

Management's Discussion and Analysis

Airgas, Inc. and Subsidiaries

Results of Operations: 2003 Compared to 2002

Overview

The Company's net sales for the fiscal year ended March 31, 2003 ("fiscal 2003") were \$1.79 billion compared to \$1.64 billion in the prior year. Sales growth was driven by the fiscal 2002 fourth quarter acquisition of the majority of Air Products and Chemicals, Inc. ("Air Products") U.S. packaged gas business. The Company continues to pursue opportunistic acquisitions to complement its national distribution network, completing four acquisitions in fiscal 2003. Although there was significant acquisition-related sales growth, net sales were adversely affected by the sluggish economic environment. The weak manufacturing and industrial markets contributed to a same-store sales decline of 1.7% compared to the prior year reflecting lower hardgoods sales mitigated by higher gas and rent sales. Higher gas and rent sales reflect the Company's focus on strategic sales initiatives related to medical and bulk gases and strategic account customers. The Company's sales initiatives contributed to an 8% increase in medical gas sales, a 9% increase in bulk gas delivery sales, and a 7% increase in sales to strategic account customers. With a focus on controlling costs and improving operational effectiveness, the Company has also embarked on other strategic initiatives, including the centralization of certain hardgoods procurement functions, roll-out of an inventory management system, and implementation of a sales force effectiveness program. The procurement centralization and inventory management system are expected to help lower both purchasing and inventory carrying costs. The sales force effectiveness program will assist the Company's sales representatives in targeting, monitoring and more effectively managing their customer accounts. Management believes that these sales and infrastructure programs will position the Company well to take advantage of a future economic rebound.

Fiscal 2003 net earnings were \$68.1 million, or \$.94 per diluted share, compared to a net loss of \$10.4 million, or a loss of \$.15 per diluted share, in fiscal 2002.

As discussed in the "Income Statement Commentary" below, fiscal 2003 results were affected by the following:

- special charges of \$2.7 million (\$1.7 million after-tax), or \$.03 per diluted share, consisting of a restructuring charge related to the integration of the business acquired from Air Products and costs related to the consolidation of certain hardgoods procurement functions.

Fiscal 2002 results were affected by the following

- a non-cash after-tax charge of \$59 million, or \$.84 per diluted share, representing the cumulative effect of a change in accounting principle associated with the adoption of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*,
- a litigation settlement charge of \$8.5 million (\$5.7 million after-tax), or \$.08 per diluted share, and
- a net non-recurring gain of \$1.9 million (\$120 thousand after-tax) resulting from divestitures and a write-down of a business held for sale to its net realizable value.

During fiscal 2003, the Company successfully integrated the business acquired from Air Products in the prior year. In addition, during fiscal 2003, the Company completed the acquisition of four complementary packaged gas distributors with combined annual sales of approximately \$33 million. The acquired businesses will further expand the Company's broad distribution network and national market reach.

Strong cash flow fundamentals have been characteristics of the Company since its inception. The cash flow generated by the Company, excluding the cash generated from the expanded trade receivables securitization program that was used to pay down the Company's revolving credit facilities, enabled it to repay debt of \$93.5 million in fiscal 2003. Additionally, the Company was able to reduce its off-balance sheet commitments by \$2.5 million in fiscal 2003. Lower interest rates prevalent in the economy during fiscal 2003 also reduced the Company's debt service requirements and aided in the ability to repay debt as well as favorably impacted net earnings during the year.

Looking forward, the Company anticipates that fiscal 2004 may be difficult given the economic climate. The Company estimates that fiscal 2004 net earnings will be approximately \$1.05 to \$1.12 per diluted share. The low-end of the range is based on a continuation of the economic conditions experienced in fiscal 2003, while the high-end of the range reflects a modest improvement in the economy during fiscal 2004. Further, the Company estimates that net earnings in the fiscal 2004 first quarter will be \$.24 to \$.26 per diluted share. Same-store sales growth of 1% is targeted for the first half of fiscal 2004. Barring any significant deterioration in the economy, the Company intends to continue its initiatives designed to position itself for growth in the future as well as take advantage of acquisition opportunities as they arise.

Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

Income Statement Commentary

Net Sales

Net sales increased 9.2% in fiscal 2003 compared to fiscal 2002 driven primarily by the prior year acquisition of Air Products' packaged gas business, while same-store sales declined 1.7%. The Company estimates same-store sales based on a comparison of current period sales to prior period sales, adjusted for acquisitions and divestitures. The pro-forma adjustments consist of adding acquired sales to, or subtracting sales of divested operations from, sales reported in the prior period. These pro forma adjustments are not reflected in the table below. The intercompany eliminations represent sales from the Gas Operations segment to the Distribution segment. The Company previously reflected these elimination entries within the Gas Operations segment.

<i>(In thousands)</i>	2003	2002	<i>Increase (Decrease)</i>	
Distribution	\$ 1,642,076	\$ 1,494,267	\$ 147,809	9.9%
Gas Operations	183,849	173,594	10,255	5.9%
Intercompany eliminations	(38,961)	(31,814)	(7,147)	
	<u>\$ 1,786,964</u>	<u>\$ 1,636,047</u>	<u>\$ 150,917</u>	<u>9.2%</u>

The Distribution segment's principal products include industrial, medical and specialty gases, process chemicals, equipment rental and hardgoods. Industrial, medical and specialty gases consist of packaged and small bulk gases. Equipment rental fees are generally charged on cylinders, cryogenic liquid containers, bulk tanks, tube trailers and welding equipment. Hardgoods consist of welding supplies and equipment, safety products, and industrial tools and supplies. Distribution segment sales increased \$148 million (9.9%) driven by acquisitions, partially offset by a decline in same-store sales. The Company estimates that net acquisition and divestiture activity contributed \$181 million to sales in fiscal 2003. The net acquisition and divestiture activity primarily reflects the current year impact of the February 28, 2002 acquisition of Air Products. The Air Products' operations contributed \$17.6 million to the Company's fiscal 2002 net sales. On a same-store basis, the Distribution segment's sales decreased \$33 million (-2.0%) reflecting a decline in hardgoods same-store sales of \$42 million (-5.2%), partially offset by gas and rent sales growth of \$9 million (1.1%). The decline in hardgoods same-store sales resulted from lower sales volumes of industrial tools and welding hardgoods, reflecting the general weakness in the industrial and manufacturing sectors of the economy. Although overall safety product sales were flat due to a decline in branch-based sales, safety product sales through the telesales channel grew 4%.

Distribution gas and rent same-store sales growth was driven by sales initiatives related to medical and bulk gases, as well as strategic accounts. The growth achieved through these initiatives was partially offset by volume declines in industrial gases reflecting the general weakness in the industrial and manufacturing sectors of the economy. Fiscal 2003 medical gas and rent revenues grew 8% to \$125 million versus the prior year reflecting volume gains.

