our Dutch legal structure. We incurred this to extend the scope of our international finance subsidiary to lend to global operations.

### Income Tax Expense

Income tax expense increased by US$21.5 million from US$40.4 million to US$61.9 million due to the increase in profit, the geographic mix of earnings, estimated income tax contingencies recorded during the year and non-deductible SCI and other related expenses.

### Operating Profit from Continuing Operations

Operating profit from continuing operations increased from US$125.3 million to US$127.9 million. Operating profit from continuing operations includes SCI and other related expenses of US$28.1 million and a related tax benefit of US$5.8 million. Operating profit from continuing operations excluding SCI and other related expenses increased 20% to US$150.2 million.

### Discontinued Operations

We recorded a loss from discontinued operations of US$1.0 million in the current year compared to income of US$4.3 million in the prior year. The current year amount relates primarily to additional costs associated with the sale of New Zealand land in March 2004 and settlement of a dispute associated with a former business. The prior year amount primarily includes a favourable outcome from matters related to our former Gypsum business and a gain on the sale of our New Zealand Building Systems business, net of other wind-up costs of Gypsum and other discontinued businesses.

## Liquidity and Capital Resources

Our treasury policy regarding our liquidity management, foreign exchange risks management, interest rate risk management and cash management is administered by our treasury department and is centralised in The Netherlands. This policy is reviewed annually and is designed to ensure that we have sufficient liquidity to support our business activities and meet future business requirements in the countries in which we operate. Counterparty limits are managed by our treasury department and based upon the counterparty credit rating; total exposure to any one counterparty is limited to specified amounts and signed off annually by the CFO.

We have historically met our working capital needs and capital expenditure requirements through a combination of cash flow from operations, proceeds from the divestiture of businesses, credit facilities and other borrowings, proceeds from the sale of property, plant and equipment and proceeds from the redemption of investments. Seasonal fluctuations in working capital generally have not had a significant impact on our short-term or long-term liquidity. We believe that we can meet our present working capital requirements for at least the next 12 months based on our current capital resources.

We had cash and cash equivalents of US$113.5 million as of 31 March 2005. At that date we also had credit facilities totalling US$449.4 million of which US$159.3 million was outstanding. At 31 March 2005, our credit facilities were all uncollateralised and consisted of the following:

| (Millions of US dollars) | At 31 March 2005 | | |
|---|---|---|---|
| Description | Effective Interest Rate | Total Facility | Principal Outstanding |
| US$ notes, fixed interest, repayable annually in varying tranches from November 2005 through November 2013 | 7.12% | $ 147.4 | $ 147.4 |
| A$ revolving loan, can be drawn down in either US$ or A$, variable interest based on US$ LIBOR or A$ bank bill rate plus margin, can be repaid and redrawn until maturity in November 2006 | N/A | 154.5 | – |
| US$ stand-by loan, can be drawn down in either US$ or A$, variable interest based on US$ LIBOR or A$ bank bill rate plus margin until maturity of US$117.5 million in April 2005 and US$15.0 million in October 2005 | N/A | 132.5 | – |
| US$ line of credit, can be drawn down in Chilean Pesos, variable interest based on Chilean Tasa Activa Bancaria rate plus margin until maturity in April[a] and December 2005 | 3.52% | 15.0 | 11.9 |
| **Total** | | **$ 449.4** | **$ 159.3** |

[a] Renewed and extended until March 2006

Net debt at year end was US$45.8 million, a decrease of US$57.7 million, from US$103.5 million as at 31 March 2004.

In June 2005, we entered into new unsecured debt facilities totalling US$355 million. These new facilities will replace the A$ revolving loan and the US$ stand-by-loan facilities that were in place at 31 March 2005. Subject to the satisfaction of customary closing conditions, these new facilities will provide us with an increased amount of liquidity, compared to what was available under our previous financing arrangements. These facilities are initially for a 364-day term, but we anticipate that two-thirds of them will be extended to a five-year term if negotiation of the Principal Agreement is completed and the Principal Agreement is subsequently executed and becomes effective. The extension of a facility will only occur if the relevant bank is satisfied with the terms of the Principal Agreement. If the final position reached in the Principal Agreement is materially different from the position in the Heads of Agreement, the extension may not occur and we may have to arrange a further refinancing.

