CORPORATE HIGH YIELD FUND III INC
Form N-CSRS
January 28, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSRS

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT
INVESTMENT COMPANIES

Investment Company Act file number 811-08497

Name of Fund: Corporate High Yield Fund III, Inc.

Fund Address: P.O. Box 9011
Princeton, NJ 08543-9011

Name and address of agent for service: Robert C. Doll, Jr., President, Corporate High Yield Fund III, Inc., 800 Scudders Mill Road, Plainsboro, NJ 08536. Mailing address: P.O. Box 9011, Princeton, NJ 08543-9011

Registrant's telephone number, including area code: (609) 282-2800

Date of fiscal year end: 05/31/05

Date of reporting period: 06/01/04 - 11/30/04

Item 1 - Report to Stockholders

[LOGO] Merrill Lynch Investment Managers www.mlim.ml.com

Corporate High Yield
Fund III, Inc.

Semi-Annual Report
November 30, 2004

[LOGO] Merrill Lynch Investment Managers

Corporate High Yield Fund III, Inc.

The Benefits and Risks of Leveraging

Corporate High Yield Fund III, Inc. utilizes leveraging through borrowings or issuance of short-term debt securities or shares of Preferred Stock. The concept of leveraging is based on the premise that the cost of assets to be obtained from leverage will be based on short-term interest rates, which normally will be lower than the income earned by the Fund on its longer-term portfolio investments. Since the total assets of the Fund (including the assets obtained from leverage) are invested in higher-yielding portfolio investments, the Fund's Common Stock shareholders are the beneficiaries of the incremental yield.

Leverage creates risks for holders of Common Stock including the likelihood of greater net asset value and market price volatility. In addition, there is the risk that fluctuations in interest rates on borrowings (or in the dividend rates on any Preferred Stock, if the Fund were to issue Preferred Stock) may reduce the Common Stock's yield and negatively impact its net asset value and market price. If the income derived from securities purchased with assets received from leverage exceeds the cost of leverage, the Fund's net income will be greater than if leverage had not been used. Conversely, if the income from the securities purchased is not sufficient to cover the cost of leverage, the Fund's net income will be less than if leverage had not been used, and therefore the amount available for distribution to Common Stock shareholders will be reduced.

Proxy Results

During the six-month period ended November 30, 2004, Corporate High Yield Fund III, Inc.'s shareholders voted on the following proposal. The proposal was approved at a shareholders' meeting on August 25, 2004. A description of the proposal and number of shares voted are as follows:

		Shares Voted For	Shares Wi From Vo
1. To elect the Fund's Board of Directors:	Terry K. Glenn	35,159,801	899,4
	James H. Bodurtha	35,162,209	897,0
	Joe Grills	35,146,937	912,2
	Herbert I. London	35,147,878	911,3
	Andre F. Perold	35,145,722	913,5
	Roberta Cooper Ramo	35,148,154	911,0
	Robert S. Salomon, Jr.	35,147,208	912,0
	Stephen B. Swensrud	35,139,120	920,1

A Letter From the President

Dear Shareholder

As we ended the current reporting period, several topics weighed heavily on investors' minds. Among them were questions about economic growth, corporate earnings, interest rates and inflation, politics, the price of oil and terrorism -- all issues that are worth addressing here.

While the pace of economic expansion slowed somewhat between the first and second quarters of 2004, gross domestic product reaccelerated in the third quarter and is expected to approach 4% for the year. The generally favorable economic environment has benefited American corporations, which continued to post strong earnings. Although the extraordinary results seen in 2004 are likely to moderate in 2005, solid productivity, improved revenue growth and cost discipline all point to a vital corporate sector.

In terms of inflation and interest rates, the Federal Reserve Board has signaled its confidence in the economic recovery by increasing the Federal Funds target rate five times since June 2004, from 1% to 2.25% as of the December 14 Federal Open Market Committee meeting. Inflation, for its part, has remained fairly subdued.

While the re-election of President Bush was generally viewed as business-friendly, the rising price of oil continued to be a concern for consumers and corporations. Although the price of oil has exceeded $50 per barrel recently, the situation is far from the crisis proportions we saw in the 1980s. Lastly, but importantly, terrorism and geopolitical tensions are unwelcome realities we are forced to live with today. Historically, however, the financial effects of any single event tend to be short-lived.

Amid the ambiguities, fixed income markets provided positive results. The Lehman Brothers Aggregate Bond Index, for example, returned +4.44% for the 12-month period and +3.82% for the six-month period ended November 30, 2004. The 10-year Treasury yield was essentially unchanged year-over-year, while the three-month Treasury ended the period at 2.23%, up from 1.08% six months ago and .93% 12 months ago.

The key during uncertain times is to remain focused on the big picture. Investment success comes not from reacting to short-term volatility, but from maintaining a long-term perspective and adhering to the disciplines of asset allocation, diversification and rebalancing. We encourage you to work with your financial advisor to ensure these time-tested techniques are incorporated into your investment plan.

Finally, after 35 years in the asset management business, it is with great satisfaction and some nostalgia that I embark on my retirement, effective January 1, 2005. The industry has evolved significantly over the past three and a half decades, and I am privileged to have been a part of it. I wish you continued success as you pursue your investment goals and, as always, I thank you for allowing Merrill Lynch Investment Managers to be a part of your financial life.

Sincerely,

/s/ Terry K. Glenn

Terry K. Glenn
President and Director

[LOGO] Merrill Lynch Investment Managers

A Discussion With Your Fund's Portfolio Manager

The Fund outperformed the benchmark CSFB High Yield Index for the six-month period, benefiting from its use of leverage and strong returns from several individual holdings.

How did the Fund perform during the period?

For the six-month period ended November 30, 2004, the Common Stock of Corporate High Yield Fund III, Inc. had net annualized yields of 9.60% and 10.05%, based on a period-end per share net asset value of $9.02 and a per share market price of $8.61, respectively, and $.434 per share income dividends. Over the same period, the total investment return on the Fund's Common Stock was +12.51%, based on a change in per share net asset value from $8.43 to $9.02, and assuming reinvestment of all distributions.

The Fund's return significantly exceeded that of the high yield market, as measured by the Credit Suisse First Boston (CSFB) High Yield Index, which returned +9.31% for the six-month period ended November 30, 2004. The Fund slightly underperformed its comparable Lipper category of High Current Yield Funds (Leveraged), which had an average return of +13.08% for the same period. (Funds in this Lipper category aim for relatively high current yield from investment in fixed income securities, have no quality or maturity restrictions and tend to invest in lower-grade debt issues.)

For a description of the Fund's total investment return based on a change in the per share market value of the Fund's Common Stock (as measured by the trading price of the Fund's shares on the New York Stock Exchange), and assuming reinvestment of dividends, please refer to the Financial Highlights section of this report. As a closed-end fund, the Fund's shares may trade in the secondary market at a premium or a discount to the Fund's net asset value. As a result, total investment returns based on changes in the market value of the Fund's Common Stock can vary significantly from total investment returns based on changes in the Fund's net asset value.

For the most part, the high yield market remained strong throughout the past six months. The market gleaned support from a generally healthy economic environment, a decline in default rates by high yield issuers and robust demand for the asset class on the part of both domestic institutional and foreign investors.

