

## Management's Discussion and Analysis

Airgas, Inc. and Subsidiaries

### Results of Operations: 2004 Compared to 2003

#### Overview

The Company's net sales for the fiscal year ended March 31, 2004 ("fiscal 2004") were \$1.90 billion compared to \$1.79 billion in the prior year ("fiscal 2003"). Sales growth of \$109 million was driven by acquisitions, same-store sales growth and the December 31, 2003 consolidation of National Welders. During fiscal 2004, the Company completed five acquisitions with combined annual sales of approximately \$59 million. Strategic product sales initiatives related to medical, bulk and specialty gases, and strategic accounts, contributed to a 1% increase in total same-store sales. Sales growth was achieved despite weakness in the manufacturing and industrial markets during much of fiscal 2004. While same-store sales were flat through the first nine months of fiscal 2004, they began rebounding in the fourth quarter led by sales of hardgoods, which increased significantly (9%) as the industrial marketplace began to show signs of an economic recovery. Gas and rent sales also showed improvement (2%) in the fiscal fourth quarter. Over the past several years, the Company has embarked on several programs to strengthen its infrastructure in anticipation of continued growth. As a result, management believes that the Company is well positioned to take advantage of a rebounding industrial economy.

Fiscal 2004 net earnings were \$80.2 million, or \$1.07 per diluted share, compared to \$68.1 million, or \$0.94 per diluted share, in fiscal 2003.

As discussed in the "Income Statement Commentary" below, fiscal 2004 results were affected by the following:

- insurance-related losses of \$2.8 million (\$1.7 million after tax), or \$0.02 per diluted share, representing the Company's self-insurance retention associated with fire-related losses;
- a \$1.7 million, or \$0.02 per diluted share, non-recurring insurance gain recognized by National Welders; and
- a special charge recovery of \$776 thousand (\$480 thousand after tax), or \$0.01 per diluted share, reflecting lower estimates of the ultimate cost of prior years' restructuring activities.

Fiscal 2003 results were affected by the following:

- special and other charges totaling \$2.9 million (\$2.2 million after-tax), or \$0.03 per diluted share, primarily consisting of a restructuring charge (\$2.7 million) related to the integration of the business acquired from Air Products and Chemicals, Inc. ("Air Products") in fiscal 2002 and costs related to the consolidation of certain hardgoods procurement functions.

On April 2, 2004, the Company announced that it signed a definitive asset purchase agreement to acquire most of the U.S. packaged gas business of The BOC Group, Inc. ("BOC") in a

transaction valued up to \$200 million. The transaction is expected to close July 30, 2004 and includes approximately 120 locations in 21 states involved in the distribution of packaged industrial, medical and specialty gases, as well as welding hardgoods. In fiscal 2003, the packaged gas business of BOC, subject to the acquisition, generated approximately \$240 million in sales of which approximately 65% was gas and rent. The acquired operations will be integrated with the existing business units of the Company's Distribution segment.

At December 31, 2003, the Company elected to adopt Financial Accounting Standards Board Interpretation No. 46R, *Consolidation of Variable Interest Entities*, ("FIN 46R") with respect to its joint venture, National Welders Supply Company, Inc. ("National Welders") and consolidated this formerly unconsolidated affiliate. Since June 1996, the Company has participated in the joint venture and has used the equity method of accounting to report the Company's proportionate share of the joint venture's operating results. Consequently, the consolidation of National Welders had no impact on the net earnings of the Company. In addition, the consolidation did not change the fact that the liabilities of the joint venture are non-recourse to the Company and the cash flows, in excess of a management fee paid by National Welders, are not available to the Company. Through the nine months ended December 31, 2003, the Company recognized \$4.4 million of "Equity in Earnings of Unconsolidated Affiliates" related to National Welders. With the prospective adoption permitted by FIN 46R (prior periods not restated), the fourth fiscal quarter operating results of the joint venture were reflected broadly across the income statement with minority interest expense reflecting the preferred stockholders' proportionate share of the joint venture's operating results. For the fourth quarter of fiscal 2004, National Welders contributed \$39.2 million to sales, \$3.4 million to operating income, \$291 thousand of minority interest expense and \$1.2 million in net earnings.

The Company generated significant cash flow in fiscal 2004, which enabled the Company to finance acquisitions and capital expenditures and to repay debt. In addition, the Company's strong cash flow fundamentals enabled it to pay its first quarterly cash dividend in the Company's history of \$0.04 per share on June 30, 2003. Subsequently, at the end of each quarter during fiscal 2004, the Company paid its stockholders regular quarterly cash dividends of \$0.04 per share. In addition, on May 25, 2004, the Company announced that its Board of Directors declared a regular quarterly cash dividend of \$0.045 per share, representing a 13% increase compared to the prior year quarterly dividend. The dividend is payable June 30, 2004 to stockholders of record as of June 15, 2004.

## Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

Looking forward, fiscal 2005 appears to hold significant opportunities for the Company. The BOC acquisition will be the largest acquisition in the Company's history. The process of integrating BOC's packaged gas business into the Company's distribution network will provide both challenges and opportunities. The Company anticipates that the economic recovery will continue during fiscal 2005. Given these factors, the Company estimates that fiscal 2005 net earnings will be approximately \$1.21 to \$1.27 per diluted share, which includes up to \$0.02 per diluted share accretion from the BOC acquisition. Additionally, in the first quarter of fiscal 2005, the Company estimates that it will earn \$0.27 to \$0.31 per diluted share, which includes modest dilution from pre-integration expenses associated with the BOC acquisition. The fiscal 2005 range of estimated net earnings anticipates a continued supportive sales environment with gas and rent sales rising throughout the year. Actual fiscal 2005 net earnings may be impacted by a number of factors including the pace of the economic recovery, the sales mix of gas and rent versus hardgoods, the interest rate environment, and the costs to integrate the BOC acquisition.

