Peter McCausland

To our Shareholders, Customers, Associates and Friends,

Twenty years ago, I was struck by the compelling economics of the packaged gas business. Gas cylinders are low-cost assets with very long useful lives, which produce recurring revenues and steady cash flow. The gases are used in a wide range of industries and are integral to our customers' business.

From the start, we have taken a simple "plain vanilla" approach to this business, managing it in a straightforward and honest manner, without a lot of complexity. It has been – and will remain – a specialized distribution business, built on local density, managed close to the customer, leveraging its national scale, with packaged gas at the center of what we do. I am not suggesting that building Airgas has been easy. We have had our growing pains as we became a larger company, expanded our capabilities, and added the infrastructure needed to meet and exceed our customers' requirements. But, by staying focused on our business model for packaged gases and on running and integrating the companies we acquired, we have become the industry leader.

We have focused on this simple strategy for this year's annual report, because there is a renewed interest in companies like ours, with strong cash flow and easy-to-understand business models. We think ours is a model that has worked well for 20 years and will continue to work well 20 years from now.

Rewarding year

The results we achieved in fiscal 2002 reflect the strength of our core business, even during a weak industrial economy. Sales rose slightly, to $1.64 billion from $1.63 billion, boosted by increases in medical gas, liquid carbon dioxide and dry ice and by some price improvement, which helped offset weakness in the manufacturing sector.

Adjusted earnings per share, excluding certain gains and charges, increased 8% over the previous year to $0.78 per diluted share. Our net result for the year was a loss, due to mandated accounting changes related to SFAS 142 and how we book goodwill.

Free cash flow increased 56% from $0.94 per diluted share to $1.47 per diluted share, which helped us reduce debt by $118 million before acquisition and divestiture activity. As a result, in February we were able to finance our largest acquisition – the majority of the U.S. packaged business of Air Products and Chemicals, Inc. – entirely with senior bank debt.

During fiscal 2002, we successfully launched Project One, which dedicated people and resources to focus on short-term value-enhancing programs and infrastructure programs to support future growth. We completed the value phase, which improved pricing discipline, contract management, and working capital management — and increased operating profit by $10 million, funding most of our Project One costs for the year. These early successes are vital because they help fund longer-term infrastructure programs that will help complete the platform needed to reach our strategic goals of $2 billion in sales with operating margins of at least 10% by fiscal 2005.

Profitable growth

In 1998, when we began to integrate our business, we mapped out two strategic objectives. The first is to drive market-leading sales growth. The second, to become the low-cost supplier. During fiscal 2002, we continued to make progress on both of these objectives.

Here's how we increased market penetration to drive market-leading sales growth:

- Strategic Accounts grew 10% to $165 million in sales in fiscal 2002 as larger customers turned to us to reduce supply chain costs.
- A third of our Strategic Account customers buy all three major product categories – gases, hardgoods, and safety.
- Medical gases through our Puritan Medical Products division increased 8%.
- Same-store sales of liquid carbon dioxide and dry ice increased 8%. We are strengthening our national position through plant upgrades and a new plant in Hopewell, Va., which opens January 2003.
- We rolled out our b2b.airgas.com website in September 2001, with an electronic catalog of almost 200,000 items. The site already has 5,000 registered users and we expect website sales to reach $10 million annually by the end of fiscal 2003. These sales and other electronic-channel sales are targeted to reach $100 million annually by fiscal year end.

We also took steps to improve our low-cost position, primarily through Project One initiatives designed to increase operating efficiencies. These entail standardizing business practices, centralizing procurement and other key functions, cylinder management, sharing best practices, and outsourcing certain financial services through a shared services center, which begins operation in July 2002.

Building for the future

Our highest priority for fiscal 2003 is to complete the integration of the Air Products acquisition. We remain confident that we will achieve the anticipated synergies as this business fits well into our existing national network. This acquisition will move us closer to reaching our strategic objectives: the pursuit of market-leading growth and the low-cost position. On the following pages, you will find more about this landmark acquisition and all it offers.

In the '80s and '90s, Airgas generated shareholder value through acquisitions. We are well past the roll-up phase now. When you look at all we have today: nearly 800 locations, 8,500 associates, and 5 million cylinders, it's clear that we now have the opportunity to generate shareholder value simply by maximizing the richness of what we acquired.

Nevertheless, Airgas today is better positioned than ever to make successful acquisitions, and we expect to see opportunities. More than half the market is served by about 900 independent distributors, and vertically integrated producers have another 30% market share. We believe industry consolidation will continue and stand ready to pursue strategic acquisitions when they arise.

As I write this letter, the economic outlook is uncertain. However, our current capabilities leave us well positioned to grow, regardless of overall market trends, by serving current customers with more products, by attracting customers who will need our unique capabilities, and by using our geographic and product diversity to capitalize on areas of market-leading growth.

Team Airgas

While our success is built on a simple strategy, it is our 8,500 Airgas associates who bring this strategy to life. We have the strongest team in the packaged gas business — from engineers and chemists to sales specialists, process welding experts, fillers and drivers, and an experienced management team. But, it is not just about their skills.

Airgas people have created a culture that is unique – a culture that has helped us integrate diverse companies, launch bold business initiatives, and add new products and services. Most companies have a vision and mission. A few companies have a culture that is aligned with their vision and mission, and Airgas is one of them.

Our people have a passion and energy about their work that truly is an asset to Airgas. With their continued commitment to winning in the packaged gas business, the next 20 years should provide even more value to customers, shareholders and associates alike.

Sincerely,

Peter McCausland
Chairman and Chief Executive Officer
June 7, 2002