The new-issue calendar remained active in 2004. As of November 30, year-to-date new issuance totaled some $127.7 billion, with the majority of the proceeds used for bank loan and other debt repayment. At the same time, the default rate of high yield corporate borrowers has continued to decline. As reported by Moody's, the default rate fell sharply over the past two years, from 8.5% at year-end 2002 to just 2% at the end of the third quarter of 2004. This trend, coupled with a healthy economy and muted inflation, has encouraged investment demand for the high yield borrowing sector.

What factors contributed to the Fund's performance?

The Fund's performance benefited from the use of leverage and positive results from several holdings that rebounded during the period. The strongest performance came from the utility sector, especially independent power producers Calpine Corporation, Mission Energy and The AES Corporation, as the improving economy and refinancings led to an improved outlook for these companies. Also outperforming were the convertible bonds of Tyco International Group SA and Halliburton Company. Tyco's earnings benefited from the expanding economy, as well as from corporate streamlining by a new management team. Halliburton resolved asbestos and silica litigation that had overshadowed the company's improving earnings picture.

What changes were made to the portfolio during the period?

We added modestly to our convertible bond holdings, raising our total allocation in that category to 7.6% of the Fund's net assets. We continue to believe that convertible securities will add incremental performance to the Fund in an environment where high yield bonds appear to be fully valued. Convertible securities can be volatile, reflecting movements in the underlying stocks; therefore, we anticipate that our holdings will be subject to the same risks. However, we have attempted to mitigate that risk by choosing higher-quality issues and by purchasing bonds that are somewhat insulated from downside volatility while benefiting from rising stock prices. Among the Fund's most significant convertible positions are Liberty Media Corporation (rated BBB-), which converts to shares of Time Warner, and CenterPoint Energy, Inc. (rated BBB-), a power distributor. During the period, we sold most of our position in Tyco International convertible bonds for a substantial profit and the securities of Citizens Utilities (rated BB+), which converted to common stock and paid a substantial dividend prior to our sale.

With short-term interest rates rising, we invested modestly in floating rate securities and bank loans, which total near 5.5% of Fund net assets at November 30, 2004. We also have maintained our overweighting in the CCC category, believing that many bonds in this category have better credit quality than is implied by the rating and that other bonds in this category will benefit from the strengthening economy.

The Fund's leverage averaged 25.2% during the past six months. That is, the Fund borrowed the equivalent of 25.2% of total assets invested, earning incremental yield on the investments we made with the borrowed funds. For the six months ended November 30, 2004, the average amount borrowed was $109.7 million, and the daily weighted average interest rate was 1.86%. While leveraging will hinder the Fund's total return in a weak market, the converse also is true. We intend to maintain our leverage position in the mid-20% range, although that level may vary somewhat as we adjust the portfolio's holdings. (For a more complete discussion of the benefits and risks of leveraging, see page 2 of this report to shareholders.)

How would you characterize the Fund's position at the close of the period?

We expect increasing pressure in the market from rising interest rates, but believe high yield securities will continue to find support from a gradually improving economy and the resultant positive corporate earnings. We have positioned the Fund to benefit in this environment and have taken steps -- for example, adding floating rate securities -- to moderate the impact of higher interest rates on the portfolio.

We continue to believe that the chemical sector represents good relative value. We have overweighted that sector, with 8.3% of total investments allocated to that industry. Our focus in that sector remains on specialty chemicals firms that have some pricing flexibility and more stable end markets. Another large industry allocation is in utilities, at 8.5% of total investments. Although we believe utilities are stable and relatively defensive, we are underweight in the sector relative to the high yield market as a whole. We believe the sector in general is fully valued and offers neither substantial appreciation potential nor significant yield. The exception is Calpine, which, though volatile, offers both appreciation and yield as the strengthening economy improves its earnings prospects.

The Fund is underweight in the leisure sector, based on our belief that these securities already have priced in the upside potential. We maintain an underweight position in information technology, given our perception of high valuations, unstable earnings and potentially limited recovery value if earnings decline in the sector. We have limited exposure to the retail, food and drug, and finance sectors, based on what we believe is inadequate and uncertain asset protection in these areas of the market. Similar to the CSFB High Yield Index, the Fund had an average credit rating of B at the close of the period.

Elizabeth M. Phillips
Vice President and Portfolio Manager

December 16, 2004

[LOGO] Merrill Lynch Investment Managers

Schedule of Investments (in U.S. dollars)

Industry+	Face Amount	Corporate Bonds
Aerospace & Defense--3.2%	$2,275,000	Alliant Techsystems Inc., 3% due 8/15/2024 (Convertible) (e)
	975,000	Esterline Technologies Corporation, 7.75% due 6/15/2013
	400,000	K & F Industries, Inc., 7.75% due 11/15/2014 (e)
	1,750,000	Standard Aero Holdings, Inc., 8.25% due 9/01/2014 (e)
	1,300,000	TD Funding Corp., 8.375% due 7/15/2011
	1,800,000	The Titan Corporation, 8% due 5/15/2011
	1,700,000	Vought Aircraft Industries, Inc., 8% due 7/15/2011
Airlines--2.3%	1,300,000	American Airlines, Inc., 7.80% due 4/01/2008
		Continental Airlines, Inc.:
	750,000	7.25% due 11/01/2005
	950,000	8% due 12/15/2005
	482,836	6.541% due 9/15/2009
	1,318,425	7.033% due 6/15/2011
	1,328,933	6.90% due 1/02/2017
		Delta Air Lines, Inc.:
	2,800,000	7.90% due 12/15/2009
	1,500,000	2.875% due 2/18/2024 (Convertible) (e)
Automotive--2.3%	1,225,000	Asbury Automotive Group, Inc., 8% due 3/15/2014
	1,900,000	Autocam Corporation, 10.875% due 6/15/2014
		Metaldyne Corporation:
	2,625,000	11% due 6/15/2012
	1,190,000	10% due 11/01/2013 (e)
	1,300,000	Tenneco Automotive Inc., 8.625% due 11/15/2014 (e)
Broadcasting--5.0%	2,275,000	CanWest Media, Inc., 8% due 9/15/2012 (e)
	2,675,000	Granite Broadcasting Corporation, 9.75% due 12/01/2010
	1,375,000	NextMedia Operating, Inc., 10.75% due 7/01/2011
		Paxson Communications Corporation:
	2,125,000	10.75% due 7/15/2008
	550,000	12.121%** due 1/15/2009
		Salem Communications Holding Corporation:
	1,175,000	7.75% due 12/15/2010
	1,364,000	9% due 7/01/2011
	3,005,000	Sinclair Broadcast Group, Inc., 4.875% due 7/15/2018 (Convert
	2,300,000	Young Broadcasting Inc., 8.75% due 1/15/2014
Cable--International--1.3%	1,750,000	Kabel Deutschland GmbH, 10.625% due 7/01/2014 (e)
	2,450,000	NTL Cable PLC, 6.07% due 10/15/2012 (d)(e)

Cable--U.S.--8.7%		Adelphia Communications Corporation (c):
	750,000	6% due 2/15/2006 (Convertible)
	1,900,000	12.531%** due 1/15/2008
	236,329	Avalon Cable LLC, 11.875% due 12/01/2008
	2,075,000	CSC Holdings, Inc., 7.625% due 4/01/2011
	4,850,000	Century Cable Holdings LLC, Term, due 12/31/2009 (a)
		Charter Communications Holdings, LLC:
	3,500,000	8.625% due 4/01/2009
	2,000,000	9.625% due 11/15/2009
	945,000	Charter Communications, Inc., 5.875% due 11/16/2009 (Converti
	2,750,000	Insight Communications Company, Inc., 12.25%** due 2/15/2011
	2,594,000	Loral Cyberstar, Inc., 10% due 7/15/2006 (c)
	950,000	Loral Space & Communications Ltd., 9.50% due 1/15/2006 (c)