### Income Statement Commentary

#### Net Sales

Net sales increased 6% in fiscal 2004 compared to fiscal 2003 driven primarily by acquisitions, same-store sales growth of 1% and the consolidation of National Welders. 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 used in calculating the same-store sales metric are not reflected in the table below. The intercompany eliminations represent sales from All Other Operations to the Distribution segment.

<i>(In thousands)</i>	2004	2003	Increase	
Distribution	\$ 1,702,471	\$ 1,642,076	\$ 60,395	4%
All Other Operations	235,926	183,849	52,077	28%
Intercompany eliminations	(42,929)	(38,961)	(3,968)	
	\$ 1,895,468	\$ 1,786,964	\$ 108,504	6%

The Distribution segment's principal products include industrial, medical and specialty gases; process chemicals; equipment rental and hardgoods. Industrial, medical and specialty gases and process chemicals are distributed in cylinders or bulk containers. Equipment rental fees are generally charged on cylinders, cryogenic liquid containers, bulk and micro-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 \$60.4 million (4%) driven by acquisitions and growth in same-store sales. The Company estimates that business acquisitions contributed \$39.3 million to sales in fiscal 2004. Same-store sales growth of \$21.1 million (1%) resulted from increases in hardgoods sales of \$12.9 million (1%) and gas and rent sales of \$8.2 million (1%). Through the first nine months of fiscal 2004, Distribution same-store sales were negative, driven by lower sales of hardgoods reflecting weakness in the industrial and manufacturing sectors of the economy. However, same-store sales of hardgoods increased significantly (9%) in the fiscal fourth quarter as the industrial marketplace began to show signs of an economic recovery. Gas and rent sales also showed improvement (2%) in the fiscal fourth quarter. Same-store sales of safety products increased a strong 6% during fiscal 2004 as the Company continued its cross-selling strategy of marketing safety products to its broad base of customers. In addition, safety sales were helped by a new channel migration program that utilizes telemarketing to sell safety products to several thousand low volume customers.

The Company has followed a strategy of focusing on opportunities in niche markets to facilitate sales growth. The strategy focuses on products and markets that are expected to grow at a faster rate than the overall economy. These growth initiatives relate to sales of strategic products, including medical and specialty gases, gases sold in bulk and micro-bulk containers, safety products, and sales to strategic account customers. During fiscal 2004, these sales initiatives contributed to sales growth of gas and rent, which helped mitigate weakness in the industrial economy. Medical gas and rent revenues increased 8% to \$146 million versus the prior year reflecting volume gains. Sales growth of specialty gases fell short of expectations, driven by pricing pressure and sluggish demand associated with economic conditions. Bulk gas and rent revenues grew 8% to \$107 million reflecting higher volumes as well as the promotion of the Company's micro-bulk program. The micro-bulk program is designed to service niche customers who require higher volumes of gases than can be provided efficiently through the use of gases packaged in cylinders. Sales to strategic account customers (sales to large customers with multiple locations) increased 3% to \$255 million in fiscal 2004. Rental revenue was also favorably impacted by a 7% increase in welding equipment rentals and sales associated with the Company's continued expansion of its rental welder fleet.

## Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

The All Other Operations segment consists of producers and distributors of gas products, principally of dry ice, carbon dioxide, nitrous oxide and specialty gases. The segment also includes the Company's National Welders joint venture, which was consolidated effective December 31, 2003. All Other Operations' sales, net of intercompany sales eliminations, increased \$48.1 million (33%), principally from the consolidation of National Welders, same-store sales growth and an acquisition during fiscal 2004. National Welders contributed sales of \$39.2 million in the fourth quarter and fiscal year. Had National Welders been consolidated for all of fiscal 2004, it would have contributed sales of \$147 million. Same-store sales growth of 5% was principally the result of higher sales volumes of liquid carbon dioxide reflecting the additional source of product from the Hopewell, Virginia plant that began operations in January 2003. Same-store sales growth associated with liquid carbon dioxide was partially offset by lower sales of dry ice. Sales of dry ice were negatively impacted during fiscal 2004 by significant pricing pressure related to additional competition in the market. The acquisition of a dry ice business in April 2003 also contributed sales of \$2.2 million in fiscal 2004.

**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 5%, while the gross profit margin decreased 30 basis points to 52.1% in fiscal 2004 compared to 52.4% in fiscal 2003.

(In thousands)	2004	2003	Increase	
Distribution	\$ 857,031	\$ 835,756	\$ 21,275	3%
All Other Operations	129,756	100,892	28,864	29%
	\$ 986,787	\$ 936,648	\$ 50,139	5%

The Distribution segment's gross profits increased \$21.3 million (3%) compared to the prior year. Distribution's gross profit margin of 50.3% in fiscal 2004 decreased 60 basis points from 50.9% in fiscal 2003. The lower gross profit margin primarily resulted from a shift in sales mix away from higher margin gas and rent sales and towards lower margin sales of hardgoods. Acquisitions of two distributors of safety products also contributed to the shift in mix. The Distribution segment's sales consisted of 51.8% gas and rent compared to 52.6% in fiscal 2003.

