Management's Discussion and Analysis

Overview

This discussion is intended to provide information that will assist in understanding James Hardie's (the company's) 31 March 2006 consolidated financial statements, the changes in significant items in those consolidated financial statements from year to year, and the primary reasons for those changes. It includes information about James Hardie's critical accounting policies and how these policies affect its 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 the financial condition and results of operations as a whole.

James Hardie's results for fiscal year 2006 were substantially affected by the net provision of US$715.6 million it recorded for estimated future asbestos-related compensation payments. The company also incurred significant costs associated with the Special Commission of Inquiry (SCI) and other related matters during fiscal year 2006. Information regarding asbestos-related matters and the SCI and other related matters can be found in this discussion and in Note 12 of the consolidated financial statements on page 104 and in *Asbestos Compensation* on pages 10 – 11.

The discussion below contains forward-looking statements that are based on the company's current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these expectations due to inaccurate assumptions and known or unknown risks and uncertainties, including those identified in the Cautionary Note Concerning Forward-Looking Statements on page 136.

The Company and the Building Product Markets
Based on net sales, James Hardie believes it is 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. The company's current primary geographic markets include the United States, Australia, New Zealand, the Philippines and Europe. Through significant research and development expenditure, James Hardie develops key product and production process technologies that it patents or holds as trade secrets. James Hardie believes that these technologies give it a competitive advantage.

James Hardie manufactures 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, fencing, internal linings, facades, floor and tile underlayments, drainage pipes and decorative columns. The company's 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. It believes that, in certain construction applications, its fibre cement products and systems provide a combination of distinctive performance, design and cost advantages over competing building products and systems.

The company's products are primarily sold in the residential housing markets. Residential construction levels fluctuate based on new home construction activity and the repair and renovation 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 renovation spending, gross domestic product growth and consumer confidence levels. These factors were generally favourable during fiscal year 2006, resulting in healthy levels of residential construction and home repair and renovation activity.

Fiscal Year 2006 Key Results
At 31 March 2006 James Hardie recorded a net provision of US$715.6 million for estimated future asbestos-related compensation payments (asbestos provision).

Total net sales increased 23% to US$1,488.5 million. However, the asbestos provision resulted in a decrease in EBIT from a profit of US$196.2 million to a loss of US$434.9 million. Operating profit from continuing operations decreased to a loss of US$506.7 million because of the asbestos provision.

Excluding the asbestos provision, EBIT increased by 43% to US$280.7 million and operating profit from continuing operations increased by 63% to US$208.9 million.

The company's largest market is North America, where fibre cement is one of the fastest growing segments of the external siding market. During the year, USA Fibre Cement net sales contributed approximately 82% 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 sales price. EBIT increased primarily due to increased sales, partially offset by higher unit costs, freight costs and selling, general and administrative expense.

Asia Pacific Fibre Cement net sales contributed approximately 16% of total net sales, and its EBIT was the second largest contributor of total company EBIT. Net sales increased in the company's Australia and New Zealand business, but fell in its Philippines Fibre Cement business. The increase in net sales in the Australia and New Zealand business was due to favourable exchange rates and increased volume, which were partially offset by a reduction in average net sales price. Sales in the Philippines business were adversely affected during the year by weaker domestic demand and increased competition in export markets. Asia Pacific Fibre Cement EBIT decreased, primarily due to increased costs in Australia.

The company's emerging businesses of Europe Fibre Cement and USA Hardie Pipe, continued to make good progress. The USA Hardie Pipe business reduced its loss compared to last year, even though sales volumes were lower. The Europe Fibre Cement business increased its sales as demand increased. On 18 April 2006 James Hardie announced that it would close its Artisan Roofing business. Following a review of the carrying value of the assets related to this operation, an asset impairment charge of US$13.4 million was recorded in fiscal year 2006.

(Millions of US dollars)	**2006**	2005	% Change
Net Sales			
USA Fibre Cement	**$ 1,218.4**	$ 939.2	30
Asia Pacific Fibre Cement	**241.8**	236.1	2
Other	**28.3**	35.1	(19)
Total Net Sales	**$ 1,488.5**	$ 1,210.4	23
Cost of goods sold	**(937.7)**	(784.0)	20
Gross profit	**550.8**	426.4	29
Selling, general and administrative expenses	**(209.8)**	(174.5)	20
Research and development expenses	**(28.7)**	(21.6)	33
Special Commission of Inquiry and other related expenses	**(17.4)**	(28.1)	(38)
Impairment of roofing plant	**(13.4)**	–	–
Asbestos provision	**(715.6)**	–	–
Other operating loss	**(0.8)**	(6.0)	(87)
EBIT	**(434.9)**	196.2	–
Net interest expense	**(0.2)**	(5.1)	(96)
Other expense	**–**	(1.3)	–
Operating (loss) profit from continuing operations before income taxes	**(435.1)**	189.8	–
Income tax expense	**(71.6)**	(61.9)	16
Operating (Loss) Profit from Continuing Operations	**$ (506.7)**	$ 127.9	–
Net Operating (Loss) Profit Including Discontinued Operations	**$ (506.7)**	$ 126.9	–
Tax rate	**–**	32.6%	–
Volume (mmsf)			
USA Fibre Cement	**2,182.8**	1,855.1	18
Asia Pacific Fibre Cement	**368.3**	376.9	(2)
Average net sales price per unit (per msf)			
USA Fibre Cement	**US$ 558**	US$ 506	10
Asia Pacific Fibre Cement	**A$ 872**	A$ 846	3

All results are for continuing operations unless otherwise stated. See Definitions starting on page 52.

Total Net Sales

Total net sales increased 23% from US$1,210.4 million to US$1,488.5 million in fiscal year 2006.

Net sales from USA Fibre Cement increased 30% from US$939.2 million to US$1,218.4 million due to continued growth in sales volume and a higher average net sales price.

Net sales from Asia Pacific Fibre Cement increased 2% from US$236.1 million to US$241.8 million primarily due to increased higher sales volume in Australia and New Zealand.

Other net sales decreased by 19% from US$35.1 million to US$28.3 million with the decline primarily due to the sale of the company's Chilean flat sheet business in July 2005.

USA Fibre Cement

Net sales increased 30% from US$939.2 million to US$1,218.4 million due to increased sales volume and a higher average net sales price. Sales volume increased 18% from 1,855.1 million square feet to 2,182.8 million square feet, due mainly to growth in primary demand and a resilient housing market. The average net sales price increased 10% from US$506 per thousand square feet to US$558 per thousand square feet due to price increases for some products that were implemented during fiscal year 2006 and proportionally stronger growth of differentiated, higher-priced products. Despite further modest interest rate increases, the business did not experience the expected 'cooling' of the new housing construction market during fiscal year 2006. New housing construction activity was very strong over the full year as it continued to be buoyed by relatively low interest rates and strong house prices. Repair and remodelling activity also remained very strong during the year.

The strong growth in sales volume was across both the business' interior and exterior product categories and its emerging and established geographic markets, reflecting further market penetration and the healthy new housing and repair and remodelling activity.