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Schedule of Investments (continued) (in U.S. dollars)

Industry+	Face Amount	Corporate Bonds
Cable--U.S. (concluded)	$4,175,000	Mediacom Broadband LLC, 11% due 7/15/2013
		New Skies Satellites BV (e):
	750,000	7.438% due 11/01/2011 (d)
	1,150,000	9.125% due 11/01/2012
	2,850,000	Rainbow National Services LLC, 10.375% due 9/01/2014 (e)
	300,000	Rogers Cable Inc., 6.75% due 3/15/2015 (e)
	525,000	WDAC Subsidiary Corp., 8.375% due 12/01/2014 (e)
Chemicals--11.4%	2,375,000	BCP Caylux Holdings Luxembourg SCA, 9.625% due 6/15/2014 (e)
		Crompton Corporation (e):
	1,875,000	7.67% due 8/01/2010 (d)
	2,175,000	9.875% due 8/01/2012
		Huntsman International LLC:
	525,000	9.875% due 3/01/2009
	2,500,000	10.125% due 7/01/2009
	2,025,000	ISP Chemco Inc., 10.25% due 7/01/2011
	1,125,000	ISP Holdings, Inc., 10.625% due 12/15/2009
	1,575,000	Innophos, Inc., 8.875% due 8/15/2014 (e)
	3,025,000	Millennium America Inc., 7% due 11/15/2006
		Nalco Company:
	450,000	7.75% due 11/15/2011
	1,125,000	8.875% due 11/15/2013
	3,500,000	Nalco Finance Holdings LLC, 9.037%** due 2/01/2014
	3,125,000	Omnova Solutions Inc., 11.25% due 6/01/2010
	725,000	PCI Chemicals, Canada, 10% due 12/31/2008
	3,125,000	PolyOne Corporation, 10.625% due 5/15/2010
		Rockwood Specialties Group, Inc.:
	1,825,000	10.625% due 5/15/2011
	250,000	7.50% due 11/15/2014 (e)
	1,966,000	Terra Capital, Inc., 11.50% due 6/01/2010
	2,830,000	Wellman, Inc., Second Lien Term, due 2/10/2010 (a)

Consumer--	1,350,000	Sealy Mattress Company, 8.25% due 6/15/2014
Durables--0.7%	785,000	Tempur-Pedic, Inc., 10.25% due 8/15/2010
Consumer--		Chattem, Inc.:
Non-Durables--2.1%	650,000	5.40% due 3/01/2010 (d)
	600,000	7% due 3/01/2014
	3,125,000	Hines Nurseries, Inc., 10.25% due 10/01/2011
	2,200,000	Samsonite Corporation, 8.875% due 6/01/2011
Diversified	2,150,000	CBD Media LLC, 8.625% due 6/01/2011
Media--6.3%	1,367,000	Dex Media West LLC, 9.875% due 8/15/2013
	2,650,000	Houghton Mifflin Company, 8.25% due 2/01/2011
	5,600,000	Liberty Media Corporation, 0.75% due 3/30/2023 (Convertible)
		PRIMEDIA Inc.:
	875,000	7.625% due 4/01/2008
	1,225,000	8.875% due 5/15/2011
	2,650,000	Six Flags, Inc., 9.50% due 2/01/2009
	3,302,000	Yell Finance BV, 12.52%** due 8/01/2011
Energy--Exploration & Production--0.9%	2,525,000	Plains Exploration & Production Company, 8.75% due 7/01/2012

Schedule of Investments (continued)   (in U.S. dollars)

Industry+	Face Amount	Corporate Bonds
Energy--	$1,875,000	Dresser, Inc., 9.375% due 4/15/2011
Other--4.3%	1,000,000	Dresser-Rand Group Inc., 7.375% due 11/01/2014 (e)
	2,300,000	Halliburton Company, 3.125% due 7/15/2023 (Convertible) (e)
	3,750,000	Ocean Rig Norway AS, 10.25% due 6/01/2008
		Star Gas Partners, LP:
	2,625,000	10.25% due 2/15/2013
	500,000	10.25% due 2/15/2013 (e)
	2,025,000	Trico Marine Services, Inc., 8.875% due 5/15/2012 (c)
Financial--0.9%	2,900,000	Refco Finance Holdings LLC, 9% due 8/01/2012 (e)
Food / Tobacco--5.2%	750,000	American Seafoods Group LLC, 10.125% due 4/15/2010
		Commonwealth Brands, Inc. (e):
	1,925,000	9.75% due 4/15/2008
	1,475,000	10.625% due 9/01/2008

	3,250,000	Cott Beverages, Inc., 8% due 12/15/2011
	1,250,000	Del Monte Corporation, 8.625% due 12/15/2012
	2,200,000	Doane Pet Care Company, 10.75% due 3/01/2010
	1,275,000	Merisant Company, 9.50% due 7/15/2013 (e)
	1,950,000	New World Pasta Company, 9.25% due 2/15/2009 (c)
	2,100,000	Smithfield Foods, Inc., 8% due 10/15/2009
	1,250,000	Tabletop Holdings, Inc., 12.25%** due 5/15/2014 (e)
	1,575,000	The Wornick Company, 10.875% due 7/15/2011 (e)
Gaming--7.6%	3,250,000	Boyd Gaming Corporation, 8.75% due 4/15/2012
	1,925,000	Inn of the Mountain Gods Resort and Casino, 12% due 11/15/201
	1,550,000	MGM Mirage Inc., 8.50% due 9/15/2010
	3,625,000	The Majestic Star Casino, LLC, 9.50% due 10/15/2010
	2,325,000	Park Place Entertainment Corporation, 7.875% due 3/15/2010
	1,425,000	Pinnacle Entertainment, Inc., 8.25% due 3/15/2012
	2,575,000	Poster Financial Group, Inc., 8.75% due 12/01/2011
	2,700,000	Resorts International Hotel and Casino, Inc., 11.50% due 3/15
		Wynn Las Vegas, LLC:
	987,000	12% due 11/01/2010
	2,825,000	6.625% due 12/01/2014 (e)
Government--	1,100,000	Cosan SA Industria e Comercio, 9% due 11/01/2009 (e)
Foreign--2.1%	2,000,000	Electricidad de Caracas Finance BV, 10.25% due 10/15/2014 (e)
		Federal Republic of Brazil:
	1,058,425	8% due 4/15/2014
	1,625,000	10.50% due 7/14/2014
	800,000	Republic of Turkey, 7.25% due 3/15/2015
Health Care--7.1%		Alpharma, Inc.:
	1,900,000	3% due 6/01/2006 (Convertible)
	2,100,000	8.625% due 5/01/2011 (e)
		Elan Finance PLC (e):
	1,250,000	6.51% due 11/15/2011 (d)
	1,550,000	7.75% due 11/15/2011
	2,902,000	Fisher Scientific International Inc., 8.125% due 5/01/2012
	3,750,000	Fresenius Medical Care Capital Trust II, 7.875% due 2/01/2008
	2,825,000	HealthSouth Corporation, 8.375% due 10/01/2011
		Tenet Healthcare Corporation:
	1,000,000	5.375% due 11/15/2006
	1,125,000	9.875% due 7/01/2014 (e)
	2,675,000	US Oncology, Inc., 9% due 8/15/2012 (e)
	1,000,000	Vanguard Health Holding Company II, LLC, 9% due 10/01/2014 (e