All Other Operations' gross profits increased \$28.9 million (29%) compared to the prior year. Higher gross profits primarily reflect the consolidation of National Welders, higher sales volumes of liquid carbon dioxide sourced from the new Hopewell, Virginia plant and an acquisition. The consolidation of National Welders contributed gross profits of \$22 million. The gross profit margin of 55% was flat compared to 54.9% in the prior year. The fourth quarter consolidation of National Welders had an insignificant impact on the gross profit margin. Had National Welders been consolidated for all of fiscal 2004, the impact on the All Other Operations segment's gross profit margin would also not have been significant.

**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 \$33.6 million (5%) compared to the prior year principally from the consolidation of National Welders, higher distribution-related expenses, costs contributed by acquired businesses and fire-related losses. The consolidation of National Welders contributed \$16 million to the increase in SD&A expenses. The increase in distribution-related expenses of approximately \$5 million was primarily driven by higher fuel, repair and maintenance costs. Higher fuel costs were directly related to the increase in oil prices during fiscal 2004. Acquired businesses contributed approximately \$13 million to the increase in SD&A expenses. During fiscal 2004, the Company sustained fire-related losses at certain of its plants of \$2.8 million, which represented the Company's self-insurance retention. The prior year included costs of \$2.7 million associated with the integration of the packaged gas business acquired from Air Products in February 2002. Acquisition integration expenses were not significant during fiscal 2004. As a percentage of net sales, SD&A expenses decreased 40 basis points to 38.7% compared to 39.1% in the prior year.

Depreciation expense of \$82.6 million in fiscal 2004 increased \$9.1 million (12%) compared to \$73.5 million in fiscal 2003. The increase reflects depreciation on the current and prior year's capital investments in revenue producing assets, including the Hopewell carbon dioxide plant, bulk and micro-bulk tanks and medical cylinders. The fourth quarter consolidation of National Welders also contributed \$2.6 million to the increase in depreciation expense.

Amortization expense of \$5.4 million in fiscal 2004 decreased \$1 million compared to \$6.4 million in fiscal 2003. The decrease in amortization expense was primarily attributable to the expiration of certain non-compete agreements.

## Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

**Special Charges (Recoveries)**

In fiscal 2004, a special charge recovery of \$776 thousand reflected lower estimates of the ultimate cost of prior years' restructuring charges. The special charge recovery was included in the Distribution segment and represented a change in estimate related to facility exit costs.

In fiscal 2003, a special charge of \$2.7 million incurred by the Distribution segment consisted 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. The special charge included facility exit costs associated with the closure of certain facilities and employee severance. 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 8% in fiscal 2004 compared to fiscal 2003. The operating income margin increased 20 basis points to 8.9% from 8.7% in the prior year.

<i>(In thousands)</i>	2004	2003	Increase	
Distribution	\$ 136,449	\$ 130,534	\$ 5,915	5%
All Other Operations	31,331	25,348	5,983	24%
	\$ 167,780	\$ 155,882	\$ 11,898	8%

The Distribution segment's operating income margin of 8% in fiscal 2004 was consistent with 7.9% in fiscal 2003. The fiscal 2004 operating income margin reflects the lower gross profit margin, described above, effectively offset by lower operating expenses as a percentage of sales.

The All Other Operations segment's operating income margin decreased 50 basis points to 13.3% compared to 13.8% in fiscal 2003. The decrease in the operating income margin primarily resulted from higher operating expenses as a percentage of sales driven by the consolidation of National Welders. National Welders has a higher cost structure compared to the other businesses included in the segment. Had National Welders been consolidated for all of fiscal 2004, the operating income margin would have been 11.5%.

**Interest Expense and Discount on Securitization of Trade Receivables**

Interest expense, net, and the discount on securitization of trade receivables totaled \$45.6 million representing a decrease of \$4.1 million (-8%) compared to the prior fiscal year. The decrease in interest expense resulted from lower average outstanding debt levels and lower weighted-average interest rates associated with the Company's variable rate debt. The Company's interest expense

and average outstanding debt levels were lower despite the July 1, 2003 consolidation of a grantor trust associated with an operating lease and the December 31, 2003 consolidation of National Welders.

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 \$162.6 million and \$158.9 million at March 31, 2004 and 2003, 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, 2004 was 57% fixed to 43% 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, 2004, for every 25 basis point increase in LIBOR, the Company estimates its annual interest expense would increase approximately \$900 thousand.

**Equity in Earnings of Unconsolidated Affiliates**

Equity in earnings of unconsolidated affiliates totaled \$5.2 million in fiscal 2004 compared to \$3.8 million in the prior year. The results of National Welders for the nine months ended December 31, 2003 (earnings of \$4.4 million) were reported in the income statement as equity in earnings of unconsolidated affiliates. Effective January 1, 2004, National Welders' results were reflected broadly across the income statement. The increase in the equity in earnings of unconsolidated affiliates compared to the prior year resulted primarily from a \$1.7 million non-recurring life insurance policy gain recognized by National Welders in December 2003. Prior to the date that the Company entered into the joint venture agreement with National Welders, the founders of National Welders had obtained life insurance policies on key personnel in which National Welders was the named beneficiary.

## Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

### Minority Interest Expense

Minority interest expense of \$291 thousand in fiscal 2004 represents the portion of National Welders' operating results applicable to the preferred stockholders of National Welders.

### Income Tax Expense

The effective income tax rate was 37.2% of pre-tax earnings in fiscal 2004 compared to 37.7% in fiscal 2003.

### Net Earnings

Net earnings in fiscal 2004 were \$80.2 million, or \$1.07 per diluted share, compared to \$68.1 million, or \$0.94 per diluted share, in fiscal 2003.

The weighted average number of shares outstanding used in computing earnings per diluted share was 2.4 million shares higher in fiscal 2004 compared to fiscal 2003. The increase in the weighted average number of shares outstanding primarily resulted from stock option exercises and shares purchased by employees under the Company's Employee Stock Purchase Plans. The Company expects that the weighted average number of shares outstanding will increase 2% to 3% per year.

## 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 fiscal 2002. Sales growth was driven by the fiscal 2002 fourth quarter acquisition of the majority of Air Products' U.S. packaged gas business. In addition, the Company continued 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 2% 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 also embarked on other strategic initiatives, including the centralization of certain hardgoods procurement functions, rollout of an inventory management system, and implementation of a sales force effectiveness program.

Fiscal 2003 net earnings were \$68.1 million, or \$0.94 per diluted share, compared to a net loss of \$10.4 million, or a loss of \$0.15 per diluted share, in fiscal 2002.

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

- special and other charges totaling \$2.9 million (\$2.2 million after-tax), or \$0.03 per diluted share, primarily consisting of a restructuring charge (\$2.7 million) 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 \$0.84 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 \$0.08 per diluted share.

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 further expanded 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 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.

### Income Statement Commentary

#### Net Sales

Net sales increased 9% 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 2%. The intercompany eliminations represent sales from All Other Operations to the Distribution segment.

(In thousands)	2003	2002	Increase	
Distribution	\$ 1,642,076	\$ 1,494,267	\$ 147,809	10%
All Other Operations	183,849	173,594	10,255	6%
Intercompany eliminations	(38,961)	(31,814)	(7,147)	
	<u>\$ 1,786,964</u>	<u>\$ 1,636,047</u>	<u>\$ 150,917</u>	<u>9%</u>

## Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

Distribution segment sales increased \$148 million (10%) 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 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%) reflecting a decline in hardgoods same-store sales of \$42 million (-5%), partially offset by gas and rent sales growth of \$9 million (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 \$135 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 \$247 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. 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.

All Other Operations' sales, net of intercompany sales eliminations, increased \$3.1 million (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 increased 15% 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>	<b>2003</b>		<b>2002</b>		<i>Increase</i>
Distribution	\$ 835,756	\$ 724,173	\$ 111,583	15%	
All Other Operations	100,892	93,121	7,771	8%	
	<b>\$ 936,648</b>	<b>\$ 817,294</b>	<b>\$ 119,354</b>	<b>15%</b>	

Distribution gross profits increased approximately \$112 million (15%) 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.

All Other Operations' gross profits increased \$7.8 million (8%) driven by lower raw material and production costs of the dry ice operations, which reduced the cost per ton produced, and net acquisition and divestiture activity. 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 All Other Operations' gross profits. All Other Operations' gross profit margin of 54.9% increased 130 basis points from 53.6% in the prior year.

**Operating Expenses**

SD&A expenses increased \$78.9 million (13%) compared to fiscal 2002 principally from the addition of the Air Products' operations. Although salaries and benefits, fuel and acquisition integration costs increased in fiscal 2003 compared to fiscal 2002, the increases were partially mitigated by lower legal expenses and management's focus on expense control in other areas. Legal expense in fiscal 2002 included a charge of \$8.5 million associated

## Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

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 correspondingly higher gross profit margins.

Depreciation expense of \$73.5 million in fiscal 2003 increased \$8.7 million (13%) compared to \$64.8 million in fiscal 2002. The increase was primarily due to depreciation on 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

A special charge of \$2.7 million incurred by the Distribution segment in fiscal 2003 consisted 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. The special charge included facility exit costs associated with the closure of certain facilities and employee severance. 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 25% in fiscal 2003 compared to fiscal 2002.

<i>(In thousands)</i>	<b>2003</b>	<b>2002</b>	<i>Increase</i>	
Distribution	\$ 130,534	\$ 103,430	\$ 27,104	26%
All Other Operations	25,348	21,603	3,745	17%
	<u>\$ 155,882</u>	<u>\$ 125,033</u>	<u>\$ 30,849</u>	<u>25%</u>

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.

All Other Operations' 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%) 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.

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.

**Management's Discussion and Analysis** continued

Airgas, Inc. and Subsidiaries

**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 either fiscal 2003 or 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 \$0.94 per diluted share, compared to \$48.6 million, or \$0.69 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 \$0.84 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 \$0.94 per diluted share, compared to a net loss in fiscal 2002 of \$10.4 million, or a loss of \$0.15 per diluted share.