Bulk gas and rent revenues increased to approximately \$100 million, representing a 9% increase over the prior year with pricing remaining relatively stable. On a same-store basis, sales to strategic account customers (sales to large customers with multiple locations) grew 7% to \$226 million in fiscal 2003 reflecting the Company's success in leveraging its broad distribution network to service large customers. Although several major strategic account customers purchased lower volumes of products, the addition of nearly 80 new strategic account customers during fiscal 2003 generated sales growth and supported the Company's long-term objective of growing strategic account sales by 10% annually. Rental revenue was also favorably impacted by an 8% increase in welding equipment rentals from the Company's expansion of its rental welder fleet. The Company has followed a strategy of focusing on strategic sales initiatives to drive sales growth and market penetration in the industries that it serves. The strategic sales initiatives are designed to develop niches in products and services that are expected to grow at a faster rate than the overall economy and to position the Company for growth into the future.

The Gas Operations segment's sales primarily include dry ice and carbon dioxide that are used for cooling and the production of food, beverages and chemical products. In addition, the segment includes businesses that produce and distribute specialty gases and nitrous oxide. Net of intercompany sales eliminations, Gas Operations' sales increased \$3.1 million (2.2%), principally from net acquisition and divestiture activity and same-store sales growth. Acquired sales of high-end specialty gases from the Air Products acquisition more than offset divested sales from two nitrous oxide plants sold in the third quarter of fiscal 2002. Same-store sales increased \$1.5 million (1%) driven by specialty gas sales and higher volumes of liquid carbon dioxide associated with the January 2003 completion of a new carbon dioxide plant in Hopewell, Virginia.

Gross Profits

Gross profits do not reflect depreciation expense and distribution costs. As disclosed in Note 1 to the Consolidated Financial Statements, the Company reflects distribution costs as elements of Selling, Distribution and Administrative Expenses and recognizes depreciation on all its property, plant and equipment on the income statement line item "Depreciation." Some companies may report certain or all of these costs as elements of their Cost of Products Sold. Consequently, gross profits discussed below may not be comparable to those of other entities.

Gross profits increased 14.6% and the gross profit margin increased 240 basis points to 52.4% in fiscal 2003 compared to 50% in fiscal 2002.

<i>(In thousands)</i>	2003	2002	<i>Increase</i>	
Distribution	\$ 835,756	\$ 724,173	\$ 111,583	15.4%
Gas Operations	100,892	93,121	7,771	8.3%
	<u>\$ 936,648</u>	<u>\$ 817,294</u>	<u>\$ 119,354</u>	<u>14.6%</u>

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Distribution gross profits increased approximately \$112 million (15.4%) primarily from the Air Products acquisition. The Distribution segment's gross profit margin of 50.9% in fiscal 2003 increased 240 basis points from 48.5% in fiscal 2002. The gross margin improvement resulted from a shift in sales mix towards higher-margin gas and rent and reduced product discounting associated with the Company's hardgoods discount management program. The shift in sales mix was primarily attributable to the Air Products acquisition, which had a sales mix of 76% gas and rent. On a same-store basis, lower volumes of hardgoods also contributed to the shift in sales mix towards gas and rent. Distribution segment sales consisted of 52.6% gas and rent compared to 47.3% in the prior year.

Gas Operations' gross profits increased \$7.8 million (8.3%) driven by lower raw material and production costs of the dry ice operations and net acquisition and divestiture activity. Gas Operations' gross profits were helped by lower raw material and production costs associated with dry ice, which reduced the cost per ton produced. Gross profits attributable to specialty gas business acquired from Air Products more than compensated for the fiscal 2002 divestiture of two nitrous oxide plants. Same-store sales growth of specialty gases also contributed to the increase in Gas Operations' gross profits. Gas Operations' gross profit margin of 54.9% increased 130 basis points from 53.6% in the prior year. Gas Operations' gross profit margin percentages were revised to reflect the change in the application of intercompany eliminations.

Operating Expenses

Selling, distribution and administrative expenses ("SD&A") consist of labor and overhead associated with the purchasing, marketing and distribution of the Company's products, as well as costs associated with a variety of administrative functions such as legal, treasury, accounting, tax and facility-related expenses. SD&A expenses increased \$78.9 million (12.7%) compared to the prior year principally from the addition of the Air Products' operations. Although salaries and benefits, fuel and acquisition integration costs increased in fiscal 2003 compared to the prior year, the increases were partially mitigated by lower legal expenses and management's focus on expense control in other areas. Legal expenses in Fiscal 2002 included a charge of \$8.5 million associated with the settlement of litigation brought by a competitor. There were no similar charges in Fiscal 2003. As a percentage of net sales, SD&A expenses increased 120 basis points to 39.1% compared to 37.9% in the prior year. The increase in operating expenses as a percentage of net sales reflects the addition of the Air Products business, a majority of which is comprised of the distribution of packaged gases. Packaged gas distribution typically carries higher operating expenses than the hardgoods portion of the business and corresponding higher gross profit margins.

Depreciation expense of \$73.5 million in fiscal 2003 increased \$8.7 million (13.4%) compared to \$64.8 million in fiscal 2002. The increase in depreciation expense was primarily due to the addition of the fixed assets from the Air Products acquisition.

Amortization expense of \$6.4 million in fiscal 2003 decreased \$1.8 million compared to \$8.2 million in fiscal 2002. The decrease in amortization expense was primarily attributable to the expiration of certain non-compete agreements.

Special Charges

Special charges of \$2.7 million incurred by the Distribution segment in fiscal 2003 consist of a first quarter restructuring charge related to the integration of the business acquired from Air Products and costs related to the consolidation of certain hardgoods procurement functions. The special charges included facility exit costs associated with the closure of certain facilities and severance for approximately 130 employees. The facilities exited and the affected employees were part of the Company's existing operations prior to the acquisition of the Air Products business.

Operating Income

Operating income increased 24.7% in fiscal 2003 compared to fiscal 2002.

<i>(In thousands)</i>	2003	2002	Increase	
Distribution	\$ 130,534	\$ 103,430	\$ 27,104	26.2%
Gas Operations	25,348	21,603	3,745	17.3%
	\$ 155,882	\$ 125,033	\$ 30,849	24.7%

The Distribution segment's operating income margin of 7.9% in fiscal 2003 increased 100 basis points compared to 6.9% in fiscal 2002. The operating income margin increase reflects the higher gross profit margin, described above, partially offset by the special charge noted above and an increase in operating expenses as a percentage of sales.

The Gas Operations segment's operating income margin increased 140 basis points to 13.8% compared to 12.4% in fiscal 2002. The improved operating income margin reflects lower raw material and production costs of the Company's dry ice operations, higher gross profits from higher specialty gas sales leveraging fixed manufacturing costs, and a focus on cost control by management.

Interest Expense and Discount on Securitization of Trade Receivables

Interest expense, net, and the discount on securitization of trade receivables totaled \$49.7 million representing a decrease of \$2.2 million (-4.2%) compared to the prior fiscal year. The decrease in interest expense resulted from lower weighted-average interest rates associated with the Company's variable rate debt, partially offset by higher average debt levels. Higher average debt levels resulted from indebtedness associated with acquisition activity, principally the Air Products acquisition.

Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

The Company participates in a securitization agreement with two commercial banks to sell up to \$175 million of qualifying trade receivables. The amount of outstanding receivables under the agreement was \$158.9 million and \$134 million at March 31, 2003 and March 31, 2002, respectively. Net proceeds from the sale of trade receivables were used to reduce borrowings under the Company's revolving credit facilities. The discount on the securitization of trade receivables represents the difference between the carrying value of the receivables and the proceeds from their sale. The amount of the discount varies on a monthly basis depending on the amount of receivables sold and market rates.

As discussed in "Liquidity and Capital Resources," the Company manages its exposure to interest rate risk through participation in interest rate swap agreements. Including the effect of the interest rate swap agreements, the Company's ratio of fixed to variable interest rates at March 31, 2003 was 41% fixed to 59% variable. A majority of the Company's variable rate debt is based on a spread over the London Interbank Offered Rate ("LIBOR"). Based on the Company's outstanding variable rate debt and credit rating at March 31, 2003, for every 25 basis point increase in LIBOR, the Company estimates its annual interest expense would increase approximately \$1.2 million.

Other Income (Expense), net

Other income (expense), net, totaled \$645 thousand of expense in fiscal 2003 compared to \$1.4 million of income in fiscal 2002. Fiscal 2003 included a loss on a divestiture of \$1.7 million partially offset by the favorable resolution of an indemnity claim of \$1.5 million. Fiscal 2002 included a net non-recurring gain of \$1.9 million consisting of a \$7.4 million gain on the divestiture of two nitrous oxide plants partially offset by a \$3.6 million charge to write down a business unit held for sale to its net realizable value and a \$1.9 million loss resulting from an indemnity claim related to a prior period divestiture.

Income Tax Expense

The effective income tax rate was 37.7% of pre-tax earnings in fiscal 2003 compared to 38% in fiscal 2002.

Pursuant to an accelerated depreciation provision of a fiscal 2002 change in the tax law, the Company anticipated receiving a tax refund of approximately \$19 million during fiscal 2003 related to the assets acquired in the Air Products acquisition. After further review, it was concluded that the Company would not be eligible for the refund in fiscal 2003, but instead would receive the cash benefit over the next four years. As a result, an adjustment was made in the first quarter of fiscal 2003 that resulted in approximately a \$19 million reclassification between current and deferred income taxes. The adjustment did not impact net earnings or operating cash flows in the current period or in fiscal 2002.

Earnings before the Cumulative Effect of a Change in Accounting Principle

Earnings before the cumulative effect of a change in accounting principle for fiscal 2003 were \$68.1 million, or \$.94 per diluted share, compared to \$48.6 million, or \$.69 per diluted share in fiscal 2002.

Cumulative Effect of a Change in Accounting Principle

In connection with the adoption of SFAS 142, *Goodwill and Other Intangible Assets*, on April 1, 2001, the Company performed an evaluation of goodwill, which indicated that goodwill of one reporting unit, its tool business, was impaired. Fiscal 2002 included a \$59 million, or \$.84 per diluted share, non-cash charge as the cumulative effect of a change in accounting principle for the write-down of goodwill to its fair value. The impaired goodwill was not deductible for taxes, and consequently, no tax benefit was recorded in relation to the charge.

Net Earnings (Loss)

Net earnings for fiscal 2003 were \$68.1 million, or \$.94 per diluted share, compared to a net loss in fiscal 2002 of \$10.4 million, or a loss of \$.15 per diluted share.

Results of Operations: 2002 Compared to 2001

Overview

The Company's net sales for the fiscal year ended March 31, 2002 ("fiscal 2002") were \$1.64 billion compared to \$1.63 billion in the prior year. Fiscal 2002 was marked by continued slowing of the U.S. economy, particularly in relation to industrial and manufacturing markets. Despite the weak economic environment, the Company was successful in maintaining sales through its focus on strategic sales initiatives, including account penetration through the sale of safety products and sales to strategic account customers. The Company also continued to implement selective price increases and a discount and contract management program during fiscal 2002 that helped offset rising costs related to purchased gases, personnel costs, insurance and process improvement initiatives. Results as reported in fiscal 2002 were a net loss of \$10.4 million, or a loss of \$.15 per diluted share, compared to net earnings of \$28.2 million, or \$.42 per diluted share, in fiscal 2001.

As discussed in the "Income Statement Commentary" below, fiscal 2002 results were affected by the following:

- a non-cash after-tax charge of \$59 million, or \$.84 per diluted share, representing the cumulative effect of a change in accounting principle,
- a litigation settlement charge of \$8.5 million (\$5.7 million after-tax), or \$.08 per diluted share, and
- a net non-recurring gain of \$1.9 million (\$120 thousand after-tax) resulting from divestitures and a write down of a business held for sale to its net realizable value.

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Fiscal 2001 results were affected by the following:

- goodwill amortization of \$14.4 million (\$13.7 million after-tax), or \$.20 per diluted share,
- net special charges of \$3.6 million (\$2.3 million after-tax), or \$.03 per diluted share,
- litigation charges, net, of \$5.8 million (\$3.6 million after-tax), or \$.06 per diluted share, and
- asset impairments associated with two equity affiliates of \$700 thousand after-tax, or \$.01 per diluted share.

Fiscal 2002 was a significant year for the Company. In February 2002, the Company completed the largest acquisition in its 20-year history with the acquisition of the majority of Air Products and Chemicals, Inc.'s U.S. packaged gas business for cash of \$247 million, including transaction costs. The acquisition included 88 locations in 30 states associated with the filling and distribution of cylinders, liquid dewars, tube trailers, and other containers of industrial gases and non-electronic specialty gases, and the selling of welding hardgoods. In September 2001, the Company also acquired six distributor locations from Air Liquide America Corporation ("Air Liquide") for \$11 million. In a separate transaction in October 2001, the Company sold two of its nitrous oxide facilities to Air Liquide for cash proceeds of \$10 million.

The Company entered into an agreement with Praxair, Inc. ("Praxair") settling the litigation brought by Praxair against the Company in July 1996. The litigation alleged tortious interference with Praxair's right of first refusal agreement with National Welders Supply Company, Inc. The parties entered into the settlement agreement in order to avoid the time and expense of a lengthy trial, which was scheduled to begin in July 2002. The settlement resulted in the Company recognizing a charge of \$8.5 million in the fourth quarter of fiscal 2002.

In July 2001, the Company refinanced its revolving credit facilities to extend the term to 2006. Concurrent with the financing, the Company issued \$225 million of 9.125% senior subordinated notes. In conjunction with the Air Products acquisition, the Company also obtained a \$100 million term loan from a syndicate of lenders. These transactions enabled the Company to finance the Air Products acquisition entirely with senior bank debt. In fiscal 2002, exclusive of acquisition and divestiture activity and the Company's trade receivables securitization, the Company reduced total debt by \$119 million. The ability to reduce debt is indicative of the strong cash flow characteristics of the Company's business.

On April 1, 2001, the Company adopted Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets*.