In the future, we may not be able to renew credit facilities on substantially similar terms, or at all; we may have to pay additional fees and expenses that we might not have to pay under normal circumstances; and we may have to agree to terms that could increase the cost of our debt structure. If we are unable to renew our debt on terms which are not materially less favorable than the terms currently available to us, we may have to scale back our levels of planned capital expenditure and/or take other measures to conserve cash in order to meet our future cash flow requirements.

At 31 March 2005, we believe that we were in compliance with all restrictive covenants contained in the uncollateralised notes, revolving loan facility and the stand-by credit facility agreements. Under the most restrictive of these covenants, we are required to maintain certain ratios of debt to equity and net worth and levels of earnings before interest and taxes and have limits on how much we can spend on an annual basis in relation to asbestos payments to either Amaca Pty Ltd (formerly James Hardie & Coy Pty Ltd) ("Amaca"), Amaba Pty Ltd (formerly Jsekarb Pty Ltd) ("Amaba") or ABN 60 Pty Ltd ("ABN 60").

**Cash Flow**

Net operating cash inflows increased by US$57.2 million or 35% from US$162.6 million to US$219.8 million for the year ended 31 March 2005 compared to the prior year, primarily due to changes in our operating assets and liabilities.

Net cash used in investing activities was US$149.2 million for the year ended 31 March 2005 compared to US$58.0 million in the prior year. The increase in the cash used was primarily due to additional capital expenditures of US$78.4 million for the year ended 31 March 2005, US$10.9 million cash received in the prior year from the sale of land and buildings of our Australia and New Zealand business in March 2004, and US$5.0 million cash received in the prior year from the sale of our New Zealand Building Systems business in May 2003 that did not recur in the current year, partly offset by proceeds of US$3.4 million from the sale of land in Sacramento, California in the current year.

Net cash used in financing activities was US$28.2 million for the year ended 31 March 2005 compared to US$87.9 million in the prior year. The decrease in cash used was primarily due to a US$68.7 million repayment of capital in the prior year that did not recur in the current period and a US$9.2 million decrease in dividends paid, partly offset by a US$17.6 million scheduled debt repayment in the current period.

## Special Commission of Inquiry and Related Matters

Discussion of the SCI and related matters is included in Note 13 of the consolidated financial statements on pages 112 – 120.

## Capital Requirements and Resources

Our capital requirements consist of the expansion, renovation and maintenance of our production facilities and the construction of new facilities. Our working capital requirements, consisting primarily of inventory and accounts receivable and payables, fluctuate seasonally and increase prior to and during months of the year when overall construction and renovation activity volumes increase. We have historically funded cash flow shortfalls with cash generated from divestiture of non-fibre cement business operations and other business assets and from available cash under bank debt facilities.

During fiscal year 2005, our continuing businesses generated cash in excess of our capital requirements. As we continue expanding our fibre cement businesses, we expect to use cash primarily generated from our operations to fund capital expenditures and working capital. We expect to spend significantly during fiscal year 2006 on capital expenditures that include facility upgrades and new facility construction. Upgrades generally include expenditures for implementing new fibre cement technologies.

On 21 December 2004, we announced that we had entered into a non-binding Heads of Agreement with the NSW Government and union representatives which is expected to form the basis of the proposed binding agreement ("the Principal Agreement") to establish and fund a special purpose fund to provide funding on a long-term basis for asbestos-related injury and death claims (the "Claims") against Amaca, Amaba and ABN 60.

Currently, the timing of any potential payments is uncertain because we have not yet reached an agreement with the NSW Government and the conditions precedent to any agreement that may be reached have not been satisfied.