**Liquidity and Capital Resources****Fiscal 2004 Cash Flows**

Net cash provided by operating activities totaled \$209.1 million in fiscal 2004 compared to \$194.4 million in fiscal 2003. The increase in fiscal 2004 operating cash flows principally resulted from improvements in cash provided by working capital, higher net earnings and the consolidation of National Welders, partially offset by a lower source of cash from the trade receivables securitization program. In fiscal 2003, deferred taxes and the change in other current assets reflect an equal and opposite impact of the reversal of a \$19 million tax refund related to a revised interpretation of a change in the tax law. Comparing the fiscal 2004 changes in working capital to the fiscal 2003 changes in working capital adjusted for the non-cash deferred tax reclassification, working

capital provided cash of \$12.9 million in 2004 versus a use of cash of \$11.2 million in 2003. Net earnings adjusted for non-cash items provided cash of \$192.4 million versus \$180.7 million in fiscal 2003, adjusted for the fiscal 2003 deferred tax reclassification. Fiscal 2004 cash from operations also reflects \$9.8 million associated with the fourth quarter operating results of National Welders. The cash flows of National Welders, in excess of a management fee paid by National Welders to the Company, are not available to the Company. Prior to the fourth quarter consolidation of National Welders, the management fee paid by National Welders to the Company was reflected as an investing activity as fees from unconsolidated affiliates. In fiscal 2004, the trade receivables securitization program was a lower source of cash by \$21.2 million compared to fiscal 2003. In fiscal 2003, the addition of trade receivables associated with the Air Products acquisition in February 2002 contributed to an increase in receivables sold under the securitization program. Cash provided by operating activities in fiscal 2004 were primarily used to fund capital expenditures and acquisitions as well as for the repayment of debt.

Cash used in investing activities totaled \$122.5 million and primarily consisted of capital expenditures and acquisitions. Capital expenditures of \$93.7 million, including \$2.2 million associated with National Welders, were \$25.8 million higher than fiscal 2003 principally due to spending for cylinders, bulk and micro-bulk tanks, two fill plant upgrades and the purchase of a corporate plane. Cylinder and bulk tank purchases were driven by continued growth in medical and bulk gas sales. The Company estimates fiscal 2005 capital expenditures will be in the range of \$115 million to \$130 million. The higher level of capital spending anticipated in fiscal 2005 is driven by a real estate and tube trailer lease buy-out program and expansion of the Company's medical product distribution infrastructure. The acquisition of five businesses during fiscal 2004 also used cash of \$34.9 million.

Financing activities used cash of \$86.6 million primarily for the net repayment of debt of \$70.7 million, lower cash overdrafts of \$14.2 million and dividends paid to stockholders of \$11.8 million. National Welders' repayment of \$7.8 million of debt in the fourth quarter of fiscal 2004 contributed to the cash used in financing activities. The cash overdraft represents the change in the balance of outstanding checks. Financing activities also included proceeds of \$13.1 million received from the exercise of stock options.

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.

**Management's Discussion and Analysis** continued

Airgas, Inc. and Subsidiaries

The Company will continue to look for appropriate acquisitions to complement its existing businesses and improve its geographic coverage. 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 of \$0.04 per share, which was paid to stockholders on June 30, 2003. Subsequently, at the end of each quarter during fiscal 2004, the Company paid its stockholders regular quarterly cash dividends of \$0.04 per share. In addition, on May 25, 2004, the Company announced that its Board of Directors declared a regular quarterly cash dividend of \$0.045 per share, representing a 13% increase compared to the prior year quarterly dividend. The dividend is payable June 30, 2004 to stockholders of record as of June 15, 2004. 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.

*Financial Instruments*

The Company's Consolidated Balance Sheet at March 31, 2004 includes the financial obligations of the National Welders joint venture in accordance with the requirements of FIN 46. National Welders' financial debt instruments are non-recourse to the Company, meaning that the creditors of National Welders do not have a claim on the assets of Airgas, Inc. in settlement of the joint venture's debt obligations. The financial instruments of National Welders are discussed separately under the heading "Financial Instruments of the National Welders Joint Venture."

*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. \$38.2 million) under a credit agreement with a maturity date of July 30, 2006. At March 31, 2004, the Company had borrowings under the credit agreement of approximately \$8 million and \$25 million Canadian (U.S. \$19 million). The Company also had commitments under letters of credit supported by the credit agreement of approximately \$33 million at March 31, 2004. 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 \$225 million at March 31, 2004. The variable interest rates of the U.S. and Canadian revolving credit facilities are based on LIBOR and Canadian Bankers' Acceptance Rates, respectively. At March 31, 2004, the effective interest rates on borrowings under the revolving credit facilities were 3.13% on U.S. borrowings and 4.44% 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 Canadian subsidiaries. The Company pledged 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 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 May 2003, the Company obtained an amendment to its credit agreement that allowed 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 (see *Senior Subordinated Notes* below). Subject to existing financial covenants, the amendment also provided the Company with additional flexibility to pay dividends, repurchase Airgas common stock and invest in acquisitions.

In anticipation of the acquisition of assets from BOC, the Company obtained an amendment to its credit agreement in February 2004 that, among other things, permits the Company to invest up to \$275 million in acquisitions during fiscal 2005.

## Management's Discussion and Analysis continued

Airgas, Inc. and Subsidiaries

### *Term Loan*

At March 31, 2004, the Company had an outstanding term loan with a principal balance of \$70 million bearing an effective interest rate of 3.11%. The term loan is due in quarterly installments with a final payment due July 30, 2006. The term loan is unsecured and bears a variable interest rate based on LIBOR plus a spread related to the Company's credit rating. 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 the payments with borrowings under its long-term revolving credit facilities.