SFAS 142 requires goodwill and intangible assets with indefinite useful lives to no longer be amortized, but instead be tested for impairment at least annually. With the adoption of SFAS 142, the Company used new criteria to assess whether goodwill associated with its business units was impaired. The valuation indicated that goodwill associated with the Company's tool business was impaired, which resulted in the recognition of a \$59 million non-cash charge as the cumulative effect of a change in accounting principle. The impaired goodwill was not deductible for taxes, and accordingly, no tax benefit was recorded in relation to the charge.

As prescribed by SFAS 142, fiscal 2002 results exclude the amortization of goodwill. For comparability to prior periods, certain discussions in the Management's Discussion and Analysis present fiscal 2001 results adjusted to exclude the amortization of goodwill. The actual results as reported in fiscal 2001 are presented in the Consolidated Financial Statements. Additionally, Note 7 to the Consolidated Financial Statements provides a reconciliation between the fiscal 2001 reported results and the adjusted results discussed in the Management's Discussion and Analysis.

Income Statement Commentary*Net Sales*

Net sales increased 0.4% in fiscal 2002 compared to 2001, reflecting same-store sales growth of 0.2%. The intercompany eliminations represent sales from the Gas Operations segment to the Distribution segment. The Company previously reflected these elimination entries within the Gas Operations segment.

<i>(In thousands)</i>	2002	2001	<i>Increase (Decrease)</i>	
Distribution	\$ 1,494,267	\$ 1,487,422	\$ 6,845	0.5%
Gas Operations	173,594	174,899	(1,305)	(0.7%)
Intercompany eliminations	(31,814)	(33,420)	1,606	
	<u>\$ 1,636,047</u>	<u>\$ 1,628,901</u>	<u>\$ 7,146</u>	<u>0.4%</u>

Sales of the Distribution segment increased \$6.8 million driven by acquisitions, partially offset by a decline in same-store sales. Fiscal 2002 acquisitions contributed sales of \$22.6 million. Distribution same-store sales decreased \$15.8 million (-0.6%) resulting from a decline in hardgoods same-store sales of \$59.9 million (-6.7%), partially offset by gas and rent sales growth of \$44.1 million (7.1%). The decline in hardgoods same-store sales resulted from lower sales volumes of industrial tools and welding products reflecting the weak industrial and manufacturing environment, particularly with regard to metal fabrication and machinery industries. The decrease in hardgoods sales was correlated with the decline in non-tech industrial production during fiscal 2002. Partially offsetting the decline in tools and welding hardgoods, sales of safety products grew 4% to \$258 million compared to the prior year reflecting continued success of account penetration initiatives and growth through the Company's telemarketing sales channel. Gas and rent same-store sales growth was driven by price increases during the year in response to rising costs and by growth derived from strategic sales initiatives. Growth in strategic gas

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sales was driven by higher volumes of medical, specialty and bulk gases. Rental revenue was also favorably impacted by a 12% increase in welder equipment rentals from the Company's expansion of its rental welder fleet. Sales to strategic account customers (sales to large customers with multiple locations) grew 10% to \$165 million in fiscal 2002 reflecting the Company's success in leveraging its broad distribution network to service large customers. The Company has followed a strategy of focusing on strategic sales initiatives to drive sales growth and market penetration in the industries that it serves.

Gas Operations' sales, net of intercompany sales eliminations, were flat as same-store sales growth was offset by divestiture activity. Same-store sales increased \$7.4 million (5.9%) driven by price increases to help offset rising costs and higher volumes of liquid carbon dioxide and dry ice. Divestiture activity consisted of the sale of two nitrous oxide plants in fiscal 2002 and the divestiture of the Jackson Dome carbon dioxide reserves and associated pipeline (the "Jackson Dome pipeline") in January 2001.

Gross Profits

Gross profits do not reflect depreciation expense and distribution costs. As disclosed in Note 1 to the Consolidated Financial Statements, the Company reflects distribution costs as elements of Selling, Distribution and Administrative Expenses and recognizes depreciation on all its property, plant and equipment on the income statement line item "Depreciation." Some companies may report certain or all of these costs as elements of their Cost of Products Sold. Consequently, gross profits discussed below may not be comparable to those of other entities.

Gross profits increased 4.6% in fiscal 2002 compared to 2001. The gross profit margin increased 200 basis points to 50% in fiscal 2002 as compared to 48% in the prior year.

(In thousands)	2002	2001	Increase	
Distribution	\$ 724,173	\$ 689,999	\$ 34,174	5.0%
Gas Operations	93,121	91,702	1,419	1.5%
	\$ 817,294	\$ 781,701	\$ 35,593	4.6%

Distribution gross profits increased \$34.2 million from both same-store gross profit growth and acquisition activity. The Distribution segment's gross profit margin of 48.5% in fiscal 2002 increased 210 basis points from 46.4% in the prior year. The improved margin was primarily due to a shift in sales mix towards higher margin gas and rent sales as well as price increases and a discount management program. The shift in sales mix was driven principally by strategic sales initiatives and declining hardgoods sales. Gas and rent comprised 47.3% of Distribution sales compared to 43.5% in the prior year.

Gas Operations' gross profits increased \$1.4 million primarily from same-store gross profit growth of \$5.5 million partially offset by divestiture activity. Same-store gross profit growth reflected higher volumes and pricing for liquid carbon dioxide and dry ice. Gas Operations' gross profit margin of 53.6% increased 120 basis

points from 52.4% in the prior year, reflecting volume gains leveraging fixed manufacturing costs and price increases.

Gas Operations' gross profit margin percentages were revised to reflect the change in the application of intercompany eliminations.

Operating Expenses

SD&A expenses increased \$36 million (6.2%) compared to the prior fiscal year primarily from net acquisition and divestiture activity and higher costs associated with personnel, health and workers' compensation insurance, costs associated with the Company's Project One initiative and litigation. The Project One initiative began in the second half of fiscal 2001 and is focused on improving certain operational and administrative processes. Higher legal expenses resulted from a litigation settlement, discussed below. As a percentage of net sales, SD&A expenses increased 210 basis points to 37.9% from 35.8% in fiscal 2001.

Legal expenses were \$11 million in fiscal 2002 compared to \$7.5 million in fiscal 2001. Fiscal 2002 included a charge of \$8.5 million, net of previously established reserves, to settle litigation brought by Praxair, a competitor, against the Company in July 1996. Fiscal 2001 included a charge of \$6.9 million for costs to defend against the lawsuit brought by Praxair and the recovery of \$1.1 million of costs associated with the settlement of a fiscal 2000 class action suite related to hazardous materials handling charges.

Amortization expense was \$8.2 million in fiscal 2002 compared to \$23.8 million in fiscal 2001. The decrease in amortization expense primarily relates to the adoption of SFAS 142 on April 1, 2001, under which goodwill is no longer amortized. Fiscal 2002 amortization expense relates to non-competition agreements, which are amortized over the terms of the respective agreements. Depreciation expense of \$64.8 million in fiscal 2002 increased 3% compared to fiscal 2001.