Schedule of Investments (continued) (in U.S. dollars)

Industry+	Face Amount	Corporate Bonds

Housing--3.4%		Building Materials Corporation of America:
	$ 400,000	7.75% due 7/15/2005
	1,050,000	8% due 10/15/2007
	5,325,000	8% due 12/01/2008
	650,000	Forest City Enterprises, Inc., 7.625% due 6/01/2015
	1,875,000	Nortek, Inc., 8.50% due 9/01/2014 (e)
	1,475,000	Texas Industries, Inc., 10.25% due 6/15/2011
Information Technology--4.8%	3,600,000	Advanced Micro Devices, Inc., 7.75% due 11/01/2012 (e)
		Amkor Technology, Inc.:
	575,000	9.25% due 2/15/2008
	1,925,000	7.125% due 3/15/2011
	2,825,000	Cypress Semiconductor Corporation, 1.25% due 6/15/2008 (Conve
	1,925,000	Freescale Semiconductor, Inc., 4.82% due 7/15/2009 (d)
	1,000,000	Quantum Corporation, 4.375% due 8/01/2010 (Convertible)
	1,150,000	UGS Corp., 10% due 6/01/2012 (e)
	3,275,000	Viasystems, Inc., 10.50% due 1/15/2011
Leisure--1.9%		FelCor Lodging LP:
	2,850,000	6.874% due 6/01/2011 (d)
	1,550,000	9% due 6/01/2011
	1,050,000	Intrawest Corporation, 7.50% due 10/15/2013
	775,000	True Temper Sports, Inc., 8.375% due 9/15/2011
Manufacturing--6.2%	800,000	Columbus McKinnon Corporation, 8.50% due 4/01/2008
	2,725,000	EaglePicher Incorporated, 9.75% due 9/01/2013
	3,450,000	Invensys PLC, 9.875% due 3/15/2011 (e)
	2,475,000	JohnsonDiversey, Inc., 9.625% due 5/15/2012
	1,175,000	Mueller Group, Inc., 10% due 5/01/2012
	775,000	Rexnord Corporation, 10.125% due 12/15/2012
	975,000	Sensus Metering Systems Inc., 8.625% due 12/15/2013
	1,825,000	Superior Essex Communications LLC, 9% due 4/15/2012
	3,125,000	TriMas Corporation, 9.875% due 6/15/2012
	1,605,000	Tyco International Group SA, 2.75% due 1/15/2018 (Convertible
Metal--Other--2.2%	1,200,000	Century Aluminum Company, 7.50% due 8/15/2014 (e)
	1,150,000	Foundation PA Coal Company, 7.25% due 8/01/2014 (e)
	2,925,000	Luscar Coal Ltd., 9.75% due 10/15/2011
	1,375,000	Vale Overseas Ltd., 8.25% due 1/17/2034
Packaging--5.6%	1,400,000	Consolidated Container Company LLC, 10.75%** due 6/15/2009
		Crown Euro Holdings SA:
	950,000	9.50% due 3/01/2011
	500,000	10.875% due 3/01/2013
		Owens-Brockway Glass Container, Inc.:
	3,325,000	8.875% due 2/15/2009
	775,000	8.25% due 5/15/2013
		Pliant Corporation:
	2,200,000	11.125%** due 6/15/2009
	3,550,000	13% due 6/01/2010

		Tekni-Plex, Inc.:
	2,375,000	12.75% due 6/15/2010
	400,000	8.75% due 11/15/2013 (e)
		U.S. Can Corporation:
	375,000	10.875% due 7/15/2010
	2,825,000	12.375% due 10/01/2010
	650,000	Wise Metals Group LLC, 10.25% due 5/15/2012 (e)

Schedule of Investments (continued) (in U.S. dollars)

Industry+	Face Amount	Corporate Bonds
Paper--6.9%	$3,400,000	Abitibi-Consolidated Inc., 5.38% due 6/15/2011 (d)
		Ainsworth Lumber Co. Ltd. (e):
	1,900,000	5.669% due 10/01/2010 (d)
	1,150,000	7.25% due 10/01/2012
		Boise Cascade LLC (e):
	250,000	5.005% due 10/15/2012 (d)
	500,000	7.125% due 10/15/2014
	3,025,000	Bowater Incorporated, 4.88% due 3/15/2010 (d)
	2,125,000	Caraustar Industries, Inc., 9.875% due 4/01/2011
	1,425,000	Georgia-Pacific Corporation, 7.375% due 7/15/2008
		Graphic Packaging International Inc.:
	825,000	8.50% due 8/15/2011
	950,000	9.50% due 8/15/2013
	1,900,000	JSG Funding PLC, 9.625% due 10/01/2012
	875,000	Jefferson Smurfit Corporation, 8.25% due 10/01/2012
		Norske Skog Canada Ltd.:
	2,450,000	8.625% due 6/15/2011
	150,000	7.375% due 3/01/2014
	1,003,000	Western Forest Products Inc., 15% due 7/28/2009 (g)
Retail--0.4%	1,250,000	The Jean Coutu Group, Inc., 8.50% due 8/01/2014 (e)
Services--6.4%	2,625,000	Allied Waste North America, Inc., 8.875% due 4/01/2008
	2,900,000	The Coinmach Corporation, 9% due 2/01/2010
	2,725,000	Corrections Corporation of America, 7.50% due 5/01/2011
	875,000	MSW Energy Finance Co. II Inc., 7.375% due 9/01/2010
	1,500,000	MSW Energy Holdings LLC, 8.50% due 9/01/2010
	3,200,000	United Rentals (North America), Inc., 7.75% due 11/15/2013 (e
	3,100,000	Waste Services, Inc., 9.50% due 4/15/2014 (e)
		Williams Scotsman, Inc.:
	3,750,000	9.875% due 6/01/2007
	375,000	10% due 8/15/2008

Steel--0.9%	1,425,000	CSN Islands VIII Corp., 9.75% due 12/16/2013 (e)
	1,200,000	UCAR Finance Inc., 10.25% due 2/15/2012
Telecommunications--7.0%		ADC Telecommunications, Inc. (Convertible):
	2,200,000	1% due 6/15/2008
	750,000	2.235% due 6/15/2013 (d)
	2,475,000	Alaska Communications System Holdings, Inc., 9.875% due 8/15/
	2,850,000	Cincinnati Bell Inc., 8.375% due 1/15/2014
	3,250,000	FairPoint Communications, Inc., 12.50% due 5/01/2010
	2,750,000	LCI International, Inc., 7.25% due 6/15/2007
	1,725,000	Qwest Capital Funding, Inc., 7.25% due 2/15/2011
	1,350,000	Qwest Services Corp., 14% due 12/15/2010 (e)
	1,000,000	Terremark Worldwide, Inc., 9% due 6/15/2009 (Convertible) (e)
	850,000	Time Warner Telecom Holdings, Inc., 6.29% due 2/15/2011 (d)
		Time Warner Telecom, Inc.:
	500,000	9.75% due 7/15/2008
	3,875,000	10.125% due 2/01/2011
Transportation--1.4%	1,900,000	Laidlaw International, Inc., 10.75% due 6/15/2011
	2,325,000	Teekay Shipping Corporation, 8.875% due 7/15/2011