Demand for exterior products continued to grow in all key regions across the United States, and further market share gains were achieved at the expense of alternative materials, mainly vinyl and wood-based siding. There was strong sales growth in differentiated, higher-priced products, as well as in the business' core products.

Implementation of the ColorPlus® product business model in the emerging markets continued during fiscal year 2006. The model is aimed at improving the positioning of the ColorPlus® product range of pre-painted products in markets dominated by vinyl siding and increasing revenue and contribution per unit. All phases of the implementation are underway and progressing well. Sales of the ColorPlus® product range as a percentage of exterior product sales in the business' emerging markets almost doubled over the fiscal year 2005. We intend to introduce ColorPlus® products to selected regions of our established markets in fiscal year 2007.

In the interior products market, sales of both Hardibacker 500® half-inch backerboard and quarter-inch backerboard grew very strongly. The business continued to take market share in this category, particularly in the half-inch segment.

In its established markets, the business continued to focus on growth strategies including an increased focus on the repair and remodel segment. Sales in the established markets were slightly affected by the impact of the September 2005 hurricanes that caused considerable damage along the Gulf Coast, particularly in the states of Louisiana and Mississippi. Sales in these states account for less than 5% of total sales of the USA Fibre Cement business.

At the end of fiscal year 2006, the business completed construction of one of the two planned production lines at its new plant in Pulaski, Virginia, and in April 2006, this line commenced commercial production. At the end of fiscal year 2006, the business also completed construction of, and commenced production on, a new ColorPlus® product line at its Blandon, Pennsylvania plant.

During fiscal year 2006, the business commenced the ramp-up of its new trim line at Peru, Illinois and continued the ramp-up of its new West Coast manufacturing plant at Reno, Nevada. It also began construction of other additional pre-finishing capacity at plants in its emerging markets.

Asia Pacific Fibre Cement

Net sales increased 2% from US$236.1 million to US$241.8 million. Net sales in Australian dollars increased 1% due to a 3% increase in the average net sales price, partly offset by a 2% decline in sales volume from 376.9 million square feet to 368.3 million square feet.

Australia and New Zealand Fibre Cement
Net sales increased 4% from US$210.1 million to US$218.1 million, primarily due to favourable currency exchange rates and a 3% increase in sales volume. In Australian dollars, net sales increased 2%. The average net sales price in Australian dollars decreased 1% compared to fiscal year 2005.

In Australia, both the residential housing construction and the renovation markets softened, particularly in New South Wales. The increase in sales volume in fiscal year 2006 was due to initiatives designed to grow primary demand for fibre cement and generate further market share in the business' targeted markets. In the commercial construction sector, activity remained at buoyant levels and, following the execution of the FFA for asbestos compensation in December 2005, the business began to regain momentum lost through product bans and boycotts imposed during the prior year and a half, particularly in Victoria. It achieved strong sales of its Linea® weatherboards, which were launched in Queensland during the first half of fiscal year 2006, and continued to roll-out its Business Builder Program in all states to help generate primary demand for its products. In addition, the business launched Aquatec™ Wet Area Flooring in Victoria during the third quarter of the fiscal year 2006.

In New Zealand, housing construction activity also softened. The growth momentum of Linea® weatherboards continued throughout the year and helped to generate increased primary demand for the business' products in a weakened market. Linea® weatherboards remain the business' number-one selling product in New Zealand.

Philippines Fibre Cement
Net sales decreased 9% from US$26.0 million to US$23.7 million. In local currency, net sales decreased 11% due to a 19% decrease in sales volume partly offset by a 10% increase in the average net sales price. Demand was adversely affected during fiscal year 2006 by weaker domestic construction activity resulting from uncertainty associated with increased domestic political and economic instability, and increased competition in the business' export markets.

Other

Other sales include sales of the company's fibre cement products manufactured in Chile (through July 2005), sales of Hardie™ Pipe in the United States, the roofing pilot plant in the United States which was closed in April 2006, and fibre cement operations in Europe.

USA Hardie Pipe
Net sales fell short against fiscal year 2005. A decrease in sales volume was partly offset by a higher average sales price.

Europe Fibre Cement
Net sales increased in fiscal year 2006 compared to fiscal year 2005 due to stronger demand resulting from increased awareness of the business' products among builders, distributors and contractors; expansion into new geographic markets; and higher average net sales price.

Artisan Roofing
The company's roofing pilot plant consisted of a small-scale roofing manufacturing plant in Fontana, California opened in 2003. Since then, the company had undertaken production and market trials of a new roofing product in Southern California to quantify the market potential of the new product. On 18 April 2006, it ceased market development initiatives for its roofing product and announced the closure of its roofing plant. Following a review of the carrying value of the assets related to this operation, an asset impairment charge of US$13.4 million was recorded in fiscal year 2006. The decision not to proceed with the roofing product was made after the company reviewed market testing results and concluded that greater shareholder value would be created by focusing on other market growth initiatives.

Chile Fibre Cement
The company sold its Chilean business in July 2005 due to its small scale and limited strategic fit.

Gross Profit

Gross profit increased 29% from US$426.4 million to US$550.8 million due mainly to a strong gross profit improvement in the USA Fibre Cement business. The gross profit margin increased 1.8 percentage points to 37.0%.

USA Fibre Cement gross profit increased 37% as a result of increases in both sales volume and the average net sales price, partially offset by higher manufacturing costs and freight costs. The gross profit margin increased 2.1 percentage points.

Asia Pacific Fibre Cement gross profit decreased 5% due to reduced profitability in the Asia Pacific businesses in Australia and the Philippines, which was partly offset by improvements in New Zealand and favourable currency movements. In Australian dollars, gross profit decreased 7% due primarily to increased costs in all the Asia Pacific businesses.

Selling, General and Administrative (SG&A) Expense

SG&A expense increased 20% from US$174.5 million to US$209.8 million, mainly due to an increase in the accrual for employees' bonuses to reflect the company's improved profit performance (before the asbestos provision); increased spending on growth initiatives in the USA Fibre Cement business; and increased professional service fees. As a percentage of sales, SG&A expense decreased 0.3 of a percentage point to 14.1%.

Research and Development Expenses

Research and development expenses include costs associated with "core" research projects that are designed to benefit all business units. These costs are recorded in the Research and Development segment rather than being attributed to individual business units. These costs were 3% higher at US$12.3 million. Other research and development costs associated with commercialisation projects in business units are included in the business unit segment results. In total, these costs increased 71% to US$16.4 million.

SCI and Other Related Expenses

In February 2004, the Government of New South Wales in Australia established an 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, James Hardie commenced negotiations with the NSW Government, the Australian Council of Trade Unions (ACTU), UnionsNSW and a representative of asbestos claimants in relation to its offer to the SCI on 14 July 2004 to provide funds voluntarily for proven Australia-based asbestos-related injury and death claims against certain former James Hardie Australian subsidiary companies. On 21 December 2004, the company entered into a Heads of Agreement with the above parties to establish and fund an SPF to provide funding for these claims on a long-term basis. The company subsequently entered negotiations with the NSW Government on a binding agreement that it intends to put to shareholders for approval. On 1 December 2005, the company and the NSW Government signed the FFA. The FFA is subject to certain conditions precedent, including the company's ability to obtain full tax deductibility for the contributions under this agreement, the tax exempt status of the SPF and its approval by the company's lenders and shareholders.