We are currently unable to estimate the cost of administering and litigating the claims under the potential Principal Agreement with the NSW Government because this is highly contingent upon the final outcome of the NSW Government's review of legal and administrative costs. However, if we enter into the Principal Agreement, we may have to make an initial payment in fiscal 2006 equal to estimated asbestos claims to be paid over the next three years less existing cash of the Foundation. We believe that the cash and cash equivalents that we currently have on hand and funds from debt facilities that we anticipate will be available will be sufficient to fund the initial payment. Additionally, we anticipate that the Principal Agreement will require us to make annual payments to fund Claims.

We are currently negotiating the Principal Agreement with the NSW Government. Costs we incur negotiating the Principal Agreement may be significant and will negatively impact our cash generated from operations over the short-term. We anticipate that our cash flows from operations, net of estimated payments that may be made under the Principal Agreement, will be sufficient to fund our planned capital expenditure and working capital requirements in the short-term. If we do not generate sufficient cash from operations to fund our planned capital expenditures and working capital requirements, we believe the cash and cash equivalents of US$113.5 million, and the cash that we anticipate will be available to us under credit facilities, will be sufficient to meet any cash shortfalls during the next two to three years.

Beyond three years, we intend to rely primarily on increased market penetration of our products and increased profitability from a more favourable product mix to generate cash to fund our growth. Historically, our products have been well accepted by the market and our product mix has changed towards higher priced, differentiated products that generate higher margins. We are relying on increased market demand for all of our products to achieve sufficient market penetration and a product-mix sufficiently profitable to fund our growth plans. We also intend to maintain sufficient levels of available cash under bank debt facilities to offset any cash shortfall.

We believe that we will be able to continue increasing our market share by further market penetration against competing products. Generally, over the past three years, a large part of our growth resulted from market share increases, especially in our major market of North America. We have historically acquired market share from vinyl and wood-based products and believe that our success is based primarily on our superior and proprietary product and production technologies that give us competitive product advantages. We expect to continue our research and development activities over the short and long-term to maintain, improve and increase our technology advantages. Based on our market penetration history, technology benefits from our research and development activities, and other factors, we expect that our market penetration trend will continue over the short and longer-term.

We believe our business is affected by general economic conditions and interest rates in the United States and in other countries because these factors affect the number of new housing starts, the level of housing prices and household income levels. We believe that housing prices, which may affect available owner equity and household income levels, are contributors to the currently robust renovation and remodel markets for our products. We believe that continued improvements in general economic conditions and continued low mortgage interest rates will maintain new housing starts and the renovation and remodel markets at historically high levels, which we expect will result in our operations generating cash flow sufficient to fund the majority of our planned capital expenditures. It is possible that a decline in residential housing starts in the United States or in other countries in which we manufacture and sell our products would negatively impact our growth and current levels of revenue and profitability and therefore decrease our liquidity and our ability to generate sufficient cash from operations to meet our capital requirements. During calendar year 2004, rising United States interest rates did not have a significant effect on United States home mortgage interest rates and new housing starts increased. However, continued interest rate increases anticipated in calendar year 2005 may slow down new housing starts in the United States and cause a decrease in housing prices, which may reduce demand for our products.

Pulp is a primary ingredient in our fibre cement formulation and affects our working capital requirements. Pulp prices increased during fiscal year 2005 and it is possible that prices will continue to fluctuate. To minimise additional working capital requirements caused by rising pulp prices, we may seek to enter into contracts with suppliers for the purchase of pulp that could fix our pulp prices over the longer-term. However, if pulp prices do not continue to rise, cash generated from our operations may be negatively impacted if pulp pricing is fixed over the longer-term.

Freight costs have increased due to continued higher fuel prices and an increase in the average length of haul of our products from our facilities to our customers' facilities. We expect fuel costs to remain higher, which will increase our working capital requirements as compared to fiscal year 2005.

The collective impact of the foregoing factors, and other factors, may affect our ability to generate sufficient cash flows from operations to meet our short and longer-term capital requirements. We believe that we will be able to fund any cash shortfalls with cash that we anticipate will be available under our credit facilities and that we will be able to maintain sufficient cash available under those facilities. Additionally, we could determine it necessary to scale back or postpone our expansion plans to maintain sufficient capital resources over the short and longer-term.