### *Medium-Term Notes*

At March 31, 2004, the Company had \$100 million of unsecured medium-term notes due September 2006 bearing interest at a fixed rate of 7.75%. 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, 2004, acquisition and other notes totaled approximately \$8.5 million with interest rates ranging from 4% to 9%.

### *Senior Subordinated Notes*

In March 2004, the Company issued \$150 million of senior subordinated notes (the "2004 Notes") with a maturity date of July 15, 2014. The 2004 Notes bear interest at a fixed annual rate of 6.25%, payable semi-annually on January 15 and July 15 of each year. Proceeds from the issuance of the 2004 Notes were used to redeem \$75 million of medium-term notes due March 2004 and to pay down borrowings on the Company's U.S. revolving credit facility. The 2004 Notes were sold in accordance with the provisions of Rule 144A under the Securities Act of 1933 (the "Securities Act"). During fiscal 2005, the Company will exchange the 2004 Notes for substantially similar notes registered with the Securities and Exchange Commission in accordance with the Securities Act.

In addition to the 2004 Notes, at March 31, 2004, the Company had \$225 million of senior subordinated notes (the "2001 Notes") outstanding with a maturity date of October 1, 2011. The 2001 Notes bear interest at a fixed annual rate of 9.125%, payable semi-annually on April 1 and October 1 of each year.

The 2004 Notes and 2001 Notes contain covenants that could restrict the payment of dividends, the repurchase of common stock, the issuance of preferred stock, and the incurrence of additional indebtedness and liens. The 2004 Notes and 2001 Notes are guaranteed on a subordinated basis by each of the domestic guarantors under the revolving credit facilities.

### *Financial Instruments of the National Welders Joint Venture*

In July 2002, National Welders entered into a credit agreement to provide for available credit up to \$100 million secured by certain assets of National Welders. The Credit Agreement provides for a Term Loan A of \$26.2 million, a Term Loan B of \$21 million, a Term Loan C of \$8.8 million, and a revolving credit line of \$44 million. Term Loan A is repayable in monthly amounts of \$254 thousand through maturity in June 2007. Term Loan B matures in July 2006. The revolving credit line matures in June 2006. Interest rates on the Credit Agreement are variable and range from LIBOR plus 150 to 225 basis points based on National Welders' leverage ratio. The Credit Agreement contains certain covenants which, among other things, limit the ability of National Welders to incur and guarantee new indebtedness, subject National Welders to minimum net worth requirements, and limit its capital expenditures, ownership changes, merger and acquisition activity, and the payment of dividends. In addition, the payment of dividends on National Welders' common stock is further limited by the joint venture agreement. The payment of dividends on the common stock is subordinate to the payment of the 5% dividend on the preferred stock. Additionally, the common stock dividends must be declared by a vote of the joint venture's board of directors.

At March 31, 2004, National Welders had borrowings under its revolving credit line of \$5.5 million, under Term Loan A of \$21.1 million and under Term Loan B of \$21 million. There were no amounts borrowed or outstanding under Term Loan C at March 31, 2004. At March 31, 2004, the effective interest rate for the debt instruments covered under the Credit Agreement was 3.09%. Based on restrictions related to certain leverage ratios, National Welders had additional borrowing capacity under its Credit Agreement of \$47.3 million at March 31, 2004. National Welders also had a note payable to a bank of \$5.5 million that is secured by a production facility and bears a fixed interest rate of 7%. National Welders' long-term debt also included acquisition and other notes totaling \$652 thousand.

## 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, 2004, the Company was party to a total of eight interest rate swap agreements. The swap agreements are with major financial institutions and aggregate \$215 million in notional principal amount at March 31, 2004. 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 1.12% at March 31, 2004). The remaining terms of these swap agreements range from between four and nineteen months. Four swap agreements with approximately \$125 million in notional principal amount require the Company to make variable interest payments based on six-month LIBOR (average effective rate of 3.16% at March 31, 2004) and receive fixed interest payments from its counterparties based on an average effective rate of 8.36% at March 31, 2004. The remaining terms of these swap agreements range from between two and seven years. The Company monitors its positions and the credit ratings of its counterparties, and does not anticipate non-performance by the counterparties.

National Welders participates in one interest rate swap agreement with a notional principal amount of \$21 million on which it makes interest payments based on a fixed rate of 6.72% and receives variable interest payments from its counterparty based on a floating 30-day LIBOR rate of 1.09% at March 31, 2004.

After considering the effect of interest rate swap agreements on the Company's debt and off-balance sheet trade receivables securitization agreement, the Company's ratio of fixed to variable interest rates was 57% fixed to 43% variable at March 31, 2004. The ratio includes the effect of the fixed to variable ratio of National Welders' debt. 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, 2004, for every 25 basis point increase in LIBOR, the Company estimates its annual interest expense would increase approximately \$900 thousand.

### *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 expires in December 2005, but may be renewed subject to renewal provisions contained in the agreement. During fiscal 2004, the Company sold, net of its retained interest, \$1,696 million of trade receivables and remitted to bank conduits, pursuant to a servicing agreement, \$1,692 million 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 \$162.6 million at March 31, 2004 and \$158.9 million at March 31, 2003.

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 \$44 million and \$45 million is included in "Trade receivables" in the accompanying Consolidated Balance Sheets at March 31, 2004 and 2003, 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 continues 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.