Special Charges

Special charges, net, in fiscal 2001 of \$3.6 million included a charge of \$8.5 million related to a cost reduction plan implemented by the Company to improve operating results at certain business units as well as to mitigate rising operating expenses. The fiscal 2001 special charges impacted the Distribution segment by \$6.3 million and the Gas Operations segment by \$2.2 million. The fourth quarter 2001 cost reduction charge included severance costs for a reduction in workforce, exit costs for the closure of 30 branch locations and losses associated with the anticipated divestiture of certain non-core businesses. The non-core businesses to be divested generated annual sales of approximately \$10 million in fiscal 2001 and were included in the Company's Distribution segment. The charge was partially offset by \$4.9 million of special charge recoveries, recognized in the Gas Operations segment, primarily consisting of a favorable insurance settlement associated with the fiscal 1997 special charge. As a result, the Gas Operations segment reflected a net special charge recovery of \$2.7 million in fiscal 2001.

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Operating Income

Operating income increased 2.2% in fiscal 2002 as compared to 2001, adjusted to exclude the amortization of goodwill.

<i>(In thousands)</i>	2002	2001^(a)	<i>Increase/ (Decrease)</i>	<i>%</i>	As Reported 2001
Distribution	\$ 103,430	\$ 98,227	\$ 5,203	5.3%	\$ 85,907
Gas Operations	21,603	24,159	(2,556)	(10.6%)	22,042
	<u>\$ 125,033</u>	<u>\$ 122,386</u>	<u>\$ 2,647</u>	<u>2.2%</u>	<u>\$ 107,949</u>

(a) Fiscal 2001 operating income has been adjusted for comparative purposes to exclude the amortization of goodwill in connection with the fiscal 2002 adoption of SFAS 142.

The Distribution segment's operating income margin of 6.9% in fiscal 2002 increased from 6.6% in fiscal 2001, as adjusted. The increase reflects the absence in fiscal 2002 of the \$6.3 million in Fiscal 2001 special charges noted above. Excluding the impact of the Fiscal 2001 Special Charges, the operating margins were relatively stable reflecting the Company's success in raising prices to offset higher operating expenses.

The Gas Operations segment's operating income margin was 12.4% in fiscal 2002, down 140 basis points from 13.8% in fiscal 2001, as adjusted. The decline in the operating income margin reflects the absence in fiscal 2002 of the Fiscal 2001 \$2.7 million net special charge recovery noted above. Additionally, higher gross profits from volume and price increases in fiscal 2002 were not enough to offset the divestiture of the Jackson Dome pipeline and the two nitrous oxide plants, both of which had higher than average operating margins reflected in the prior year's results.

Interest Expense and Discount on Securitization of Trade Receivables

Interest expense, net, and the discount on securitization of trade receivables totaled \$51.9 million representing a decrease of \$9.7 million (-15.7%) compared to the prior fiscal year. The decrease resulted primarily from lower average debt levels. The decrease in average debt levels was attributable to cash flow provided from operations and proceeds from the divestiture of the Jackson Dome pipeline in the fourth quarter of fiscal 2001. Although the Air Products acquisition increased debt levels at the end of fiscal 2002, average debt levels during fiscal 2002 were approximately \$130 million lower than fiscal 2001. Weighted-average financing costs were slightly lower in the current year compared to the prior year as higher rates of fixed cost debt associated with the Company's July 2001 debt refinancing were offset by lower prevailing market rates related to variable rate debt.

The Company participates in a securitization agreement with two commercial banks to sell up to \$175 million of qualifying trade receivables. The amount of outstanding receivables under the agreement was \$134 million and \$73 million at March 31, 2002 and March 31, 2001, respectively. Net proceeds from the sale of trade receivables were used to reduce borrowings under the Company's revolving credit facilities. The discount on the securitization of trade receivables represents the difference between the carrying value of the receivables and the proceeds from their sale. The amount of the discount varies on a monthly basis depending on the amount of receivables sold and market rates.

As discussed in "Liquidity and Capital Resources," the Company manages its exposure to interest rate risk of certain borrowings through participation in interest rate swap agreements. Including the effect of interest rate swap agreements, the Company's ratio of fixed to variable interest rates at March 31, 2002 was 48% fixed to 52% variable. A majority of the Company's variable rate debt is based on a spread over LIBOR.

Other Income, net

Other income, net, totaled \$1.4 million in fiscal 2002 compared to \$242 thousand in fiscal 2001. Fiscal 2002 includes a net non-recurring gain of \$1.9 million consisting of a \$7.4 million gain on the divestiture of two nitrous oxide plants partially offset by a \$3.6 million charge to write down a business unit held for sale to its net realizable value and a \$1.9 million loss resulting from an indemnity claim related to a prior period divestiture.

Equity in Earnings of Unconsolidated Affiliates

Equity in earnings of unconsolidated affiliates of \$3.8 million was relatively flat compared to \$4.0 million in fiscal 2001, adjusted for comparative purposes to exclude goodwill amortization. Fiscal 2001 includes after-tax charges of \$700 thousand related to asset impairments associated with two equity affiliates. Including goodwill amortization, equity in earnings of unconsolidated affiliates as reported in fiscal 2001 was \$2.3 million.

Income Tax Expense

The effective income tax rate was 38.0% of pre-tax earnings in fiscal 2002 compared to 35.5% in fiscal 2001, adjusted for comparative purposes for the impact of SFAS 142. The increase in the effective income tax rate in fiscal 2002 was primarily due to the \$3.6 million write-down of a business unit to its net realizable value, which was not deductible for income taxes. The effective income tax rate as reported in fiscal 2001 was 42.3%.

Earnings before the Cumulative Effect of a Change in Accounting Principle

Earnings before the cumulative effect of a change in accounting principle for fiscal 2002 were \$48.6 million, or \$.69 per diluted share, compared to \$28.2 million, or \$.42 per diluted share in fiscal 2001.

Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

Cumulative Effect of a Change in Accounting Principle

In connection with the adoption of SFAS 142, the Company performed an evaluation of goodwill as of April 1, 2001. The results of the evaluation indicated that goodwill related to one reporting unit, the Company's tool business, was impaired. The Company measured the amount of impairment based on a comparison of the fair value of the reporting unit to its carrying value. Accordingly, the Company recognized a \$59 million, or \$.84 per diluted share, non-cash, after-tax charge, recorded as of April 1, 2001, as a cumulative effect of a change in accounting principle for the write-down of goodwill of the tool business reporting unit to its fair value. The impaired goodwill was not deductible for taxes, and as a result, no tax benefit was recorded in relation to the charge.

On April 1, 2001, the Company adopted SFAS 133, Accounting for Derivative Instruments and Certain Hedging Activities, as amended by SFAS No. 137 and 138. SFAS 133 requires all derivatives to be recorded on the balance sheet at fair value. In accordance with the transition provisions of SFAS 133, the Company recorded the cumulative effect of this accounting change as a liability and a deferred loss of \$6.7 million in the accumulated other comprehensive income (loss) component of stockholders' equity to recognize, at fair value, interest rate swap agreements that are designated as cash flow hedging instruments. Additionally, the Company recorded an asset and adjusted the carrying value of the hedged portion of its fixed rate debt by \$6 million to recognize, at fair value, interest rate swap agreements that are designated as fair value hedging instruments.