Costs incurred associated with the SCI and other related expenses totalled US$17.4 million compared to US$28.1 million in the previous year.

Further information on the SCI and other related matters can be found in Note 12 to the consolidated financial statements and in *Asbestos Compensation* on pages 10 – 11 of this annual report.

Asbestos Provision

The recording of the asbestos provision is in accordance with US accounting standards because the company has determined that it is probable that it will make payments to fund asbestos-related claims on a long-term basis. The amount of the asbestos provision, of US$715.6 million (A$1.0 billion) at 31 March 2006, is the company's best estimate of the probable outcome. Under alternative arrangements such as those discussed in the next paragraph, this estimate may change.

This estimate is based on the terms of the FFA, which includes an actuarial estimate prepared by KPMG Actuaries at 31 March 2006 of the projected future cash outflows, undiscounted and uninflated, and the anticipated tax deduction arising from Australian legislation which came into force on 6 April 2006.

On 23 June 2006, the ATO advised the company that it has refused to endorse the SPF as a tax concession charity, arguing that, in its opinion, the scope of its activities under the Trust Deed and the FFA does not meet current legislative requirements for such an endorsement.

On 29 June 2006, the ATO issued a ruling to the company to the effect that James Hardie's contributions to the SPF would be tax deductible over the anticipated life of the arrangements in accordance with the recent "blackhole expenditure" Federal Legislation which was enacted in April 2006. At the time of filing this report, the company believes that the ATO's refusal to endorse the SPF as a tax concession charity continues to place the FFA in doubt.

Intention to Make Payments to Asbestos Claimants

Even if conditions to the company's funding obligations under the FFA, including the achievement of tax deductibility, are not fulfilled, it has determined that it is nevertheless likely that it will make payments in respect of certain claimants who were injured by asbestos products manufactured by certain former Australian subsidiary companies. The Board of James Hardie has made it clear that, in a manner consistent with its obligations to shareholders and other stakeholders in the company, it intends to proceed with fair and equitable actions to compensate the injured parties. Any such alternative settlement may be subject to conditions precedent and would require lender and shareholder approval. However, if James Hardie proceeds with an alternative settlement without the current conditions precedent being met, it is likely, as a function of economic reality, that the company will have less funds to support payments in respect of asbestos claims. While the company continues to hope that the conditions precedent to the FFA will be fulfilled, it has determined that its intention to continue to proceed responsibly in either event makes it appropriate for it to record the asbestos liability reserve in the amounts set forth in the financial statements.

Further information on the SCI and other related matters can be found in Note 12 to the consolidated financial statements and in *Asbestos Compensation* on pages 104 – 114 of this annual report.

EBIT

EBIT decreased from US$196.2 million profit to a loss of US$434.9 million. EBIT includes the asbestos provision of US$715.6 million, SCI and other related expenses of US$17.4 million and an asset impairment charge of US$13.4 million relating to the closure of the roofing pilot plant.

As shown in the table on the following page, EBIT excluding asbestos provision, impairment charge and SCI and other related expenses, increased by 39% to US$311.5 million. EBIT margin excluding these items increased 2.4 percentage points to 20.9%.

USA Fibre Cement EBIT increased 42% from US$241.5 million to US$342.6 million. The increase was due to increased sales volume and higher average net sales price, partially offset by higher unit costs, freight costs and SG&A expenses. The EBIT margin was 2.4 percentage points higher at 28.1%.

EBIT

(Millions of US dollars)	2006	2005	% Change
USA Fibre Cement	**$ 342.6**	$ 241.5	42
Asia Pacific Fibre Cement	**41.7**	46.8	(11)
Research and Development	**(15.7)**	(17.5)	(10)
Other	**(13.1)**	(11.8)	11
Impairment of roofing plant	**(13.4)**	–	–
General Corporate	**(61.4)**	(62.8)	(2)
Asbestos provision	**(715.6)**	–	–
EBIT before interest and tax	**(434.9)**	196.2	–
Excluding			
Impairment of roofing plant	**13.4**	–	–
Asbestos provision	**715.6**	–	–
SCI and other related expenses	**17.4**	28.1	(38)
EBIT excluding asbestos provision, impairment charge and SCI and other related expenses	**$ 311.5**	$ 224.3	39
Net Sales	**$ 1,488.5**	$ 1,210.4	23
EBIT margin excluding asbestos provision, impairment charge and SCI and other related expenses	**20.9%**	18.5%	–

Asia Pacific Fibre Cement EBIT decreased 11% from US$46.8 million to US$41.7 million due to a reduced profit performance in both the Australia and New Zealand, and Philippines businesses. The EBIT margin was 2.6 percentage points lower at 17.2%.

Australia and New Zealand Fibre Cement EBIT decreased 8% from US$42.4 million to US$38.9 million. In Australian dollars, the Australia and New Zealand business EBIT fell by 10% due to increased costs in Australia, partially offset by increased sales volume in Australia and New Zealand. The EBIT margin was 2.4 percentage points lower at 17.8%.

The Philippines Fibre Cement business recorded a decrease in EBIT due to the impact of weaker domestic construction activity on demand for its products, as well as increased competitive activity in its export markets.

The USA Hardie Pipe business reduced its EBIT loss compared to the previous year.

The Europe Fibre Cement business incurred an EBIT loss as it continued to build net sales.

Following a review of the results of its roofing product trials in California, James Hardie announced on 18 April 2006 that the pilot plant was to close. Following a review of the carrying value of the assets related to this operation, an asset impairment charge of US$13.4 million was recorded.

The Chile Fibre Cement business was sold in July 2005.

General corporate costs decreased by US$1.4 million from US$62.8 million to US$61.4 million. There was a decrease of US$10.7 million in SCI and other related expenses, a US$0.7 million loss in the prior year on the sale of land owned in Sacramento, which did not recur in fiscal year 2006, and a reduction of US$3.5 million in the cost of the Australian companies' defined benefit pension scheme. These decreases were partly offset by a US$8.6 million increase in employee bonus plan expense, a US$3.5 million increase in employee share-based compensation expense from stock options and from stock appreciation rights, primarily caused by an increase in the company's share price, and an increase in other general costs of US$1.4 million.

Net Interest Expense

Net interest decreased by US$4.9 million to US$0.2 million. The decrease in interest expense was primarily due to the company being in a positive net cash position for the majority of fiscal year 2006.

Income Tax Expense

Income tax expense increased US$9.7 million from US$61.9 million to US$71.6 million. The increase in expense was due to an increase in profits and the geographic mix of earnings. This was partially offset by a reduction in the income tax reserves in the US arising as a result of the finalisation of certain tax audits during the year.