### *Debt of Grantor Trust*

Since October 1999, the Company has leased certain real estate and equipment from a grantor trust (the "Trust") under a sale-leaseback arrangement. The Trust incurred debt to purchase the properties and equipment from the Company. The Company, in turn, paid rent to the Trust. The rental payments to the Trust were based on LIBOR plus an applicable margin and matched the debt service requirements for the debt held by the Trust. The Trust was not consolidated for financial reporting purposes and the non-cancelable lease obligation of the real estate and equipment leases totaled approximately \$41 million at March 31, 2003.

**Management's Discussion and Analysis** continued

Airgas, Inc. and Subsidiaries

Effective July 1, 2003, the Company elected to early adopt FIN 46 with respect to the Trust (see Note 2 to the Consolidated Financial Statements). The Company determined the Trust to be a variable interest entity as defined by FIN 46. In addition, the Company was determined to be the primary beneficiary of the sale-leaseback arrangement. FIN 46 required the Company to consolidate the Trust for financial reporting purposes. Upon consolidation, the Company recorded on its balance sheet approximately \$29 million of real estate and equipment and debt of \$42 million, while eliminating a deferred gain of \$13 million. The consolidation of the Trust resulted in the Company recognizing \$1 million in interest expense and \$1 million in depreciation expense in the nine months ended March 31, 2004, which had previously been recognized as rent expense to the Trust. The debt of the grantor trust matures in October 2004 and is classified as long-term based upon the Company's ability and intention to refinance it with borrowings under its long-term credit facilities.

*Employee Benefits Trust*

Since March 1999, the Company has maintained a trust (the "Employee Benefits Trust") to fund certain future obligations of the Company's employee benefit and compensation plans. From inception through 2001, the Company, pursuant to a Common Stock Purchase Agreement, sold approximately 7 million shares of common stock, previously held as treasury stock, to the Employee Benefits Trust. The Company holds promissory notes from the Employee Benefits Trust in the amount of common stock purchased by the trust. Shares held by the Employee Benefits 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 Employee Benefits Trust are not considered outstanding for earnings per share purposes until they are released from serving as collateral for the promissory notes. Approximately 1.2 million and 900 thousand shares were issued from the Employee Benefits Trust for employee benefit programs during fiscal 2004 and 2003, respectively. As of March 31, 2004, the Employee Benefits Trust held approximately 2.2 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 Employee Benefits Trust in accordance with instructions received from the participants in the employee benefit and compensation plans funded by the Employee Benefits 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 Estimates*

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 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, known bankruptcies and problem accounts. Management believes that the allowances for doubtful accounts as of March 31, 2004 and 2003 are adequate.

**Management's Discussion and Analysis** continued

Airgas, Inc. and Subsidiaries

*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*

The Company accounts for goodwill in accordance with SFAS 142, *Goodwill and Other Intangible Assets*. Under SFAS 142, goodwill is not amortized, but is instead 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 product liability claims. 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. National Welders is also self-insured for workers' compensation claims. Workers' compensation claims are self-insured up to \$250 thousand per person annually with an aggregate liability of \$575 thousand. Provisions for expected future claim payments are accrued based on estimates of the aggregate liability for claims incurred plus an estimate for incurred but not reported claims using historical 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. Both the Company and National Welders will adjust their 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

**Contractual Obligations and Off-Balance Sheet Arrangements**

The following table presents the Company's contractual obligations and off-balance sheet arrangements as of March 31, 2004:

<i>(In thousands)</i>	<i>Payments Due by Period</i>				
	<b>Total</b>	<b>Less than 1 year</b>	<b>1 to 3 years</b>	<b>3 to 5 years</b>	<b>More than 5 years</b>
<b>Contractual and Off-Balance Sheet Obligations</b>					
Obligations reflected on the March 31, 2004 Balance Sheet:					
Long-term debt (1)	\$ 688,838	\$ 6,140	\$ 288,106	\$ 12,157	\$ 382,435
Off-balance sheet obligations as of March 31, 2004:					
Operating leases (2)	134,389	39,329	55,874	28,194	10,992
Trade receivables securitization (3)	162,600	—	162,600	—	—
Letters of credit (4)	32,598	32,598	—	—	—
Purchase obligations:					
Liquid bulk gas supply agreements (5)	539,000	52,000	91,500	84,000	311,500
Liquid carbon dioxide supply agreements (6)	124,470	12,401	18,548	11,826	81,695
Other purchase commitments (7)	5,104	4,160	683	261	—
<b>Total</b>	<b>\$ 1,686,999</b>	<b>\$ 146,628</b>	<b>\$ 617,311</b>	<b>\$ 136,438</b>	<b>\$ 786,622</b>

(1) Aggregate long-term debt instruments are reflected in the Consolidated Balance Sheet as of March 31, 2004. Long-term debt includes capital lease obligations, which were not material and, therefore, did not warrant separate disclosure. See Note 10 to the Consolidated Financial Statements for more information regarding long-term debt instruments.

(2) The Company's operating leases include approximately \$55 million in fleet vehicles under long-term operating leases. The Company guarantees a residual value of \$13.8 million related to its leased vehicles.