Net Earnings (Loss)

The Company recognized a net loss in fiscal 2002 of \$10.4 million, or a loss of \$.15 per diluted share, compared to net earnings of \$28.2 million, or \$.42 per diluted share, in fiscal 2001.

Liquidity and Capital Resources*Fiscal 2003 Cash Flows*

Net cash provided by operating activities totaled \$194.4 million in fiscal 2003 compared to \$249.4 million in fiscal 2002. The decline in operating cash flows resulted from the completion of the second tranche of the trade receivables securitization program in the prior year period. Excluding the trade receivables securitization, cash provided by operating activities decreased by approximately \$19 million. Fiscal 2003 cash flows from operations were driven by an increase in net earnings offset by cash used for working capital. Cash used for working capital in the current period primarily resulted from the settlement of accrued expenses and higher levels of trade receivables. Accrued expenses used cash primarily due to the payment of prior year obligations associated with the Praxair, Inc. litigation, accrued interest on the senior subordinated notes, and prior year bonuses. The Company's trade receivables increased due to the higher level of sales from the operations acquired from Air Products. Cash flows provided by operating activities were primarily used to fund capital expenditures and to repay outstanding debt.

Cash used in investing activities totaled \$87 million and primarily consisted of capital expenditures and acquisitions, partially offset by proceeds from the sale of plant and equipment and a divestiture. Capital expenditures of \$68 million were approximately \$10 million higher than fiscal 2002 primarily due to construction of a liquid carbon dioxide plant in Hopewell, Virginia during fiscal 2003. The Company estimates fiscal 2004 capital spending will remain approximately \$70 million. Cash of \$27.2 million was used in fiscal 2003 to acquire four packaged gas distributors and to settle liabilities associated with the Air Products acquisition. The divestiture of Kendeco, Inc., an industrial tool business, during the first quarter of fiscal 2003 provided cash of \$3.2 million.

Financing activities used cash of \$107.4 million primarily for the net repayment of debt under the Company's revolving credit facilities of \$118.4 million. Financing activities also included proceeds received from the exercise of stock options of \$9.8 million and an increase in the cash overdraft of \$1.1 million. The cash overdraft represents the change in the balance of outstanding checks.

Cash on hand at the end of each fiscal year is zero. On a daily basis, depository accounts are swept of all available funds. The funds are deposited into a concentration account through which all cash on hand is used to repay debt under the Company's revolving credit facilities.

The Company will continue to look for appropriate acquisitions of businesses to complement its broad distribution network. Capital expenditures, current debt maturities and any future acquisitions will be funded through the use of cash flow from operations, revolving credit facilities, and other financing alternatives. The Company believes that its sources of financing are adequate for its anticipated needs and that it could arrange additional sources of financing for unanticipated requirements. The cost and terms of any future financing arrangement depend on the market conditions and the Company's financial position at that time.

Dividends

On May 13, 2003, the Company's Board of Directors declared the first quarterly cash dividend in the Company's history. The first quarterly dividend of \$.04 per share will be paid on June 30, 2003 to stockholders of record of the Company's common stock as of June 13, 2003. Future dividend declarations and associated amounts paid will depend upon the Company's earnings, financial condition, loan covenants, capital requirements and other factors deemed relevant by management and the Company's Board of Directors.

Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

*Financial Instruments**Revolving Credit Facilities*

The Company has unsecured revolving credit facilities with a syndicate of lenders totaling \$367.5 million and \$50 million Canadian (U.S. \$33.9 million) under a credit agreement with a maturity date of July 30, 2006. At March 31, 2003, the Company had borrowings under the credit agreement of approximately \$124 million and \$31 million Canadian (U.S. \$21 million). The Company also had commitments under letters of credit supported by the credit agreement of approximately \$31 million at March 31, 2003. The credit agreement contains covenants that include the maintenance of certain leverage ratios, a fixed charge ratio, and potential restrictions on certain additional borrowing, the amount of dividends declared and paid, and the repurchase of common stock. Based on restrictions related to certain leverage ratios, the Company had additional borrowing capacity under the revolving credit facilities of approximately \$197 million at March 31, 2003. The variable interest rates of the U.S. and Canadian revolving credit facilities are based on the London Interbank Offered Rate ("LIBOR") and Canadian Bankers' Acceptance Rates, respectively. At March 31, 2003, the effective interest rates on borrowings under the revolving credit facilities were 3.52% on U.S. borrowings and 3.08% on Canadian borrowings.

Borrowings under the revolving credit facilities are guaranteed by certain of the Company's domestic subsidiaries and Canadian borrowings are guaranteed by foreign subsidiaries. During the fourth quarter of fiscal 2002, the Company's credit rating as determined by third-party credit agencies was lowered in response to additional indebtedness related to the Air Products acquisition. The lower credit rating required the Company to pledge 100% of the stock of its domestic guarantor subsidiaries and 65% of the stock of its foreign guarantor subsidiaries for the benefit of the syndicate of lenders. If the Company's credit rating is further reduced, the Company will be required to grant a security interest in substantially all of the tangible and intangible assets of the Company for the benefit of the syndicate of lenders. In January 2003, one third-party credit agency reaffirmed the Company's credit rating and revised its outlook to positive from stable based on expectations that the Company's financial position will continue to strengthen as economic conditions improve.

In May 2003, the Company obtained an amendment to its credit agreement associated with its revolving credit facilities. Subject to existing financial covenants, the amendment allows for the issuance of up to an additional \$200 million of senior public debt and for the expansion of its senior credit facilities by up to \$150 million. The amendment also provided the Company with additional flexibility to pay dividends and repurchase shares as well as invest in acquisitions.

Term Loan

In connection with the fiscal 2002 Air Products acquisition, the Company obtained a \$100 million term loan from a syndicate of lenders. The term loan is due in quarterly installments with a final payment due July 30, 2006. Principal payments on the term loan are classified as "Long-term Debt" in the Company's Consolidated Balance Sheets based on the Company's ability and intention to refinance them with borrowings under its long-term revolving credit facilities. The term loan is unsecured and bears a variable interest rate based on LIBOR plus a spread related to the Company's credit rating. At March 31, 2003, the Company had \$87 million outstanding under the term loan at an effective interest rate of 3.29%.

Medium-Term Notes

The Company had the following medium-term notes outstanding at March 31, 2003: \$75 million of unsecured notes due March 2004 bearing interest at a fixed rate of 7.14% and \$100 million of unsecured notes due September 2006 bearing interest at a fixed rate of 7.75%. The medium-term notes due in March 2004 are classified as "Long-term debt" based upon the Company's ability and intention to refinance the medium-term notes with borrowings under its long-term revolving credit facilities. Additionally, the medium-term notes are guaranteed by each of the domestic guarantors under the revolving credit facilities.