**Capital Expenditures**

Our total capital expenditures, including amounts accrued, for continuing operations for fiscal year 2005 was US$153.0 million. The capital expenditures were primarily used to create additional low cost, high volume manufacturing capacity to meet increased demand for our fibre cement products and to create new manufacturing capacity for new fibre cement products. Significant capital expenditures in fiscal year 2005 included the completion of our new Reno, Nevada plant and the construction of a new trim line at our Peru, Illinois plant.

## Contractual Obligations

The following table summarises our significant contractual obligations at 31 March 2005:

| | | Payments due During Fiscal Year Ending 31 March | | | |
|---|---|---|---|---|---|
| (Millions of US dollars) | Total | 2006 | 2007 to 2008 | 2009 to 2010 | Thereafter |
| Long-Term Debt | $ 147.4 | $ 25.7 | $ 35.2 | $ 46.2 | $ 40.3 |
| Interest on Long-Term Debt | 44.3 | 10.5 | 15.5 | 9.3 | 9.0 |
| Operating Leases | 133.8 | 11.7 | 21.4 | 19.4 | 81.3 |
| Purchase Obligations[a] | 70.3 | 50.2 | 17.8 | 2.3 | — |
| Line of Credit | 11.9 | 11.9 | — | — | — |
| Total | $ 407.7 | $ 110.0 | $ 89.9 | $ 77.2 | $ 130.6 |

[a] Purchase Obligations are defined as agreements to purchase goods or services that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transactions. Purchase obligations listed above primarily represent commitments for capital expenditures, the majority of which relate to the construction of our new Pulaski, Virginia plant. In addition, the total purchase obligations includes agreements related to software maintenance contracts and approximately US$20 million that will be incurred beginning fiscal year 2006, related to the implementation and maintenance of a new enterprise resource planning ("ERP") system. Contracts related to our new ERP system were executed after the end of fiscal year 2005. We did not have any significant agreements with variable price provisions.

The table above does not include amounts related to our future funding obligations for our Australian defined benefit plan. We estimate that our pension plan funding will be approximately US$1.8 million for fiscal year 2006. Projected payments beyond fiscal year 2006 are not currently determinable. See also Note 8 to our consolidated financial statements beginning on page 108.

In addition, the table above does not include any amounts related to funding obligations that might arise from asbestos-related matters discussed in Note 13 to our consolidated financial statements beginning on page 112. We have not established a provision for any of these liabilities because at this time such liabilities are not probable and estimable. Depending on future developments, the impact of future cash funding obligations could be significant and our financial position, results of operations and cash flows could be materially adversely affected and our ability to pay dividends could be impaired.

See Notes 10 and 13 to our consolidated financial statements beginning on pages 111 and 112, respectively, for further information regarding long-term debt and operating leases, respectively.

### Off-Balance Sheet Arrangements

As of 31 March 2005 and 2004, we did not have any material off-balance sheet arrangements.

### Inflation

We do not believe that inflation has had a significant impact on our results of operations for the fiscal years ended 31 March 2005, 2004 or 2003.

### Seasonality and Quarterly Variability

Our earnings are seasonal and typically follow activity levels in the building and construction industry. In the United States, the calendar quarters ending December and March reflect reduced levels of building activity depending on weather conditions. In Australia and New Zealand, the calendar quarter ending March is usually affected by a slowdown due to summer holidays. In the Philippines, construction activity diminishes during the wet season from June to September and during the last half of December due to the slowdown in business activity over the holiday period. In Chile, we experience decreased construction activity from May through September due to weather. Also, general industry patterns can be affected by weather, economic conditions, industrial disputes and other factors.

## Outlook

The short-term outlook for housing construction in North America remains positive, despite the prospect of modest interest rate rises later calendar year 2005.

Building permit numbers remain strong and the US-based National Association of Home Builders ("NAHB") reports that there is a backlog of houses that have been permitted but not yet started. These factors suggest the upside potential for housing starts to be good for the immediate future. In addition, the NAHB reported that builders remain positive about industry prospects in the months ahead, and it also refined its expected decline in housing starts for the 2005 calendar year from 3 to 5% to 1.4%.