10 CORPORATE HIGH YIELD FUND III, INC. NOVEMBER 30, 2004

Schedule of Investments (continued) (in U.S. dollars)

Industry+	Face Amount	Corporate Bonds
Utility--11.7%		The AES Corporation:
	$4,458,000	9.375% due 9/15/2010
	2,100,000	8.75% due 5/15/2013 (e)
	850,000	AES Drax Energy Limited, 11.50%** due 8/30/2010 (c)
	7,025,000	Calpine Canada Energy Finance ULC, 8.50% due 5/01/2008
		Calpine Corporation:
	1,500,000	8.25% due 8/15/2005
	950,000	8.75% due 7/15/2007
	4,600,000	CenterPoint Energy, Inc., 3.75% due 5/15/2023 (Convertible)
	2,071,000	ESI Tractebel Acquisition Corp., 7.99% due 12/30/2011
	1,900,000	Edison Mission Energy, 9.875% due 4/15/2011
	2,725,000	El Paso CGP Company, 7.75% due 6/15/2010
	2,600,000	Mission Energy Holding Company, 13.50% due 7/15/2008
		Nevada Power Company:
	3,300,000	10.875% due 10/15/2009
	600,000	9% due 8/15/2013
	1,650,000	Sierra Pacific Power Company, 8% due 6/01/2008
	1,200,000	Sierra Pacific Resources, 8.625% due 3/15/2014
	925,000	Southern Natural Gas Company, 8.875% due 3/15/2010

Wireless--3.8%	825,000	American Tower Escrow Corporation, 14.887%** due 8/01/2008
	2,000,000	Centennial Communications Corp., 10.125% due 6/15/2013
	2,800,000	Crown Castle International Corp., 9.375% due 8/01/2011
		Rogers Wireless Inc:
	250,000	5.525% due 12/15/2010 (d)(e)
	250,000	8% due 12/15/2012 (e)
	3,400,000	6.375% due 3/01/2014
	625,000	Rural Cellular Corporation, 6.38% due 3/15/2010 (d)
	2,850,000	SBA Telecommunications, Inc., 7.534%** due 12/15/2011
		Total Investments in Corporate Bonds (Cost--$427,192,360)--13

	Shares Held	Common Stocks
Airlines--0.2%	81,243	ABX Air, Inc. (b)
Cable--International--1.0%	223,675	Telewest Global, Inc. (b)
Paper--0.4%	203,785	Western Forest Products Inc. (b)
Telecommunications--0.1%	16,244	MCI, Inc.
		Total Investments in Common Stocks (Cost--$5,039,325)--1.7%

		Preferred Stocks
Automotive--1.0%	128,000	General Motors Corporation (Convertible)
		Total Investments in Preferred Stocks (Cost--$3,199,472)--1.0

[LOGO] Merrill Lynch Investment Managers

Schedule of Investments (concluded) (in U.S. dollars)

Industry+	Shares Held	Warrants (h)
Cable--U.S.--0.0%	32,981	Loral Space & Communications Ltd.
Health Care--0.0%	32,042	HealthSouth Corporation

Packaging--0.0%	4,000	Pliant Corporation
Paper--0.0%	700	JSG Funding PLC
Wireless--0.1%	825	American Tower Escrow Corporation
		Total Investments in Warrants (Cost--$112,171)--0.1%

	Beneficial Interest	Other Interests (f)
	$3,780,240	US Airways Group, Inc.--Certificate of Beneficial Interest
		Total Investments in Other Interests (Cost--$1,020,665)--0.3%

Total Investments (Cost--$436,563,993*)--137.1%

Liabilities in Excess of Other Assets--(37.1%)

Net Assets--100.0%

+ For Fund compliance purposes, "Industry" means any one or more of the industry sub-classifications used by one or more widely recognized market indexes or ratings group indexes, and/or as defined by Fund management. This definition may not apply for purposes of this report, which may combine such industry sub-classifications for reporting ease.

* The cost and unrealized appreciation/depreciation of investments as of November 30, 2004, as computed for federal income tax purposes, were as follows:

Aggregate cost	$436,016,861
Gross unrealized appreciation	$ 34,501,465
Gross unrealized depreciation	(9,757,990)
Net unrealized appreciation	$ 24,743,475

** Represents a zero coupon or step bond; the interest rate shown reflects the effective yield at the time of purchase by the Fund.

(a) Floating rate corporate debt in which the Fund invests generally pays interest at rates that are periodically redetermined by reference to a base lending rate plus a premium. The base lending rates are generally (i) the lending rate offered by one or more major European banks, such as LIBOR (London InterBank Offered Rate), (ii) the prime rate offered by one or more major U.S. banks or (iii) the certificate of deposit rate. Corporate loans represent 2.3% of the Fund's net assets.

(b) Non-income producing security.

(c) Non-income producing security; issuer filed for bankruptcy or is in default of interest payments.

(d) Floating rate note.

(e) The security may be offered and sold to "qualified institutional buyers" under Rule 144A of the Securities Act of 1933.

(f) Other interests represent beneficial interest in liquidation trusts and other reorganization entities.

(g) Represents a pay-in-kind security which may pay interest/dividends in additional face/shares.

(h) Warrants entitle the Fund to purchase a predetermined number of shares of common stock and are non-income producing. The purchase price and number of shares are subject to adjustment under certain conditions until the expiration date.

Investments in companies considered to be an affiliate of the Fund (such companies are defined as "Affiliated Companies" in Section 2 (a)(3) of the Investment Company Act of 1940) were as follows:

Affiliate	Net Activity	Interest Income
Merrill Lynch Liquidity Series, LLC Cash Sweep Series I	$(82,499)	$1,918

Swaps outstanding as of November 30, 2004 were as follows:

	Notional Amount	Unrealized Appreciation
Receive a variable rate return based on 1-month USD LIBOR and pay a fixed rate equal to 1.56% interest Broker, UBS Warburg Expires June 2005	$30,000,000	$241,700

See Notes to Financial Statements.

Statement of Assets, Liabilities and Capital

As of November 30, 2004

Assets		
Investments in unaffiliated securities, at value (identified cost--$436,563,993)		
Unrealized appreciation on swaps		
Receivables:		
Interest	$	
Dividends		
Prepaid expenses and other assets		
Total assets		

Liabilities		
Loans		
Payables:		

Securities purchased ....
Custodian bank ....
Dividends to shareholders ....
Interest on swaps ....
Interest on loans ....
Investment adviser ....
Other affiliates ....

Accrued expenses ....

Total liabilities ....

Net Assets

Net Assets ....

Capital

Common Stock, $.10 par value, 200,000,000 shares authorized ....
Paid-in capital in excess of par ....
Undistributed investment income--net .... $
Accumulated realized capital losses--net .... (
Unrealized appreciation--net ....

Total accumulated losses--net ....

Total--Equivalent to $9.02 per share based on 37,279,531 shares of capital stock outstanding (market price--$8.61) ....

See Notes to Financial Statements.

[LOGO] Merrill Lynch Investment Managers

Statement of Operations

For the Six Months Ended November 30, 2004

Investment Income

Interest (including $1,918 from affiliates) ....
Dividends ....
Other ....

Total income ....

Expenses

Investment advisory fees .... $
Loan interest expense ....
Borrowing costs ....
Accounting services ....

Professional fees ....
Transfer agent fees ....
Printing and shareholder reports ....
Custodian fees ....
Listing fees ....
Pricing services ....
Directors' fees and expenses ....
Other ....

Total expenses ....