Acquisition and Other Notes

The Company's long-term debt also included acquisition and other notes principally consisting of notes issued to sellers of businesses acquired and are repayable in periodic installments. At March 31, 2003, acquisition and other notes totaled approximately \$10 million with interest rates ranging from 7.00% to 9.00%.

Senior Subordinated Notes

The Company has \$225 million of senior subordinated notes (the "Notes") outstanding with a maturity date of October 1, 2011. The Notes bear interest at a fixed annual rate of 9.125%, payable semi-annually on April 1 and October 1 of each year. The Notes contain covenants that could restrict the amount of dividends declared and paid, issuance of preferred stock, and the incurrence of additional indebtedness and liens. The Notes are guaranteed on a subordinated basis by each of the domestic guarantors under the revolving credit facilities.

Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

Interest Rate Swap Agreements

The Company manages its exposure to changes in market interest rates. At March 31, 2003, the Company was party to a total of 9 interest rate swap agreements. The swap agreements are with major financial institutions and aggregate \$245 million in notional principal amount at March 31, 2003. Four swap agreements with approximately \$90 million in notional principal amount require the Company to make fixed interest payments based on an average effective rate of 4.55% and receive variable interest payments from its counterparties based on three-month LIBOR (average rate of 1.36% at March 31, 2003). The remaining terms of these swap agreements range from between sixteen and thirty-one months. Five swap agreements with approximately \$155 million in notional principal amount require the Company to make variable interest payments based primarily on six-month LIBOR (average effective rate of 3.05% at March 31, 2003) and receive fixed interest payments from its counterparties based on an average effective rate of 8.05% at March 31, 2003. The remaining terms of these swap agreements range from between one and nine years. The Company monitors its positions and the credit ratings of its counterparties, and does not anticipate non-performance by the counterparties. After considering the effect of interest rate swap agreements on the Company's debt and off-balance sheet financing agreements, the Company's ratio of fixed to variable interest rates was 41% fixed to 59% variable at March 31, 2003.

A majority of the Company's variable rate debt is based on a spread over LIBOR. Based on the Company's outstanding variable rate debt and credit rating at March 31, 2003, for every increase in LIBOR of 25 basis points, the Company estimates its annual interest expense would increase approximately \$1.2 million.

Trade Receivables Securitization

The Company participates in a securitization agreement with two commercial banks to sell up to \$175 million of qualifying trade receivables. The agreement was originally to expire in December 2003, but the agreement was extended to December 2005, and remains subject to renewal provisions contained in the agreement. During fiscal 2003, the Company sold, net of its retained interest, \$1.879 billion of trade receivables and remitted to bank conduits, pursuant to a servicing agreement, \$1.720 billion in collections on those receivables. The net proceeds were used to reduce borrowings under the Company's revolving credit facilities. The amount of outstanding receivables under the agreement was \$158.9 million at March 31, 2003 and \$134 million at March 31, 2002.

The transaction has been accounted for as a sale under the provisions of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Under the securitization agreement, eligible trade receivables are sold to bank conduits through a bankruptcy-remote special purpose entity, which is consolidated for financial reporting purposes. The difference between the proceeds from the sale and the carrying value of the receivables is recognized as "Discount on securitization of trade receivables" in the accompanying Consolidated Statements of Earnings and varies on a monthly basis depending on the amount of receivables sold and market rates. The Company retains a subordinated interest in the receivables sold, which is recorded at the receivables' previous carrying value. A subordinated retained interest of approximately \$45 million and \$41 million is included in "Trade receivables" in the accompanying Consolidated Balance Sheets at March 31, 2003 and 2002, respectively. The Company's retained interest is generally collected within 60 days. On a monthly basis, management measures the fair value of the retained interest at management's best estimate of the undiscounted expected future cash collections on the transferred receivables. Changes in the fair value are recognized as bad debt expense. Actual cash collections may differ from these estimates and would directly affect the fair value of the retained interest. In accordance with a servicing agreement, the Company will continue to service, administer and collect the trade receivables on behalf of the bank conduits. The servicing fees charged to the bank conduits approximate the costs of collections.

Operating Lease with Trust

The Company leases real estate and certain equipment from a trust established by a commercial bank. The operating leases are structured as a sale-leaseback transaction in which the trust holds title to the properties and equipment included in the leases. The operating leases terminate in October 2004, but may be renewed subject to provisions of the lease agreements. The rental payments are based on LIBOR plus an applicable margin and the cost of the property acquired by the trust. At March 31, 2003, the non-cancelable lease obligation of the real estate and equipment lease totaled approximately \$42 million. The Company has guaranteed a residual value of the real estate and the equipment at the end of the lease term of approximately \$30 million. A gain of approximately \$12 million on the equipment portion of the transaction has been deferred until the expiration of the Company's guarantee of the residual value. The trust established in connection with the sale-leaseback arrangement has been determined to be a variable interest entity as defined by Financial Interpretation ("FIN") No. 46, *Consolidation of Variable Interest Entities*. In accordance with FIN 46, the Company will consolidate the trust for financial reporting purposes effective July 1, 2003.

Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

Employee Benefits Trust

The Company maintains a grantor trust (the "Trust") to fund certain future obligations of the Company's employee benefit and compensation plans. The Company, pursuant to a Common Stock Purchase Agreement, sold shares of common stock to the Trust. During fiscal 1999 through 2001, the Trust purchased a total of approximately 7 million shares of common stock, previously held as treasury stock, from the Company, for approximately \$54 million (based on the average market closing price for the five days preceding each transaction). The Company holds promissory notes from the Trust in the amount of each purchase. Shares held by the Trust serve as collateral for the promissory notes and are available to fund certain employee benefit plan obligations as the promissory notes are repaid. The shares held by the Trust are not considered outstanding for earnings per share purposes until they are released from serving as collateral for the promissory notes. Approximately 900 thousand and 1.4 million shares were issued from the Trust for employee benefit programs during fiscal 2003 and 2002, respectively. As of March 31, 2003, the Trust held approximately 3.4 million shares of Company common stock. An independent third-party financial institution serves as the Trustee. The Trustee votes or tenders shares held by the Trust in accordance with instructions received from the participants in the employee benefit and compensation plans funded by the Trust.

Inflation

While the U.S. inflation rate has been relatively modest for several years, rising costs continue to affect the Company's business. The Company strives to minimize the effects of inflation through cost containment and price increases under highly competitive conditions.

Other*Critical Accounting Policies*

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make judgments, assumptions and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Note 1 to the Consolidated Financial Statements describes the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements. Estimates are used for, but not limited to, determining the net carrying value of trade receivables, inventories, goodwill, other intangible assets and business insurance reserves. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of the Consolidated Financial Statements.

Trade Receivables

The Company must make estimates of the collectability of its trade receivables. Management has established an allowance for doubtful accounts to adjust the carrying value of trade receivables to fair value based on an estimate of the amount of trade receivables that are uncollectible. The allowance for doubtful accounts is determined based on historical experience, economic trends, and known bankruptcies and problem accounts. Management believes that the allowances for doubtful accounts as of March 31, 2003 and 2002 are adequate.