In North America, strong sales growth is expected, but the rate of growth for the year ahead is forecast to be less than the very high level of fiscal year 2005. In fiscal year 2006, we expect to continue to grow primary demand for fibre cement and to penetrate our targeted markets. Margins are expected to remain attractive over the short-term despite the impact of higher raw material and freight costs.

In our Australia and New Zealand business, no improvement to the current soft levels of new housing and renovations activity is expected over the short-term. The progressive lifting of product bans and boycotts in Australia is expected to continue throughout the year. In New Zealand, housing construction activity is expected to continue at previously solid levels. Further manufacturing efficiency gains and other cost savings are also expected.

In the Philippines, building and construction activity is forecast to be softer but another solid quarterly EBIT performance is expected.

In our emerging Europe Fibre Cement and our USA Hardie Pipe businesses, further sales growth and market share are expected as awareness of our products increases among builders, contractors and distributors.

We have continued to incur costs associated with the SCI and other related matters including: preparation and negotiation of a Principal Agreement with the NSW Government to provide long-term funding of proven asbestos-related claims for Australian personal injury claimants against certain former James Hardie Australian subsidiaries; finalisation of the NSW Government's review of legal and administrative costs; and in co-operating with the Australian Securities and Investments Commission's investigation into the circumstances surrounding the establishment of the Foundation. SCI and other related expenses are again likely to be material over the short-term.

## Critical Accounting Policies

The accounting policies affecting our financial condition and results of operations are more fully described in Note 2 to our consolidated financial statements beginning on page 102. Certain of our accounting policies require the application of judgment by management in selecting appropriate assumptions for calculating financial estimates, which inherently contain some degree of uncertainty. Management bases its estimates on historical experience and other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the reported carrying value of assets and liabilities and the reported amounts of revenues and expenses that may not be readily apparent from other sources. Actual results may differ from these estimates under different assumptions and conditions. We consider the following policies to be the most critical in understanding the judgments that are involved in preparing our consolidated financial statements and the uncertainties that could impact our results of operations, financial condition and cash flows.

### Accounting for Contingencies

We account for loss contingencies in accordance with SFAS No. 5, "Accounting for Contingencies," under which we accrue amounts for losses arising from contingent obligations when the obligations are probable and the amounts are reasonably estimable. As facts concerning contingencies become known, we reassess our situation and make appropriate adjustments to the consolidated financial statements. Additional information regarding asbestos-related matters is included in Note 13 to the consolidated financial statements beginning on page 112, and in the section *Special Commission of Inquiry and Asbestos Compensation* beginning on page 12 of this Annual Report.

### Sales

We record estimated reductions to sales for customer rebates and discounts including volume, promotional, cash and other rebates and discounts. Rebates and discounts are recorded based on management's best estimate when products are sold. The estimates are based on historical experience for similar programs and products. Management reviews these rebates and discounts on an ongoing basis and the related accruals are adjusted, if necessary, as additional information becomes available.

### Accounts Receivable

We evaluate the collectibility of accounts receivable on an ongoing basis based on historical bad debts, customer credit-worthiness, current economic trends and changes in our customer payment activity. An allowance for doubtful accounts is provided for known and estimated bad debts. Although credit losses have historically been within our expectations, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. Because our accounts receivable are concentrated in a relatively small number of customers, a significant change in the liquidity or financial position of any of these customers could impact their ability to make payments and result in the need for additional allowances which would decrease our net sales.

**Inventory**

Inventories are recorded at the lower of cost or market. In order to determine market, management regularly reviews inventory quantities on hand and evaluates significant items to determine whether they are excess, slow-moving or obsolete. The estimated value of excess, slow-moving and obsolete inventory is recorded as a reduction to inventory and an expense in cost of sales in the period it is identified. This estimate requires management to make judgments about the future demand for inventory, and is therefore at risk to change from period to period. If our estimate for the future demand for inventory is greater than actual demand and we fail to reduce manufacturing output accordingly, we could be required to record additional inventory reserves, which would have a negative impact on our gross profit.