Investment income--net ....

Realized & Unrealized Gain (Loss)--Net

Realized gain (loss) on:
Investments--net ....
Swaps--net ....
Foreign currency transactions--net ....

Change in unrealized appreciation on:
Investments--net ....
Swaps--net ....

Total realized and unrealized gain--net ....

Net Increase in Net Assets Resulting from Operations ....

See Notes to Financial Statements.

Statements of Changes in Net Assets

F
M
N

Increase (Decrease) in Net Assets:

Operations

Investment income--net .... $
Realized gain (loss)--net ....
Change in unrealized appreciation--net ....

Net increase in net assets resulting from operations ....

Dividends to Shareholders

Dividends to shareholders from investment income--net ....

Capital Stock Transactions

Value of shares issued to Common Stock shareholders in reinvestment of dividends	
Recovery of previously expensed Common Stock offering costs	
Net increase in net assets resulting from capital stock transactions	

Net Assets

Total increase in net assets	
Beginning of period	
End of period*	$
* Undistributed investment income--net	$

See Notes to Financial Statements.

[LOGO] Merrill Lynch Investment Managers

Statement of Cash Flows

For the Six Months Ended November 30, 2004

Cash Used for Operating Activities

Net increase in net assets resulting from operations	$ 38,054,020
Adjustments to reconcile net increase in net assets resulting from operations to net cash used for operating activities:	
Increase in receivables	(342,133
Decrease in prepaid expenses and other assets	243,613
Increase in other liabilities	1,562,581
Realized and unrealized gain--net	(21,689,845
Amortization of discount	(1,375,905
Proceeds from sales and paydowns of long-term investments	135,011,864
Purchases of long-term investments	(152,585,507
Proceeds from sales of short-term investments--net	82,499
Termination of swap contracts	94,904
Net cash used for operating activities	(943,909

Cash Provided by Financing Activities

Cash receipts from borrowings	101,500,000
Cash payments on borrowings	(85,200,000
Dividends paid to shareholders	(15,574,196
Net cash provided by financing activities	725,804

Cash

Net decrease in cash	(218,105
Cash at beginning of period	218,105
Cash at end of period	$ --

Cash Flow Information

Cash paid for interest	$ 1,005,954

Non-Cash Financing Activities

Reinvestment of dividends paid to shareholders	$ 531,254

See Notes to Financial Statements.

Financial Highlights

The following per share data and ratios have been derived from information provided in the financial statements. Increase (Decrease) in Net Asset Value:	For the Six Months Ended November 30, 2004	For the 2004	2003
Per Share Operating Performance			
Net asset value, beginning of period	$ 8.43	$ 7.86	$ 7.6
Investment income--net**	.44	.88	.9
Realized and unrealized gain (loss)--net	.58	.58	.1
Total from investment operations	1.02	1.46	1.0
Less dividends from investment income--net	(.43)	(.89)	(.9
Recovery of previously expensed offering costs (capital charge) resulting from issuance of Common Stock	--	--+	-
Net asset value, end of period ..	$ 9.02	$ 8.43	$ 7.8
Market price per share, end of period	$ 8.61	$ 7.97	$ 8.3

Total Investment Return***

Based on net asset value per share	12.51%@	19.33%	16.4
Based on market price per share	13.59%@	6.07%	15.7
Ratios to Average Net Assets			
Expenses, excluding interest expense	.99%*	1.01%	1.0
Expenses	1.62%*	1.51%	1.5
Investment income--net	10.09%*	10.48%	13.3
Leverage			
Amount of borrowings outstanding, end of period (in thousands)	$125,900	$109,600	$ 98,80
Average amount of borrowings outstanding during the period (in thousands)	$109,688	$112,297	$ 75,55
Average amount of borrowings outstanding per share during the period**	$ 2.95	$ 3.03	$ 2.0
Supplemental Data			
Net assets, end of period (in thousands)	$336,083	$313,583	$289,82
Portfolio turnover	30.78%	82.54%	76.6

* Annualized.
** Based on average shares outstanding.
*** Total investment returns based on market value, which can be significantly greater or lesser than the net asset value, may result in substantially different returns. Total investment returns exclude the effect of sales charges.
\+ Amount is less than $.01 per share.
@ Aggregate total investment return.

See Notes to Financial Statements.

[LOGO] Merrill Lynch Investment Managers

Notes to Financial Statements

1. Significant Accounting Policies:

Corporate High Yield Fund III, Inc. (the "Fund") is registered under the

Investment Company Act of 1940, as amended, as a diversified, closed-end management investment company. The Fund's financial statements are prepared in conformity with U.S. generally accepted accounting principles, which may require the use of management accruals and estimates. Actual results may differ from these estimates. These unaudited financial statements reflect all adjustments, which are, in the opinion of management, necessary to present a fair statement of the results for the interim period. The Fund determines and makes available for publication the net asset value of its Common Stock on a daily basis. The Fund's Common Stock is listed on the New York Stock Exchange ("NYSE") under the symbol CYE. The following is a summary of significant accounting policies followed by the Fund.

(a) Valuation of investments -- Debt securities are traded primarily in the over-the-counter markets and are valued at the last available bid price in the over-the-counter market or on the basis of values obtained by a pricing service. Pricing services use valuation matrixes that incorporate both dealer-supplied valuations and valuation models. The procedures of the pricing service and its valuations are reviewed by the officers of the Fund under the general direction of the Board of Directors. Such valuations and procedures will be reviewed periodically by the Board of Directors of the Fund. Financial futures contracts and options thereon, which are traded on exchanges, are valued at their closing prices as of the close of such exchanges. Options written or purchased are valued at the last sales price in the case of exchange-traded options. In the case of options traded in the over-the-counter ("OTC") market, valuation is the last asked price (options written) or the last bid price (options purchased). Swap agreements are valued by quoted fair valuations received daily by the Fund from the counterparty. Short-term investments with a remaining maturity of 60 days or less are valued at amortized cost which approximates market value, under which method the investment is valued at cost and any premium or discount is amortized on a straight line basis to maturity. Repurchase agreements are valued at cost plus accrued interest. Investments in open-end investment companies are valued at their net asset value each business day. Securities and other assets for which market quotations are not readily available are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund.

Equity securities that are held by the Fund, which are traded on stock exchanges or the Nasdaq National Market, are valued at the last sale price or official close price on the exchange, as of the close of business on the day the securities are being valued or, lacking any sales, at the last available bid price for long positions, and at the last available ask price for short positions. In cases where equity securities are traded on more than one exchange, the securities are valued on the exchange designated as the primary market by or under the authority of the Board of Directors of the Fund. Long positions traded in the OTC market, Nasdaq Small Cap or Bulletin Board are valued at the last available bid price obtained from one or more dealers or pricing services approved by the Board of Directors of the Fund. Short positions traded in the OTC market are valued at the last available asked price. Portfolio securities that are traded both in the OTC market and on a stock exchange are valued according to the broadest and most representative market.

Generally, trading in foreign securities is substantially completed each day at various times prior to the close of business on the NYSE. The values of such securities used in computing the net asset value of the Fund's shares are determined as of such times. Foreign currency exchange rates also are generally determined prior to the close of business on the NYSE. Occasionally, events affecting the values of such securities and such exchange rates may occur between the times at which they are determined and the close of business on the NYSE that may not be reflected in the computation of the Fund's net asset value. If events (for example, a company announcement, market volatility or a natural disaster) occur during such periods that are expected to materially affect the value of such securities, those securities may be valued at their fair value as determined in good faith by the Fund's Board of Directors or by the Investment Adviser using a pricing service and/or procedures approved by the Fund's Board of Directors.