Operating Profit from Continuing Operations

Operating profit from continuing operations decreased from a profit of US$127.9 million to a loss of US$506.7 million. Operating profit from continuing operations includes US$715.6 million relating to the booking of the asbestos provision; an impairment charge of US$13.4 million (US$8.0 million, after tax) relating to the closure of the company's roofing pilot plant; SCI and other related expenses of US$17.4 million (US$16.5 million, after tax); and a write-back of tax provisions of US$20.7 million.

Operating profit from continuing operations excluding asbestos provision, impairment charge, SCI and other related expenses, and write-back of tax provisions, increased 42% to US$212.7 million as shown in the table below:

Operating (Loss) Profit

(Millions of US dollars)	2006	2005	% Change
Operating (loss) profit from continuing operations	**$ (506.7)**	$ 127.9	–
Excluding			
Impairment of roofing plant (net of tax)	**8.0**	–	–
Asbestos provision	**715.6**	–	–
SCI and other related expense (net of tax)	**16.5**	22.3	(26)
Write-back of tax provisions	**(20.7)**	–	–
Operating profit from continuing operations excluding asbestos provision, impairment charge, SCI and other related expenses and write-back of tax provisions	**$ 212.7**	$ 150.2	42

Discontinued Operations

In total, the company recorded US$ nil from discontinued operations compared to a loss of US$1.0 million in the previous year, which related primarily to additional costs associated with the sale of New Zealand land in March 2004 and settlement of a dispute with a former business. See Note 14 to the consolidated financial statements for additional information about the results of discontinued operations.

Liquidity and Capital Resources

The company's treasury policy regarding liquidity management, foreign exchange risks management, interest rate risk management and cash management is administered by its treasury department and is centralised in The Netherlands. This policy is reviewed annually and is designed to ensure that the company has sufficient liquidity to support its business activities and meet future business requirements in the countries in which it operates. Counterparty limits are managed by the 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.

The company had cash and cash equivalents of US$315.1 million as of 31 March 2006. At that date, it also had credit facilities totalling US$476.7 million, of which US$302.7 million was outstanding. The credit facilities are all non-collateralised and, as of 31 March 2006, consisted of the following:

James Hardie has historically met its 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 the company's short-term or long-term liquidity. The company believes that it can meet its present working capital requirements for at least the next 12 months based on its current capital resources. Any cash commitments arising from the FFA will be met either from cash generated by operating activities or, should this prove insufficient, from borrowings under existing credit facilities.

In March 2006, RCI Pty Ltd (RCI) a wholly-owned subsidiary of the company, received an amended assessment from the ATO of A$412.0 million (US$310.0 million). The assessment was subsequently amended to A$378.0 million (US$284.6 million). On 23 June 2006, the ATO advised that in order to appeal the assessment, the company would be required to make a partial payment of 50% of the amended assessment (A$189.0 million). This payment will reduce the company's liquidity. The company believes that RCI's tax position will ultimately prevail in this matter. Accordingly, it is expected that any amounts paid would be recovered by RCI (with interest) at the time RCI is successful in its appeal against the amended assessment. However, if RCI is unsuccessful in its appeal, RCI will be required to pay the entire assessment. As of 31 March 2006, the company had not recorded any liability for the amended assessment. See Note 13 of the consolidated financial statements for further information.

(Millions of US dollars)		**At 31 March 2006**	
Description	Effective Interest Rate	Total Facility	Principal Outstanding
US$ notes, fixed interest, repayable annually in varying tranches from November 2006 through November 2013	7.16%	$ 121.7	$ 121.7
US$ 364-day term facilities, can be drawn in US$, variable interest rates based on LIBOR plus margin, can be repaid and redrawn until December 2006	5.41%	110.0	81.0
US$ term facilities, can be drawn in US$, variable interest rates based on LIBOR plus margin, can be repaid and redrawn until June 2006	5.27%	245.0	100.0
Total		**$ 476.7**	**$ 302.7**

As of 31 March 2006 the company had net cash of US$12.4 million, compared with net debt of US$45.8 million as of 31 March 2005, an increase of US$58.2 million.

Its credit facilities currently consist of 364-day facilities in the amount of US$110.0 million, which mature in June 2007, and term facilities in the amount of US$245.0 million, which mature in December 2006. The maturity dates of the US$110.0 million and US$245.0 million term facilities were extended from December 2006 and June 2006, respectively, in June 2006. For both facilities, interest is calculated at the commencement of each draw-down period based on the US-dollar London Interbank Offered Rate (LIBOR) plus the margins of individual lenders, and is payable at the end of each draw-down period. During fiscal year 2006, the company paid US$0.7 million in commitment fees. As of 31 March 2006, US$181.0 million was drawn under the combined facilities and US$174.0 million was available.

Additionally, if the conditions precedent to the full implementation of the FFA, including lender approval, are satisfied, the maturity date of the US$245.0 million term facilities will be automatically extended until June 2010.

As a result of recording the asbestos provision at 31 March 2006, and the Supervisory Board's approval thereof on 12 May 2006, the company would not have been in compliance with certain of the restrictive covenants in respect of the US-dollar non-collateralised notes. However, under the terms of the non-collateralised notes agreement, prepayment of these notes was permitted, and on 28 April 2006 the company issued a notice to all noteholders to prepay in full all outstanding notes on 8 May 2006. On that date, the US-dollar non-collateralised notes were prepaid in full, including a make-whole payment of US$6.0 million. In the fourth quarter of fiscal year 2006, US$181.0 million was drawn down on the credit facilities

in anticipation of the prepayment of the US-dollar non-collateralised notes as described above.

The company anticipates being able to meet its payment obligations from:

– net operating cash flow during the current year;

– existing cash and unutilised committed facilities; and

– the addition of proposed new funding facilities.

However, if the conditions precedent to the full implementation of the FFA are not satisfied, the company may not be able to renew its credit facilities on substantially similar terms, or at all; it may have to pay additional fees and expenses that it might not have to pay under normal circumstances; and it may have to agree to terms that could increase the cost of its debt structure.

If the company is unable to extend its credit facilities, or is unable to renew its credit facilities on terms that are substantially similar to the ones it presently has, it may experience liquidity issues and will have to reduce its levels of planned capital expenditures, reduce or eliminate dividend payments, or take other measures to conserve cash in order to meet its future cash flow requirements. Nevertheless, the company believes it will have sufficient funds to meet its working capital and other cash requirements for at least the next 12 months based on its existing cash balances and anticipated operating cash flows arising during the year.

At 31 March 2006, the company's management believes that it was in compliance with all restrictive covenants contained in the non-collateralised notes, revolving loan facility and the stand-by credit facility agreements. Under the most restrictive of these covenants, it is required to maintain certain ratios of debt to equity and net worth and levels of earnings before interest and taxes and is limited in how much it can spend on an annual basis in relation to asbestos payments to Amaca, Amaba or ABN 60.

Cash Flow

Net operating cash inflows increased by 9% from US$219.8 million to US$240.6 million primarily due to the improved operating performance of the business, offset by increases in operating assets.

Net cash used in investing activities increased from US$149.8 million to US$154.0 million as the company continued to invest in increasing its production capacity. The increase in capital expenditure was partially offset by US$8.0 million net proceeds from the sale of the Chilean flat sheet business in July 2005.