(3) The Company participates in a securitization agreement with two commercial banks to sell up to \$175 million of qualifying trade receivables. The agreement expires in December 2005, but the term is subject to renewal provisions contained in the agreement. Under the securitization agreement, on a monthly basis, eligible trade receivables are sold to two commercial banks through a bankruptcy-remote special purpose entity. Proceeds received from the sale of receivables were used by the Company to reduce its borrowings on its revolving credit facilities. The securitization agreement is a form of off-balance sheet financing. Also see Note 13 to the Consolidated Financial Statements.

(4) Letters of credit are guarantees of payment to third parties. The Company's letters of credit principally back obligations associated with the Company's self-insured retention on workers' compensation, automobile and general liability claims and acquisition notes. The letters of credit are supported by the Company's revolving credit facility.

(5) In connection with the Air Products acquisition, the Company entered into a 15-year take-or-pay supply agreement, expiring September 1, 2017, under which Air Products will supply at least 35% of the Company's bulk liquid nitrogen, oxygen and argon requirements, exclusive of the volumes purchased under the new BOC supply agreement noted below. Additionally, the Company has commitments to purchase helium under the terms of the supply agreement. Based on the volume of fiscal 2004 purchases, the Air Products supply agreement represents approximately \$42 million in annual liquid bulk gas purchases. The purchase commitments for future periods contained in the table above reflect estimates based on fiscal 2004 purchases.

In December 2002, the Company entered into a 3-year take-or-pay supply agreement with BOC to purchase liquid nitrogen, oxygen and argon. Under the BOC supply agreement, BOC reserves specified production volumes at certain plants and the Company has agreed to purchase at least 75% of those volumes.

Purchases under the existing BOC supply agreement are anticipated to be approximately \$10 million annually. The BOC supply agreement will be replaced with a new BOC supply agreement upon closing of the acquisition of the BOC packaged gas business.

Both the Air Products and BOC supply agreements contain market pricing subject to certain economic indices and market analysis. The Company believes the minimum product purchases under the agreements are well within the Company's normal product purchases. Actual purchases in future periods under the supply agreements could differ materially from those presented in the table due to fluctuations in demand requirements related to varying sales levels as well as changes in economic conditions.

(6) The Company is a party to long-term take-or-pay supply agreements for the purchase of liquid carbon dioxide. The aggregate obligations under the supply agreements represent approximately 20% of the Company's annual carbon dioxide requirements. The purchase commitments for future periods contained in the table above reflect estimates based on fiscal 2004 purchases. The Company believes the minimum product purchases under the Agreements are within the Company's normal product purchases. Actual purchases in future periods under the carbon dioxide supply agreements could differ materially from those presented in the table due to fluctuations in demand requirements related to varying sales levels as well as changes in economic conditions. Certain of the liquid carbon dioxide supply agreements contain market pricing subject to certain economic indices.

(7) Other purchase commitments primarily include property, plant and equipment expenditures.

**Management's Discussion and Analysis** continued

Airgas, Inc. and Subsidiaries

*New Accounting Pronouncements*

There were no new accounting pronouncements that have been issued and not adopted as of the date of this Annual Report.

*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: management's belief that the Company is well positioned to take advantage of a rebounding industrial economy; the closing of the BOC acquisition on July 30, 2004; the process of integrating the BOC acquisition providing both challenges and opportunities; the components of the BOC business and the revenues to be acquired; the Company's belief that the economic recovery will continue during fiscal 2005; the Company's estimate of fiscal 2005 net earnings of \$1.21 to \$1.27 per diluted share, including \$0.02 per diluted share of accretion from the BOC acquisition; the Company's estimate that net earnings in the fiscal 2005 first quarter will be \$0.27 to \$0.31 per diluted share; the success of strategic sales initiatives as platforms for sales growth and market penetration in the industries served by the Company; the ability to grow sales through the strategy of focusing on opportunities in niche markets, including the Core Business and Medical strategies; the success of focusing on products and markets that will grow at a faster rate than the overall economy; the Company's belief that the minimum product purchases under its liquid bulk gas and carbon dioxide supply agreements are well within the Company's normal product purchases; the Company's estimate that for every 25 basis point increase in LIBOR, annual interest expense will increase approximately \$900 thousand; the Company's expectation that the weighted average number of shares outstanding will increase 2% to 3% per year; the Company's estimate that fiscal 2005 capital spending will be in the range of \$115 million to \$130 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 future payment of dividends; the Company's ability to refinance the term loan and grantor trust debt with borrowings under its long-term revolving credit facilities; the ability to contain costs and/or pass-on cost increases to customers in an inflationary environment; the Company's estimates of purchase commitments associated with product supply agreements; and the 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 penetration; the Company's inability to identify niche products and services that will grow at a faster rate than the overall economy; the inability to take delivery of minimum product purchases under the liquid bulk gas and carbon dioxide supply agreements; 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; 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; the failure to close the BOC acquisition by July 30, 2004; higher or lower capital spending in fiscal 2005 than that estimated by the Company; a lack of available cash flow necessary to pay future dividends; higher levels of options exercised or shares purchased under the employee stock purchase programs and their effect on weighted average shares outstanding; actual earnings in the first quarter of fiscal 2005 and/or in fiscal 2005 falling outside the Company's range of estimates; the inability of the Company to increase sales despite a rebound in the economy; the inability to generate sufficient cash flow from operations or other sources to fund future acquisitions, capital expenditures, current debt maturities and to reduce debt; the inability to identify and successfully integrate acquisition candidates; defaults by counterparties under interest rate swap agreements; 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; the inability to pass-on cost increases to customers; 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.