(b) Derivative financial instruments -- The Fund may engage in various portfolio investment strategies both to increase the return of the Fund and to hedge, or protect, its exposure to interest rate movements and movements in the securities markets. Losses may arise due to changes in the value of the contract or if the counterparty does not perform under the contract.

- Options -- The Fund may write and purchase call and put options. When the Fund writes an option, an amount equal to the premium received by the Fund is reflected as an asset and an equivalent liability. The amount of the liability is subsequently marked-to-market to reflect the current market value of the option written. When a security is purchased or sold through an exercise of an option, the related premium paid (or received) is added to (or deducted from) the basis of the security acquired or deducted from (or added to) the proceeds of the security sold. When an option expires (or the Fund enters into a closing transaction), the Fund realizes a gain or loss on the option to the extent of the premiums received or paid (or gain or loss to the extent the cost of the closing transaction exceeds the premium paid or received).

  Written and purchased options are non-income producing investments.

- Financial futures contracts -- The Fund may purchase or sell financial futures contracts and options on such futures contracts. Futures contracts are contracts for delayed delivery of securities at a specific future date and at a specific price or yield. Upon entering into a contract, the Fund deposits and maintains as collateral such initial margin as required by the exchange on which the transaction is effected. Pursuant to the contract, the Fund agrees to receive from or pay to the broker an amount of cash equal to the daily fluctuation in value of the contract. Such receipts or payments are known as variation margin and are recorded by the Fund as unrealized gains or losses. When the contract is closed, the Fund records a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed.

- Swaps -- The Fund may enter into swap agreements, which are over-the-counter contracts in which the Fund and a counterparty agree to make periodic net payments on a specified notional amount. The net payments can be made for a set period of time or may be triggered by a predetermined credit event. The net periodic payments may be based on a fixed or variable interest rate; the change in market value of a specified security, basket of securities, or index; or the return generated by a security.

(c) Foreign currency transactions -- Transactions denominated in foreign currencies are recorded at the exchange rate prevailing when recognized. Assets and liabilities denominated in foreign currencies are valued at the exchange rate at the end of the period. Foreign currency transactions are the result of settling (realized) or valuing (unrealized) assets or liabilities expressed in foreign currencies into U.S. dollars. Realized and unrealized gains or losses from investments include the effects of foreign exchange rates on investments.

(d) Income taxes -- It is the Fund's policy to comply with the requirements of the Internal Revenue Code applicable to regulated investment companies and to distribute substantially all of its taxable income to its shareholders. Therefore, no federal income tax provision is required.

(e) Security transactions and investment income -- Security transactions are recorded on the dates the transactions are entered into (the trade dates). Realized gains and losses on security transactions are determined on the identified cost basis. Dividend income is recorded on the ex-dividend dates. Interest income is recognized on the accrual basis. The Fund amortizes all premiums and discounts on debt securities.

(f) Dividends and distributions -- Dividends from net investment income are declared and paid monthly. Distributions of capital gains are recorded on the ex-dividend dates.

(g) Securities lending -- The Fund may lend securities to financial institutions that provide cash or securities issued or guaranteed by the U.S. government as collateral, which will be maintained at all times in an amount equal to at least 100% of the current market value of the loaned securities. The market value of the loaned securities is determined at the close of business of the Fund and any additional required collateral is delivered to the Fund on the next business day. Where the Fund receives securities as collateral for the loaned securities, it collects a fee from the borrower. The Fund typically receives the income on the loaned securities but does not receive the income on the collateral. Where the Fund receives cash collateral, it may invest such collateral and retain the amount earned on such investment, net of any amount rebated to the borrower. Loans of securities are terminable at any time and the borrower, after notice, is required to return borrowed securities within five business days. The Fund may pay reasonable finder's, lending agent, administrative and custodial fees in connection with its loans. In the event that the borrower defaults on its obligation to return borrowed securities because of insolvency or for any

other reason, the Fund could experience delays and costs in gaining access to the collateral. The Fund also could suffer a loss where the value of the collateral falls below the market value of the borrowed securities, in the event of borrower default or in the event of losses on investments made with cash collateral.

(h) Custodian bank -- The Fund recorded an amount payable to the custodian bank reflecting an overnight overdraft, which resulted from an unprojected payment of net investment income dividends.

2. Investment Advisory Agreement and Transactions with Affiliates:

The Fund has entered into an Investment Advisory Agreement with Fund Asset Management, L.P. ("FAM"). The general partner of FAM is Princeton Services, Inc. ("PSI"), an indirect, wholly-owned subsidiary of Merrill Lynch & Co., Inc. ("ML & Co."), which is the limited partner.

FAM is responsible for the management of the Fund's portfolio and provides the necessary personnel, facilities, equipment and certain other services necessary to the operation of the Fund. For such services, the Fund pays a monthly fee at an annual rate of .60% of the Fund's average weekly net assets plus the proceeds of any outstanding principal borrowed. FAM has entered into a Sub-Advisory Agreement with Merrill Lynch Asset Management U.K. Limited ("MLAM U.K."), an affiliate of FAM, pursuant to which MLAM U.K. provides investment advisory services to FAM with respect to the Fund. There is no increase in the aggregate fees paid by the Fund for these services.

The Fund has received an exemptive order from the Securities and Exchange Commission permitting it to lend portfolio securities to Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S"), a subsidiary of ML & Co., or its affiliates. Pursuant to that order, the Fund also has retained Merrill Lynch Investment Managers, LLC ("MLIM, LLC"), an affiliate of FAM, as the securities lending agent for a fee based on a share of the returns on investment of cash collateral. MLIM, LLC may, on behalf of the Fund, invest cash collateral received by the Fund for such loans, among other things, in a private investment company managed by MLIM, LLC or in registered money market funds advised by FAM or its affiliates.

In addition, MLPF&S received $1,641 in commissions on the execution of portfolio security transactions for the Fund for the six months ended November 30, 2004.

For the six months ended November 30, 2004, the Fund reimbursed FAM $3,606 for certain accounting services.

Certain officers and/or directors of the Fund are officers and/or directors of FAM, PSI, MLAM U.K., and/or ML & Co.

3. Investments:

Purchases and sales of investments, excluding short-term securities, for the six months ended November 30, 2004 were $150,337,509 and $133,379,427, respectively.

4. Capital Share Transactions:

The Fund is authorized to issue 200,000,000 shares of capital stock, par value $.10, all of which were initially classified as Common Stock. The Board of Directors is authorized, however, to classify and reclassify any unissued shares of capital stock without approval of the holders of Common Stock.

Shares issued and outstanding during the six months ended November 30, 2004 and for the year ended May 31, 2004 increased by 60,292 and 325,778, respectively, as a result of dividend reinvestment.

5. Short-Term Borrowings:

On May 26, 2004, the Fund entered into a $160,000,000 revolving credit and security agreement with Citibank, N.A. and other lenders (the "Lenders"). Under the revolving credit and security agreement, the Fund may borrow money through (i) a line of credit from certain Lenders at the Eurodollar rate plus .75% or the highest of the federal funds rate plus .50%, a base rate as determined by Citibank, N.A. and/or the latest three-week moving average of secondary market morning offering rates in the United States for three-month certificates of deposit of major U.S. money market banks plus .50%, or (ii) the issuance of commercial paper notes by certain Lenders at rates of interest based upon the weighted average of the per annum rates paid or payable by such Lenders in respect of those commercial paper notes. As security for its obligations to the Lenders under the revolving credit and security agreement, the Fund has granted a security interest in substantially all of its assets to and in favor of the Lenders. The Fund also pays additional borrowing costs which include a commitment fee for this facility at the annual rate of .10% and a program fee of .24% on the borrowings outstanding.