Net cash provided by financing activities increased from a utilisation of US$27.6 million to US$116.5 million in fiscal year 2006 due to the drawdown of US$181.0 million on the company's term facilities in preparation for the prepayment of the US-dollar non-collateralised notes on 8 May 2006, and an increase in proceeds from issuance of shares of US$16.1 million. This increase was offset by an increase of US$32.2 million in dividend payments and a US$20.0 million increase in loan repayments.

Capital Requirements and Resources

James Hardie's capital requirements consist of expansion, renovation and maintenance of its production facilities and construction of new facilities. The company's working capital requirements, consisting primarily of inventory and accounts receivable and payables, fluctuate seasonally during months of the year when overall construction and renovation activity volumes increase.

During each fiscal year in the three-year period ended 31 March 2006, the company's continuing businesses generated cash in excess of its capital requirements. As it continues expanding its fibre cement businesses, the company expects to use cash primarily generated from its operations to fund capital expenditures and working capital. It expects to spend significantly during fiscal year 2007 on capital expenditures that include facility upgrades, on capital to complete new facility construction and on capital to implement new fibre cement technologies. The company plans funding any cash flow shortfalls that it may experience due to payments that may be made under the FFA and payments made to the ATO under the amended assessment, with future cash flow surpluses, cash on hand of US$315.1 million at 31 March 2006, and cash that it anticipates will be available to it under credit facilities.

On 1 December 2005, the company announced that it, the NSW Government and the Performing Subsidiary had entered into a FFA to provide long-term funding to a SPF that will provide compensation for Australian asbestos-related personal injury claims against the former James Hardie Australian subsidiaries. The FFA is subject to a number of conditions precedent, including the company being satisfied with the tax treatment of the proposed funding arrangements and receiving approval of its lenders and shareholders. As of 31 March 2006, James Hardie recorded the asbestos provision of US$715.6 million. The booking of the asbestos provision is based on the company's assumption that the conditions precedent to the effectiveness of the FFA will be fulfilled, including the achievement of tax deductibility of asbestos compensation payments. If these conditions are not fulfilled, the company is likely to propose an alternative settlement, in which case the amount of the provision may be adjusted to reflect the funds available for contribution by the company if deductibility is not achieved. Any such alternative settlement may be subject to conditions precedent and would require lender and shareholder approval.

Currently, the timing of any potential payments is uncertain because the conditions precedent to the FFA have not been satisfied. If the conditions precedent to the FFA are satisfied, James Hardie expects to make an initial payment of approximately A$154.0 million (equal to estimated asbestos claims to be paid over the next three years less existing cash of the Foundation). The company believes that the cash and cash equivalents that it currently has on hand and funds from credit facilities that it anticipates will be available, will be sufficient to fund the initial payment. Additionally, it anticipates that the FFA will require it to make annual payments to fund asbestos claims.

James Hardie is continuing to discuss tax treatment with the ATO and the Federal Treasury.

On 23 June 2006, the ATO advised the company that it has refused to endorse the SPF as a tax concession charity, arguing that, in its opinion, the scope of its activities under the Trust Deed and the FFA does not meet current legislative requirements for such an endorsement.

On 29 June 2006, the ATO issued a ruling to the company to the effect that James Hardie's contributions to the SPF would be tax deductible over the anticipated life of the arrangements in accordance with the recent "blackhole expenditure" Federal Legislation which was enacted in April 2006. At the time of filing this report, the company believes that the ATO's refusal to endorse the SPF as a tax concession charity continues to place the FFA in doubt.

Costs incurred to satisfy the conditions precedent related to FFA may be significant and will negatively affect the company's cash generated from operations over the short-term. The company anticipates that its cash flows from operations, net of estimated payments that may be made under the FFA, will be sufficient to fund its planned capital expenditure and working capital requirements in the short-term. If it does not generate sufficient cash from operations to fund its planned capital expenditures and working capital requirements, the company believes the cash and cash equivalents of US$315.1 million, and the cash that it anticipates will be available to it under credit facilities, will be sufficient to meet any cash shortfalls during at least the next 12 months.

The company expects to rely primarily on increased market penetration of its products and increased profitability from a more favourable product mix to generate cash to fund its long-term growth. Historically, the company's products have been well-accepted by the market and the company's product mix has changed towards higher-priced, differentiated products that generate higher margins. The company has historically reinvested a portion of the cash generated from its operations to fund additional capital expenditures, including research and development activities, which the company believes has facilitated greater market penetration and increased profitability. The company's ability to meet its long-term liquidity needs, including its long-term growth plan, is dependent on the continuation of this trend and other factors discussed herein.

The company believes its 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 net worth. It believes that higher housing prices, which may affect available owner equity and household net worth, are contributors to the currently relatively strong renovation and remodel markets for its products. Over the past several years, favourable economic conditions and historically-reasonable mortgage interest rates in the United States helped sustain new housing starts and renovation and remodel expenditures in the United States. However, increases in housing prices during these years, and increases in interest rates during 2005 and 2006 may cause a levelling-off or decrease in new housing starts over at least the short-term. It expects that business derived from current US forecasts of new housing starts and continued healthy renovation and remodel expenditures will result in its operations generating cash flow sufficient to fund the majority of its planned capital expenditures.

It is possible that a decline in new housing starts in the United States or in other countries in which James Hardie manufactures and sells its products would negatively affect its growth and current levels of revenue and profitability and therefore decrease its liquidity and its ability to generate sufficient cash from operations to meet its capital requirements. During calendar years 2005 and 2006, United States home mortgage interest rates steadily increased and, along with continued housing price increases, the US housing affordability index has decreased. James Hardie believes that these economic factors, along with others, will cause a slow-down in growth of US new housing construction over the short-term, which may reduce demand for its products.

Pulp and cement are primary ingredients in James Hardie's fibre cement formulation, which have been subject to price volatility, affecting the company's working capital requirements. Cement prices increased in fiscal year 2006. Pulp prices increased in fiscal year 2005 and the increase continued during fiscal year 2006. The company expects that cement prices will remain high in the short-term. In addition, it is possible that pulp prices will also fluctuate. To minimise additional working capital requirements caused by rising pulp or cement prices, the company may seek to enter into contracts with suppliers for the purchase of pulp or cement that could fix its pulp or cement prices over the longer-term. However, if pulp or cement prices do not continue to rise, cash generated from its operations may be negatively affected if pulp or cement pricing is fixed over the longer-term.

Freight costs have increased primarily due to continued higher fuel prices. James Hardie expects fuel costs to remain higher, which will increase the company's working capital requirements as compared to fiscal year 2006.

The collective impact of the foregoing factors, and other factors, including those identified in the Cautionary Note Concerning Forward-Looking Statements on page 136, may affect the company's ability to generate sufficient cash flows from operations to meet its short and longer-term capital requirements. The company believes that it will be able to fund any cash shortfalls for at least the next 12 months with cash that it anticipates will be available under its credit facilities and that it will be able to maintain sufficient cash available under those facilities. Additionally, the company could determine it necessary to reduce or eliminate dividend payments, scale back or postpone its expansion plans and/or take other measures to conserve cash to maintain sufficient capital resources over the short and longer-term.