**Accrued Warranty Reserve**

We offer various warranties on our products, including a 50-year limited warranty on certain of our fibre cement siding products in the United States. Because our fibre cement products have only been used since the early 1980s, there is a risk that these products will not perform in accordance with our expectations over an extended period of time. A typical warranty program requires that we replace defective products within a specified time period from the date of sale. We record an estimate for future warranty related costs based on an analysis of actual historical warranty costs as they relate to sales. Based on this analysis and other factors, we adjust the amount of our warranty provisions as necessary. Although our warranty costs have historically been within calculated estimates, if our experience is significantly different from our estimates, it could result in the need for additional reserves.

**Accounting for Income Tax**

We account for income taxes according to Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," under which we compute our deferred tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes. We must assess whether, and to what extent, we can recover our deferred tax assets. If full or partial recovery is unlikely, we must increase our income tax expense by recording a valuation allowance against the portion of deferred tax assets that we cannot recover. We believe that we will recover all of the deferred tax assets recorded (net of valuation allowance) on our consolidated balance sheet at 31 March 2005. However, if facts later indicate that we will be unable to recover all or a portion of our net deferred tax assets, our income tax expense would increase in the period in which we determine that recovery is unlikely. Additional information regarding accounting for income taxes is included in Note 14 to the consolidated financial statements beginning on page 121.

# Definitions

## Financial Measures – US GAAP equivalents

**EBIT and EBIT Margin** – EBIT is defined as operating income. EBIT margin is defined as EBIT as a percentage of our net sales. We believe EBIT and EBIT margin to be relevant and useful information as these are the primary measures used by our management to measure the operating profit or loss of our business. EBIT is one of several metrics used by our management to measure the earnings generated by our operations, excluding interest and income tax expenses. Additionally, EBIT is believed to be a primary measure and terminology used by our Australian investors. EBIT and EBIT margin should be considered in addition to, but not as a substitute for, other measures of financial performance reported in accordance with accounting principles generally accepted in the United States of America. EBIT and EBIT margin, as we have defined them, may not be comparable to similarly titled measures reported by other companies.

EBIT and EBIT margin, as used in this document, are equivalent to the US GAAP measures of operating income and operating income margin.
**Operating profit from continuing operations before income taxes** – is equivalent to the US GAAP measure of income from continuing operations before income taxes.
**Operating profit from continuing operations** – is equivalent to the US GAAP measure of income from continuing operations.
**Net operating profit including discontinued operations** – is equivalent to the US GAAP measure of net income.

## Sales Volumes

**mmsf** – million square feet – where a square foot is defined as a standard square foot of 5/16 inch thick product.
**msf** – thousand square feet – where a square foot is defined as a standard square foot of 5/16 inch thick product.

## Financial Ratios

**Net debt** – is short-term and long-term debt less cash and cash equivalents.
**Net debt payback** – Net debt divided by cash flow from operations times 12 months.
**Gearing Ratio** – is net debt divided by net debt plus shareholders' equity.

## Non US GAAP Financial Measures

**EBIT and EBIT margin excluding SCI and other related expenses** – not a measure of financial performance under US GAAP and should not be considered to be more meaningful than operating income. The Company has included this financial measure to provide investors with an alternative method for assessing the Company's operating results in a manner that is focused on the performance of the company's ongoing operations. The Company's management uses this non-GAAP measure for the same purposes.
**Operating profit from continuing operations excluding SCI and other related expenses** – not a measure of financial performance under US GAAP and should not be considered to be more meaningful than operating profit. The Company has included this financial measure to provide investors with an alternative method for assessing the Company's operating results in a manner that is focused on the performance of the company's ongoing operations. The Company's management uses this non-GAAP measure for the same purposes.