Inventories

The Company's inventories are stated at the lower of cost or market. The Company writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon its physical condition as well as assumptions about future demand and market conditions. If actual demand or market conditions in the future are less favorable than those estimated, additional inventory write-downs may be required.

Goodwill and Other Intangible Assets

The Company adopted SFAS 142, *Goodwill and Other Intangible Assets*, as of April 1, 2001. SFAS 142 requires goodwill and intangible assets with indefinite useful lives will not be amortized, but instead be tested for impairment at least annually. The Company has elected to perform its annual tests for indications of goodwill impairment as of October 31 of each year. The annual impairment test used by the Company consists of a discounted cash flow analysis. The discounted cash flow analysis requires estimates, assumptions and judgments that could be materially different if different estimates, assumptions and judgments were used.

Business Insurance Reserves

The Company has insurance programs to cover workers' compensation, business automobile, general and products liability. The insurance programs have self-insured retention of \$500 thousand per occurrence and an annual aggregate limit of \$1.7 million of claims in excess of \$500 thousand. The Company accrues estimated losses using actuarial models and assumptions based on the Company's historical loss experience. Although management believes that the insurance reserves are adequate, the reserve estimates are based on historical experience, which may not be indicative of current and future losses. In addition, the actuarial calculations used to estimate insurance reserves are based on numerous assumptions, some of which are subjective. The Company will adjust its insurance reserves, if necessary, in the event that future loss experience differs from historical loss patterns.

Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

New Accounting Pronouncements

In July 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. SFAS 143 requires the recognition of a liability for an asset retirement obligation in the period in which it is incurred. A retirement obligation is defined as one in which a legal obligation exists in the future resulting from existing laws, statutes or contracts. The Company was required to adopt SFAS 143 on April 1, 2003. The Company's adoption of SFAS 143 did not have a material impact on its results of operations, financial position or liquidity.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS 149 requires, among other things, that contracts with comparable characteristics be accounted for similarly and clarifies the circumstances under which a contract with an initial net investment meets the characteristic of a derivative and when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS 149 is generally effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The Company has not yet determined the impact that the adoption of SFAS 149 will have on its financial position, results of operations or liquidity.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity in the statement of financial position. The Standard requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those financial instruments were previously classified as equity. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for the Company as of July 1, 2003. The Company does not believe that adoption of SFAS 150 will have a material impact on its financial position, results of operations or liquidity.

In January 2003, the FASB issued Financial Interpretation No. 46, *Consolidation of Variable Interest Entities*, ("FIN 46"). FIN 46 addresses consolidation by a business enterprise of variable interest entities. Variable interest entities are defined as corporations, partnerships, trusts, or any other legal structure used for business purposes, and by design, the holders of equity instruments in those entities lack one of the characteristics of a controlling financial interest. Under previous accounting practice, entities generally were not consolidated unless the entity was controlled through voting interests. FIN 46 changes previous accounting practice by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46 applied immediately to variable interest entities created after January 31, 2003. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest in existence before February 1, 2003. If it is reasonably possible that an enterprise will consolidate or disclose information about a variable interest entity when FIN 46 becomes effective, then disclosure is required in financial statements issued after January 31, 2003. Accordingly, the Company has provided certain disclosures required by FIN 46 in Notes 15 and 20 to the Consolidated Financial Statements included herein.

Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

Forward-looking Statements

This report contains statements that are forward looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, but are not limited to, statements regarding: the Company's strategy of leveraging its distribution network and focusing on strategic sales initiatives to drive sales growth and market penetration in the industries that it serves; management's belief that the Company's sales and infrastructure programs will position the Company well to take advantage of a future economic rebound; the expectation that the procurement centralization and inventory management system will lower both purchasing and inventory carrying costs; the success of the sales effectiveness program in assisting the Company's sales representatives in targeting, monitoring and more effectively managing their customer accounts; the Company's anticipation that fiscal 2004 may be difficult given the economic climate; the Company's ability to execute in any environment and continue towards our goal of \$2 billion in sales with operating margins of at least 10% by the end of fiscal 2005; the Company's ability to find profitable growth without waiting for a general upswing in the market; the Company's ability to control costs; the Company's estimate that net earnings in fiscal 2004 will be in the range of \$1.05 to \$1.12 per diluted share; the Company's estimate that net earnings in the fiscal 2004 first quarter will be \$.24 to \$.26 per diluted share; the Company's estimate of same-store sales growth of 1% for the first half of fiscal 2004; the Company's long-term objective of growing strategic account sales by 10% annually; the success of strategic sales initiatives in developing niches in products and services that are expected to grow at a faster rate than the overall economy and position the Company for future growth; the success of the Project One initiative in improving certain operational and administrative processes; the Company's estimate that for every 25 basis point increase in LIBOR, annual interest expense will increase approximately \$1.2 million; the Company's strong cash flow characteristics and its ability to reduce debt; the Company's cash flow will allow the payment of dividends without compromising its ability to make acquisitions, capital investments and pay down debt; the Company's estimate of fiscal 2004 capital spending of approximately \$70 million; the identification of acquisition candidates; the funding of capital expenditures, current debt maturities and any future acquisitions through the use of cash flow from operations, revolving credit facilities and other financing alternatives; the ability of the Company to arrange additional sources of financing for unanticipated requirements; the effect on the Company of higher interest rates; and performance of counterparties under interest rate swap agreements. These forward-looking statements involve risks and uncertainties. Factors that could cause actual results to differ materially from those predicted in any forward-looking statement include, but are not limited to: adverse customer response to the Company's strategic sales initiatives and resulting inability to drive sales growth and market pen-

etration; the ineffectiveness of the Company's infrastructure programs in lowering purchasing and inventory carrying costs; the Company's inability to identify niche products and services that will grow at a faster rate than the overall economy; the Company's inability to control operating expenses and the potential impact of higher operating expenses in future periods; adverse changes in customer buying patterns; the inability of the Company's Project One initiatives to improve operational and administrative processes; an economic downturn (including adverse changes in the specific markets for the Company's products); higher than estimated interest expense resulting from increases in LIBOR and/or changes in the Company's credit rating; disruption to the Company's business from integration problems associated with acquisitions; higher or lower capital spending in fiscal 2004 than that estimated by the Company; inability to generate sufficient cash flow from operations or other sources to fund future acquisitions, capital expenditures, current debt maturities and to reduce debt; a lack of cash flow necessary to pay dividends, make acquisitions, make capital investments and pay down debt; the inability to identify and successfully integrate acquisition candidates; changes in the Company's debt levels and/or credit rating which prevent the Company from arranging additional financing; the inability to manage interest rate exposure; the effects of competition from independent distributors and vertically integrated gas producers on products, pricing and sales growth; changes in product prices from gas producers and name-brand manufacturers and suppliers of hardgoods; uncertainties regarding accidents or litigation which may arise in the ordinary course of business; and the effects of, and changes in, the economy, monetary and fiscal policies, laws and regulations, inflation and monetary fluctuations and fluctuations in interest rates, both on a national and international basis. The Company does not undertake to update any forward-looking statement made herein or that may be made from time to time by or on behalf of the Company.