Capital Expenditures
James Hardie's total capital expenditures, including amounts accrued, for continuing operations for fiscal year 2006 was US$162.8 million. The capital expenditures were primarily used to create additional low cost, high volume manufacturing capacity to meet increased demand for the company's fibre cement products and to create new manufacturing capacity for new fibre cement products.

Significant capital expenditures in fiscal year 2006 included (i) completion of the first line at the new Pulaski, Virginia plant and (ii) the continued implementation of the company's ColorPlus® product strategy. This strategy includes constructing additional ColorPlus® coating capacity inside its existing plants. In fiscal year 2006, the company completed construction of, and commenced production on, a new ColorPlus® product line at its Blandon, Pennsylvania plant. In addition, it began construction on new ColorPlus® coating lines at its Reno, Nevada and Pulaski, Virginia plants.

Contractual Obligations

The following table summarises the company's significant contractual obligations at 31 March 2006:

		Payments due During Fiscal Year Ending 31 March			
(Millions of US dollars)	Total	2007	2008 to 2009	2010 to 2011	Thereafter
Long-Term Debt[1]	$ 121.7	$ 121.7	$ –	$ –	$ –
Interest on Long-Term Debt	10.4	10.4	–	–	–
Operating Leases	142.8	15.8	26.3	22.0	78.7
Purchase Obligations[2]	22.2	22.2	–	–	–
Total	$ 297.1	$ 170.1	$ 26.3	$ 22.0	$ 78.7

1 Under the terms of the US-dollar non-collateralised notes agreement (fixed-rate debt), prepayment is permitted and on 28 April 2006, we issued a notice to all noteholders to prepay in full all outstanding notes on 8 May 2006. On that date, the US-dollar non-collateralised notes were prepaid in full, incurring a make-whole payment of US$6.0 million.

2 Purchase Obligations are defined as agreements to purchase goods or services that are enforceable and legally-binding on the company 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 the plant the company is building in Pulaski, Virginia.

The table above does not include amounts related to the future funding obligations for the company's Australian defined benefit plan. James Hardie estimates that its pension plan funding will be approximately US$1.4 million for fiscal year 2007. Projected payments beyond fiscal year 2007 are not currently determinable. See also Note 7 to the consolidated financial statements.

The table above does not include any amounts related to funding obligations that might arise from asbestos–related matters discussed in Note 12 to the consolidated financial statements. Although James Hardie has recorded an asbestos provision at 31 March 2006 of US$715.6 million, conditions precedent to the FFA have not been met. If conditions precedent to the FFA are not met, the company may seek to enter into an alternative arrangement under which it would make payments for the benefit of asbestos claimants. Under alternative arrangements, the estimate may change. Depending on future developments, the impact of future cash funding obligations is significant and the company's financial position, results of operations and cash flows would be materially adversely affected and its ability to pay dividends would be impaired.

In addition, the table above does not include any amounts related to the amended Australian income tax assessment discussed under Note 13 to the consolidated financial statements. James Hardie has not established a provision for the amended assessment because at this time such liabilities are not probable and estimable. On 23 June 2006, the ATO advised that in order to appeal the assessment, the company would be required to make a partial payment of 50% of the A$378.0 million amended assessment (A$189.0 million). This payment will reduce the company's liquidity. In addition, if the company is unsuccessful in its appeal, it would be required to pay the entire assessment, in which case, its financial position, liquidity and cash flow will be materially and adversely affected.

See Notes 9 and 12 to the consolidated financial statements for further information regarding long-term debt and operating leases, respectively.

Off-Balance Sheet Arrangements

As of 31 March 2006 and 2005, the company did not have any material off-balance sheet arrangements.

Inflation

The company does not believe that inflation has had a significant impact on its results of operations for the fiscal years ended 31 March 2006, 2005 or 2004.

Seasonality and Quarterly Variability

James Hardie's 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. Also, general industry patterns can be affected by weather, economic conditions, industrial disputes and other factors.

Outlook

Housing construction in North America is expected to soften to more sustainable levels over the short to medium term as the gradual onset of higher long-term interest rates affects affordability and house price expectations.

In a 14 June 2006 report, NAHB Chief Economist, David Seiders, noted: "The 'moderate' and 'orderly' housing slowdown appears to be on track, marked by systematic declines in mortgage applications, home sales and housing starts as well as by a slowdown in house price appreciation. The process should extend well into next year as long as our broad economic and financial market forecasts stay on track."

Despite an expected moderate softening in new housing construction, the company expects its business to continue growing sales through further penetration of its targeted markets and by increasing the proportion of higher-priced differentiated products in its sales mix.

James Hardie expects its US business to continue to have high costs for raw materials, energy and freight in the first quarter of fiscal year 2007.

In Australia and New Zealand, a further softening of the new housing and renovations markets is expected over the short to medium-term. However, sales volumes are expected to increase through initiatives to grow primary demand for the company's products. Increased sales volumes and cost savings are expected to improve profitability.

Conditions in the Philippines are expected to remain difficult due to some continuing political and economic uncertainty, high levels of inflation, and the company's market share being aggressively pursued by competitors.

James Hardie continues to incur costs associated with the SCI and other related matters, including: discussions with the Federal Treasury and ATO on the tax exempt status of the SPF; co-operating with ASIC's ongoing investigation into the circumstances surrounding the establishment of the Foundation; providing an updated actuarial assessment of the total asbestos liabilities of the former subsidiary companies; and associated legal and advisory costs. These costs are likely to continue to be material over the short term.

In addition, the asbestos provision will be updated annually, based on the most recent actuarial determinations and claims experience. Changes to the actuarial reports may have a material impact on the company's consolidated financial statements.

Critical Accounting Policies

The accounting policies affecting James Hardie's financial condition and results of operations are more fully described in Note 2 to the consolidated financial statements. Certain of the company's 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. The company considers the following policies to be the most critical in understanding the judgments that are involved in preparing its consolidated financial statements and the uncertainties that could affect its results of operations, financial condition and cash flows.

Accounting for Contingencies

James Hardie accounts for loss contingencies in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, "Accounting for Contingencies", under which it accrues amounts for losses arising from contingent obligations when the obligations are probable and the amounts are reasonably estimable. As facts concerning contingencies become known, the company reassesses its situation and makes appropriate adjustments to the consolidated financial statements. For additional information regarding asbestos-related matters and the ATO assessment see Notes 12 and 13 to the consolidated financial statements and *Asbestos Compensation* on pages 10 – 11.

Accounting for Asbestos-Related Payments

During fiscal year 2006, James Hardie and the NSW Government signed the FFA to provide long-term funding for Australian asbestos-related personal injury claims that result from exposure to products made by Former James Hardie Companies.

In the fourth quarter of fiscal year 2006, the company recorded a liability for future asbestos-related payments because it is probable and estimable that it will make payments to fund asbestos-related claims on a long-term basis.