**Reconciliation of Adjusted EBITDA to net cash provided by operating activities:**

| | Fiscal Years Ended 31 March | | | | |
|---|---|---|---|---|---|
| **Adjusted EBITDA** (Millions of US dollars) | **2005** | 2004 | 2003 | 2002 | 2001 |
| Net cash provided by operating activities | **$ 219.8** | $ 162.6 | $ 64.8 | $ 76.6 | $ 94.6 |
| Adjustments to reconcile net income to net cash provided by operating activities, net | **(61.2)** | (51.1) | 62.1 | (41.1) | (44.8) |
| Change in operating assets and liabilities, net | **(31.7)** | 18.1 | 43.6 | (4.7) | (11.2) |
| Net Income | **$ 126.9** | $ 129.6 | $ 170.5 | $ 30.8 | $ 38.6 |
| Loss (Income) from discontinued operations | **1.0** | (4.3) | (87.0) | (3.5) | (9.1) |
| Income tax expense (benefit) | **61.9** | 40.4 | 26.1 | 3.1 | (0.6) |
| Interest expense | **7.3** | 11.2 | 23.8 | 18.4 | 21.4 |
| Interest income | **(2.2)** | (1.2) | (3.9) | (2.4) | (8.2) |
| Other expense (income) | **1.3** | (3.5) | (0.7) | 0.4 | (1.6) |
| Depreciation and amortization | **36.3** | 36.4 | 27.4 | 23.5 | 20.6 |
| Impairment of property, plant and equipment | **–** | – | – | – | 7.5 |
| Adjusted EBITDA | **$ 232.5** | $ 208.6 | $ 156.2 | $ 70.3 | $ 68.6 |

**Adjusted EBITDA** is not a measure of financial performance under US GAAP and should not be considered an alternative to, or more meaningful than, income from operations, net income or cash flows as defined by US GAAP or as a measure of our profitability or liquidity. Not all companies calculate Adjusted EBITDA in the same manner as we have and, accordingly, Adjusted EBITDA may not be comparable with other companies. We have included information concerning Adjusted EBITDA because we believe that this data is commonly used by investors to evaluate the ability of a company's earnings from its core business operations to satisfy its debt, capital expenditure and working capital requirements. To permit evaluation of this data on a consistent basis from period to period, Adjusted EBITDA has been adjusted for noncash charges such as goodwill and asset impairment charges, as well as nonoperating income and expense items.

**Endnotes:**

**Volume and Average Net Sales Price – Asia Pacific Fibre Cement – Adjusted:**
In fiscal years 2004 and 2003, our Asia Pacific Fibre Cement segment reported incorrect volume figures due to errors when converting to our standard square feet measurement and due to our Philippines Fibre Cement business including intercompany volume during fiscal year 2004. The following table presents adjusted volume and average net sales price for our Asia Pacific Fibre Cement business segment. We have adjusted this Annual Report for the revised volume and average net sales price.

| | **Fiscal Year 2004** | | **Fiscal Year 2003** | |
|---|---|---|---|---|
| | **As previously published** | **As adjusted** | **As previously published** | **As adjusted** |
| Volume (mmsf[1]) | 402.1 | 362.1 | 368.3 | 349.9 |
| Average net sales price per unit (per msf[1]) | A$788 | A$862 | A$843 | A$887 |

**Net Sales – Philippines Fibre Cement – Adjusted**

In fiscal year 2004, our Philippines business incorrectly reported intercompany transfers as external net sales and cost of sales. Adjustment to the Philippines Fibre Cement discussion is necessary to provide an accurate year-to-year discussion of Philippines Fibre Cement net sales. Therefore, for discussion purposes only, for the Philippines Fibre Cement business, we adjusted fiscal year 2004 Philippines Fibre Cement net sales. We have not restated the Asia Pacific Fibre Cement business segment results or the consolidated financial statements since these adjustments are not material to our Asia Pacific Fibre Cement segment or to the consolidated financial statements taken as a whole. The following table presents adjusted Philippines Fibre Cement net sales for discussion purposes only:

| (Millions of US dollars) | **Fiscal Year 2004** |
|---|---|
| Previously Reported | US$24.2 |
| Adjustment | (3.4) |
| Adjusted Net Sales | US$20.8 |