



PETER MCCAUSLAND

TO OUR SHAREHOLDERS, CUSTOMERS, ASSOCIATES AND FRIENDS,

I remember back in 1983 when we made our third acquisition, a company called Potomac Oxygen with a branch in Alexandria, Virginia. The store was a trailer and the cylinder storage shed was an old icehouse. TDH Capital Company had financed us, and I took the partners to see what we were buying. As we walked away from the shed, one said: “Peter, there sure isn’t a lot of romance in this business.”

Maybe not “romance,” but there has always been a passion about running this business at the local level, in facilities close to our customers. Through more than 300 acquisitions, and now nearly 800 locations, Airgas has sustained the same local focus and entrepreneurial spirit we had in Alexandria 20 years ago.

We’ve come a long way since that icehouse, as you would see in a visit to Cheshire, Connecticut—with its fast-fill plant and specialty gas labs—or our new carbon dioxide plant in Hopewell, Virginia. **We have emerged as the industry leader in packaged gases and related supplies, a leading distributor of safety products, and one of the top five industrial distributors in the U.S.**

We’ve built a dynamic organization, with a clear national strategy, yet filled with people passionate about succeeding locally. We give local leaders autonomy, and they act like owners. We’ve structured the business to help customers with solutions, regardless of their size.

PROVING OUR STRENGTH

This past year proved the strength of our organization. We faced a business environment that was tough for all industrial distributors. Existing customers bought less. New customers were not buying much. And, the elusive economic recovery always seemed two quarters away. Yet, Airgas found ways to grow, increase earnings, improve margins, and execute strategic initiatives to strengthen our infrastructure. At the same time, we successfully integrated our largest acquisition ever, the U.S. packaged gas business of Air Products, and closed four additional acquisitions by year-end.

Total sales increased 9% to nearly \$1.8 billion. Acquisition growth, as well as targeted growth in specialty, medical and bulk gases, and Strategic Accounts, helped offset an extremely difficult industrial economy, as reflected in a 2% decline in same-store sales.

As outlined in our Financial Highlights, we grew our adjusted earnings per share by 24% to \$0.97, excluding three cents in restructuring charges, which was in line with our expectations. Last year’s adjusted earnings per share, excluding a change in accounting and other charges, were \$0.78. Free cash flow remained strong at \$104 million, contributing to debt reduction of \$96 million. Return on capital was 9.1 percent, a 60-basis-point increase over last year.

Demonstrating our confidence, we declared our first quarterly cash dividend of \$0.04 per share payable on June 30, 2003. We believe shareholders deserve a return without needing to sell their shares. We are confident that our cash flow will allow us to pay dividends without compromising our ability to make acquisitions, to fund capital investments, and to pay down debt.

FINDING GROWTH IN CHALLENGING TIMES

So, where did Airgas find growth in a bleak U.S. industrial economy? Fortunately, we began broadening our customer base in the mid 1990s into targeted service industries, which now represent about 20% of total revenue, helping to counterbalance industrial cycles. These customers are more likely to use non-traditional products, such as medical gases, specialty gases, and carbon dioxide and dry ice.

Among the key growth contributors were:

MEDICAL GASES: Puritan Medical Products and Airgas regional companies achieved 8% growth in medical gases for the second consecutive year, driving growth through innovation. For example, Puritan Medical Products sold 30,000 Walk O₂ Bout portable oxygen delivery systems and expanded the Puritan Plus program to deliver gas and equipment on behalf of home care providers.

SPECIALTY GAS: Specialty gas sales for the year were \$127 million, up 6% after adjusting for the business acquired from Air Products. As expected, that acquisition added new products, some strong customer relationships and new expertise. Now we are working to build a world-class specialty gas infrastructure to sustain our leadership position. Recently, 20 of our 52 specialty gas laboratories

received ISO 9001:2000 certification for the manufacture and sale of specialty gases, demonstrating our commitment to quality and consistency.

STRATEGIC ACCOUNTS: We grew sales to larger customers looking for ways to manage supply chains and reduce vendors to \$226 million, up 7% from a year ago on a same-store sales basis. In addition to integrating about \$20 million in business from Air Products, we signed 80 new accounts in fiscal 2003.

ACQUISITIONS: We successfully integrated the Air Products acquisition and made additional acquisitions. Most notably, we acquired the assets of Welding Metals, a Detroit-based distributor of packaged gas and welding supplies with about \$10 million in annual sales, and we added 14 branches in Florida, Georgia and California from Union Industrial Gas Group with more than \$20 million in gas and hardgoods sales.

In addition, we increased bulk gas sales by 9% and grew our Red-D-Arc welder rental business 8%. Safety telesales grew 4%, despite a flat overall safety market due to the decline in industrial employment.

We also positioned the company to better serve customers by strengthening our infrastructure and streamlining processes. We moved to centralize purchasing into four buying centers and implement demand-planning software. We continued to pursue brand strategies to promote our own Radnor® private-label products and generate more sales from our largest suppliers.

We launched a sales effectiveness program to help sales reps set goals, target accounts, measure their progress and monitor their performance. We also migrated 13,000 safety-only field accounts to telesales to more effectively serve those customers and free up field sales reps to pursue other business.

CULTIVATING STRATEGIC PLANNING AND LEADERSHIP

I have spent much of the past year developing a formal strategic planning process. Kelly Justice, vice president of strategic planning and market development, leads a strategy council that will continually review and update our strategies, as well as help us find new strategies to meet emerging customer needs.

I also have started a formal process to promote leadership at every level of Airgas. Last fall, Airgas leaders reviewed the factors responsible for Airgas' success, including our entrepreneurial culture and our decentralized organizational structure. We developed a leadership model, which includes two sets of attributes. One set—including collaboration, flexibility, integrity and communication—relates to our people and our customers. The other set—with vision, entrepreneurship, accountability and prioritization—focuses on our business performance.

Using this model, we are driving leadership training to the "next wave" of 200 to 300 Airgas managers, to ensure "Leadership at Every Level." This will enhance the organizational health of Airgas, which is the foundation for sustainable growth.

This year, we also sadly lost John Musselman, a good friend who epitomized the Airgas leader. Muss attacked his illness like he did his job—head-on with honesty, strength and determination. In honor of his fight, Airgas made a contribution in Muss' name to leukemia research at the Dana-Farber Cancer Institute—to help others in their fight against this disease.

THE YEAR AHEAD

The year ahead will continue to prove our leadership. I remain convinced that Airgas has the ability to execute in any environment and the stamina to continue toward our goal of \$2 billion in sales with operating margins of at least 10% by the end of fiscal 2005.

We will look for ways to control costs, manage our margins, and continue to pursue core growth niches like medical and specialty gas, and Strategic Accounts. We will find profitable growth with or without a general upswing in the industrial market by selling more product lines to customers in our traditional markets, including safety, Red-D-Arc welder rentals and bulk and MicroBulk gas delivery. We also plan to stay disciplined in finding the right opportunities to make acquisitions and integrate those operations into our national network.

Finally, we have agreed that Airgas needs to rededicate itself to traditional industrial gas and welding supply customers, the kind served from that icehouse 20 years ago. We will begin a long-term project to improve the buying experience of these customers by enhancing training programs, launching retail marketing programs, and focusing on our local facilities and the services they provide.

I'd like to thank customers for entrusting us with their business and associates for their leadership at every level.

By listening to our customers and associates through the years, by thinking nationally and leading locally, we have become the industry leader and have repositioned Airgas for long-term success.

Sincerely,



PETER MCCAUSLAND | CHAIRMAN AND CHIEF EXECUTIVE OFFICER
JUNE 7, 2003