The amount of the asbestos provision is based on the company's best estimate of the probable outcome. This estimate, which reflects the terms of the FFA, includes the most recent actuarial estimate of projected future cash flows prepared by KPMG Actuaries. The asbestos provision includes cash flows that are undiscounted and uninflated and also includes an allowance for the future operating costs of the SPF. The estimate is also adjusted for any anticipated tax deductions arising from Australian legislation which came into force on 6 April 2006.

On 23 June 2006, the ATO advised the company that it has refused to endorse the SPF as a tax concession charity, arguing that, in its opinion, the scope of its activities under the Trust Deed and the FFA does not meet current legislative requirements for such an endorsement.

On 29 June 2006, the ATO issued a ruling to the company to the effect that James Hardie's contributions to the SPF would be tax deductible over the anticipated life of the arrangements in accordance with the recent "blackhole expenditure" Federal Legislation which was enacted in April 2006. At the time of filing this report, the company believes that the ATO's refusal to endorse the SPF as a tax concession charity continues to place the FFA in doubt.

In estimating the potential financial exposure, the actuaries have made a number of assumptions. These include an estimate of the total number of claims by disease type which are reasonably estimated to be asserted through to 2071, the typical average cost of a claim settlement (which is sensitive to, among other factors, the industry in which the plaintiff claims exposure, the alleged disease type and the jurisdiction in which the action is being brought), the legal costs incurred in the litigation of such claims, the proportion of claims for which liability is repudiated, the rate of receipt of claims, the settlement strategy in dealing with outstanding claims, the timing of settlements of future claims and the long-term rate of inflation of claim awards and legal costs.

Further, the actuaries have relied on the data and information provided by the Foundation and Amaca Claim Services and Amaca Pty Ltd (Under NSW External Administration) and have assumed that it is accurate and complete in all material respects. The actuaries have neither verified the information independently nor established the accuracy or completeness of the data and information provided or used for the preparation of the report.

Due to inherent uncertainties in the legal and medical environment, the number and timing of future claim notifications and settlements, the recoverability of claims against insurance contracts, and estimates of future trends in average claim awards, as well as the extent to which the above-named entities will contribute to the overall settlements, the actual amount of liability could differ materially from that which is currently projected and could result in significant debits or credits to the consolidated balance sheet and statement of operations.

On 23 June 2006, the ATO advised the company that it has refused to endorse the SPF as a tax concession charity, arguing that the scope of its activities agreed under the FFA does not meet current legislative requirements for such an endorsement.

If the conditions precedent to the FFA are not met, the company may seek to enter into an alternative arrangement under which it would make payments for the benefit of asbestos claimants. Under alternative arrangements, the estimate may change.

An updated actuarial assessment will be performed as of 31 March each year. Any changes in the estimate will be reflected as a charge or credit to the company's consolidated statement of operations at that date. Material adverse changes to the actuarial estimate would have an adverse effect on the business, results of operations and financial condition.

Since the asbestos provision is denominated in Australian dollars, at each period end there will be either a charge or credit to the consolidated statement of operations to reflect the effect of any change in the A$ to US$ exchange rate.

For additional information regarding the asbestos provision see Note 12 to the consolidated financial statements and *Asbestos Compensation* on pages 10 – 11.

Sales

James Hardie records 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

The company evaluates the collectibility of accounts receivable on an ongoing basis based on historical bad debts, customer credit-worthiness, current economic trends and changes in its customer payment activity. An allowance for doubtful accounts is provided for known and estimated bad debts. Although credit losses have historically been within the company's expectations, it cannot guarantee that it will continue to experience the same credit loss rates that it has in the past. Because the company's 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 affect their ability to make payments and result in the need for additional allowances which would decrease the company's 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 the estimate for the future demand for inventory is greater than actual demand and the company fails to reduce manufacturing output accordingly, it could be required to record additional inventory reserves, which would have a negative impact on its gross profit.

Accrued Warranty Reserve
James Hardie offers various warranties on its products, including a 50-year limited warranty on certain of its fibre cement siding products in the United States. Because its fibre cement products have only been used in North America since the early 1990s, there is a risk that these products will not perform in accordance with the company's expectations over an extended period of time. A typical warranty program requires that the company replace defective products within a specified time period from the date of sale. The company records 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, it adjusts the amount of its warranty provisions as necessary. Although warranty costs have historically been within calculated estimates, if the company's experience is significantly different from its estimates, it could result in the need for additional reserves.

Accounting for Income Tax
The company accounts for income taxes according to SFAS No. 109, "Accounting for Income Taxes", under which it computes its deferred tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes. It must assess whether, and to what extent, it can recover its deferred tax assets. If full or partial recovery is unlikely, the company must increase its income tax expense by recording a valuation allowance against the portion of deferred tax assets that it cannot recover. The company believes that it will recover all of the deferred tax assets recorded (net of valuation allowance) on its consolidated balance sheet at 31 March 2006. However, if facts later indicate that it will be unable to recover all or a portion of its net deferred tax assets, the company's income tax expense would increase in the period in which it determines that recovery is unlikely.

Due to the size and the nature of its business, the company is subject to ongoing reviews by taxing jurisdictions on various tax matters, including challenges to various positions it asserts on its income tax returns. The company accrues for tax contingencies based upon its best estimate of the taxes ultimately expected to be paid, which it updates over time as more information becomes available and includes knowledge of all relevant facts and circumstances, taking into account existing tax laws, the company's experience with previous audits and settlements, the status of current tax examinations and how the tax authorities view certain issues. Such amounts are included in taxes payable or other non-current liabilities, as appropriate. If the company ultimately determines that payment of these amounts is unnecessary, it reverses the liability and recognises a tax benefit during the period in which it determines that the liability is no longer necessary. The company records an additional charge in the period in which it determines that the recorded tax liability is less than it expects the ultimate assessment to be.

In March 2006, RCI Pty Ltd (RCI) a wholly-owned subsidiary of the company received an amended assessment from the ATO in respect of RCI's income tax return for the year ended 31 March 1999. The company believes that the probable and estimable requirements under SFAS No. 5, "Accounting for Contingencies", for recording a liability have not been met with respect to the amended assessment. Therefore it has not recorded any liability as of 31 March 2006 for the amended assessment. For additional information on the company's accounting policy regarding the amended assessment, see Note 13 to the consolidated financial statements.

For additional information regarding income tax, see Note 13 to the consolidated financial statements.

Definitions

Financial Measures – US GAAP Equivalents

EBIT and EBIT margin – EBIT is equivalent to the US GAAP measure of operating income. EBIT margin is defined as EBIT as a percentage of net sales. James Hardie believes EBIT and EBIT margin to be relevant and useful information as these are the primary measures used by management to measure the operating profit or loss of its business. EBIT is one of several metrics used by management to measure the earnings generated by the company's operations, excluding interest and income tax expenses. Additionally, EBIT is believed to be a primary measure and terminology used by its 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 the company has defined them, may not be comparable to similarly titled measures reported by other companies.
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" thickness.
msf – thousand square feet, where a square foot is defined as a standard square foot of 5/16" thickness.

Financial Ratios

Gearing Ratio – Net debt/cash divided by net debt/cash plus shareholders' equity.
Net interest expense cover – EBIT divided by net interest expense.
Net interest paid cover – EBIT divided by cash paid during the period for interest, net of amounts capitalised.
Net debt payback – Net debt/cash divided by cash flow from operations.
Net debt/cash – short-term and long-term debt less cash and cash equivalents.

Non-US GAAP Financial Measures

EBIT and EBIT margin excluding asbestos provision – are not measures of financial performance under US GAAP and should not be considered to be more meaningful than EBIT and EBIT margin. James Hardie has included these financial measures to provide investors with an alternative method for assessing its operating results in a manner that is focused on the performance of its ongoing operations and provides useful information regarding its financial condition and results of operations. The company uses these non-US GAAP measures for the same purposes.

Millions of US dollars	**FY06**	FY05
EBIT	**$ (434.9)**	$ 196.2
Asbestos provision	**715.6**	–
EBIT excluding asbestos provision	**$ 280.7**	196.2
Net Sales	**$ 1,488.5**	$ 1,210.4
EBIT margin excluding asbestos provision	**18.9%**	16.2%

EBIT excluding asbestos provision, impairment charge and SCI and other related expenses – is not a measure of financial performance under US GAAP and should not be considered to be more meaningful than EBIT. James Hardie has included this financial measure to provide investors with an alternative method for assessing its operating results in a manner that is focused on the performance of its ongoing operations and provides useful information regarding its financial condition and results of operations. The company uses this non-US GAAP measure for the same purposes.

Millions of US dollars	**FY06**	FY05
EBIT	**$ (434.9)**	$ 196.2
Asbestos provision	**715.6**	–
Impairment of roofing plant	**13.4**	–
SCI and other related expenses	**17.4**	28.1
EBIT excluding asbestos provision, impairment charge and SCI and other related expenses	**$ 311.5**	$ 224.3

Operating profit from continuing operations excluding asbestos provision – is not a measure of financial performance under US GAAP and should not be considered to be more meaningful than operating profit from continuing operations. The company has included this financial measure to provide investors with an alternative method for assessing its operating results in a manner that is focused on the performance of its ongoing operations. The company uses this non-US GAAP measure for the same purposes.

Millions of US dollars	**FY06**	FY05
Operating (loss) profit from continuing operations	**$ (506.7)**	$ 127.9
Asbestos provision	**715.6**	–
Operating profit from continuing operations excluding asbestos provision	**208.9**	127.9

Diluted earnings per share from continuing operations excluding asbestos provision – is not a measure of financial performance under US GAAP and should not be considered to be more meaningful than Diluted earnings per share from continuing operations. The company has included this financial measure to provide investors with an alternative method for assessing its operating results in a manner that is focused on the performance of its ongoing operations. The company's management uses this non-US GAAP measure for the same purposes.

Millions of US dollars	**FY06**	FY05
Operating (loss) profit from continuing operations	**$ (506.7)**	$ 127.9
Asbestos provision	**715.6**	–
Operating profit from continuing operations excluding asbestos provision	**$ 208.9**	$ 127.9
Weighted average common shares outstanding (Millions)		
– Diluted	**465.0**	461.0
Diluted earnings per share from continuing operations excluding asbestos provision (US cents)	**44.9**	27.7

Reconciliation of Adjusted EBITDA and Adjusted EBITDA excluding asbestos provision to net cash provided by operating activities:

	Years Ended 31 March				
Adjusted EBITDA (Millions of US dollars)	**2006**	2005	2004	2003	2002
Net cash provided by operating activities	**$ 240.6**	$ 219.8	$ 162.6	$ 64.8	$ 76.6
Adjustments to reconcile net income to net cash provided by operating activities, net	**(791.3)**	(61.2)	(51.1)	62.1	(41.1)
Change in operating assets and liabilities, net	**44.0**	(31.7)	18.1	43.6	(4.7)
Net (loss) Income	**(506.7)**	$ 126.9	$ 129.6	$ 170.5	$ 30.8
Loss (Income) from discontinued operations	**–**	1.0	(4.3)	(87.0)	(3.5)
Income tax expense	**71.6**	61.9	40.4	26.1	3.1
Interest expense	**7.2**	7.3	11.2	23.8	18.4
Interest income	**(7.0)**	(2.2)	(1.2)	(3.9)	(2.4)
Other expense (income)	**–**	1.3	(3.5)	(0.7)	0.4
Depreciation and amortisation	**45.3**	36.3	36.4	28.7	39.9
Adjusted EBITDA	**(389.6)**	232.5	208.6	157.5	86.7
Asbestos provision	**715.6**	–	–	–	–
Adjusted EBITDA excluding asbestos provision	**$ 326.0**	$ 232.5	$ 208.6	$ 157.5	$ 86.7

Adjusted EBITDA and Adjusted EBITDA excluding asbestos provision – are not measures of financial performance under US GAAP and should not be considered alternatives to, or more meaningful than, income from operations, net income or cash flows as defined by US GAAP or as measures of our profitability or liquidity. Not all companies calculate Adjusted EBITDA and Adjusted EBITDA excluding asbestos provision in the same manner as we have and, accordingly, Adjusted EBITDA and Adjusted EBITDA excluding asbestos provision may not be comparable with other companies. We have included information concerning Adjusted EBITDA and Adjusted EBITDA excluding asbestos provision 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 and Adjusted EBITDA excluding asbestos provision have been adjusted for non cash charges such as goodwill, as well as non operating income and expense items.

Working Capital – is not a US GAAP measure of assets employed and should not be considered an alternative to, or more meaningful than, total current assets or total assets as defined by US GAAP. The company has included information concerning working capital because it believes that this data is commonly used by investors to evaluate the efficiency of the company's business operations.

Effective Income Tax Rate excluding asbestos provision – is not a measure of financial performance. We have included data on effective tax rate excluding asbestos provision because we believe that this data is commonly used by investors.

Millions of US dollars	**FY06**	FY05
Operating (loss) profit from continuing operations before income tax	**(435.1)**	189.8
Asbestos provision	**715.6**	-
Operating (loss) profit from continuing operations before taxes excluding asbestos provision	**280.5**	198.8
Tax charge	**71.6**	61.9
Effective income tax rate excluding asbestos provision	**25.5%**	32.6%

Endnotes

Volume and Average Net Sales Price – Asia Pacific Fibre Cement – Adjusted:

In fiscal 2003 and 2004, our Asia Pacific Fibre Cement segment reported incorrect volume figures due to errors when converting to our standard square feet metric 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. This Management's Discussion and Analysis uses these revised volume and average net sales price.

	Years Ended 31 March	
	2004	2003
Volume (mmsf1)	362.1	349.9
Average net sales price per unit (per msf1)	A$ 862	A$ 887

Net Sales – Philippines Fibre Cement – Adjusted:

In fiscal 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 and analysis of Philippines Fibre Cement net sales. Therefore, for discussion purposes only, for the Philippines Fibre Cement business, we adjusted the 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 the adjustment to Philippines Fibre Cement net sales for fiscal 2004.

(Millions of US dollars)	2004
Previously Reported	24.2
Adjustment	(3.4)
Adjusted Net Sales	20.8