For the six months ended November 30, 2004, the average amount borrowed was approximately $109,688,000 and the daily weighted average interest rate was 1.86%.

Notes to Financial Statements (concluded)

6. Capital Loss Carryforward:

On May 31, 2004, the Fund had a net capital loss carryforward of $236,944,109, of which $6,419,421 expires in 2007, $21,954,305 expires in 2008, $34,200,029 expires in 2009, $52,918,036 expires in 2010, $119,513,437 expires in 2011 and $1,938,881 expires in 2012. These amounts will be available to offset like amounts of any future taxable gains.

7. Subsequent Event:

The Fund paid an ordinary income dividend in the amount of $.074000 per share on December 21, 2004 to shareholders of record on December 10, 2004.

[LOGO] Merrill Lynch Investment Managers

Portfolio Information

As of November 30, 2004

Ten Largest Holdings	
Sierra Pacific Resources*	Sierra Pacific Resources is the holding company for t Power Company and Sierra Pacific Power Company. Both serve the state of Nevada.
The AES Corporation*	AES is a worldwide power producer with operations in Europe, Latin America and Asia. Electricity generatio primarily to wholesale customers, though the company distribution business to end users.
Calpine Corporation*	Calpine owns, develops and operates power-generation as sells electricity in the United States. The compan thermal energy for industrial customers.
Building Materials Corporation of America*	Building Materials is a manufacturer of residential r Timberline as its major brand.
Liberty Media Corporation*	These bonds are an obligation of Liberty Media, but u exchangeable into shares of media giant Time Warner c
Qwest Communications International*	Qwest provides a broad range of telecommunications se broadband Internet-based data, voice and image commun exchange services and data and long-distance services business customers. The company also provides Web hos Internet access and private networks.

Charter Communications*	Controlled by Microsoft co-founder Paul Allen, Charte cable television services throughout the United State
Edison International Inc.*	This utility holding company operates, through subsid power generation facilities worldwide. The company al energy and infrastructure projects. Our bonds are at Energy and Edison Mission subsidiaries.
Pliant Corporation*	Pliant is a top U.S. manufacturer of flexible packagi films for food, personal care, medical and industrial
CenterPoint Energy, Inc.*	Centerpoint is a regulated gas and electric transmiss company providing energy services to customers in the as well as Texas.

* Includes combined holdings and/or affiliates, where applicable.

Portfolio Profile

Quality Ratings by Standard & Poor's	Percent of Total Investments
BBB	5%
BB	17
B	54
CCC	20
NR (Not Rated)	2
Other*	2

* Includes portfolio holdings in common stocks, preferred stocks, warrants and other interests.

Average Portfolio Maturity	6.86 Years

Five Largest Industries*	Percent of Total Investments
Utility	8.5%
Chemicals	8.3
Cable--U.S	6.4
Gaming	5.5
Paper	5.3

* For Fund compliance purposes, "Industries" means any one or more of the industry sub-classifications used by one or more widely recognized market indexes or ratings group indexes, and/or as defined by Fund management. This definition may not apply for purposes of this report, which may combine such industry sub-classifications for reporting ease.

Five Largest Foreign Countries*	Percent of Total Investments
Canada	5.2%
United Kingdom	1.7
Netherlands	1.3
Luxembourg	0.9

Ireland 0.9

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* All holdings are denominated in U.S. dollars.

Officers and Directors

Terry K. Glenn, President and Director
James H. Bodurtha, Director
Joe Grills, Director
Herbert I. London, Director
Roberta Cooper Ramo, Director
Robert S. Salomon, Jr., Director
Stephen B. Swensrud, Director
Elizabeth M. Phillips, Vice President
Donald C. Burke, Vice President and Treasurer
Jeffrey Hiller, Chief Compliance Officer
Alice A. Pellegrino, Secretary

Custodian

State Street Bank and Trust Company
P.O. Box 351
Boston, MA 02101

Transfer Agent

EquiServe
P.O. Box 43010
Providence, RI 02940-3010
1-800-426-5523

NYSE Symbol

CYE

Andre F. Perold resigned as a Director of the Fund effective October 22, 2004.

Effective January 1, 2005, Terry K. Glenn will retire as President and Director of Corporate High Yield Fund III, Inc. The Fund's Board of Directors wishes Mr. Glenn well in his retirement.

Effective January 1, 2005, Robert C. Doll, Jr. will become President and Director of the Fund.

Availability of Quarterly Schedule of Investments

The Fund files its complete schedule of portfolio holdings with the Securities and Exchange Commission ("SEC") for the first and third quarters of each fiscal year on Form N-Q. The Fund's Forms N-Q are available on the SEC's Web site at http://www.sec.gov. The Fund's Forms N-Q may also be reviewed and copied at the SEC's Public Reference Room in Washington, DC. Information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330.

Electronic Delivery

The Fund offers electronic delivery of communications to its shareholders. In order to receive this service, you must register your account and provide us with e-mail information. To sign up for this service, simply access this Web site at http://www.icsdelivery.com/live and follow the instructions. When you visit this site, you will obtain a personal identification number (PIN). You will need this PIN should you wish to update your e-mail address, choose to discontinue this service and/or make any other changes to the service. This service is not available for certain retirement accounts at this time.

Corporate High Yield Fund III, Inc. seeks to provide shareholders with current income by investing primarily in a diversified portfolio of fixed income securities that are rated in the lower rating categories of the established rating services (Ba or lower by Moody's Investors Service, Inc. or BB or lower by Standard & Poor's Corporation) or are unrated securities of comparable quality.

This report, including the financial information herein, is transmitted to shareholders of Corporate High Yield Fund III, Inc. for their information. It is not a prospectus. The Fund has leveraged its Common Stock to provide Common Stock shareholders with a potentially higher rate of return. Leverage creates risk for Common Stock shareholders, including the likelihood of greater volatility of net asset value and market price of Common Stock shares, and the risk that fluctuations in short-term interest rates may reduce the Common Stock's yield. Past performance results shown in this report should not be considered a representation of future performance. Statements and other information herein are as dated and are subject to change.

A description of the policies and procedures that the Fund uses to determine how t

2,327

2,327

2,327

Diluted shares outstanding

82,629

81,055

82,553

80,679

Diluted earnings per share from continuing operations

$
0.49

$
0.37

$
0.97

$
0.75

Diluted earnings per share from discontinued operations

0.01

0.01

Diluted net earnings per share

$
0.49

$
0.38

$
0.97

$
0.76

(1) Pursuant to a joint venture agreement between the Company and the holders of the preferred stock of National Welders, until September 2009, the preferred shareholders have the option to exchange their 3.2 million preferred shares of National Welders either for cash at a price of $17.78 per share or to tender them to the joint venture in exchange for approximately 2.3 million shares of Airgas common stock. If Airgas common stock has a market value of $24.45 per share, the stock and cash redemption options are

equivalent. Since the average market price of Airgas common stock for each of the periods presented above was in excess of $24.45 per share, the conversion of the preferred stock to Airgas common stock was assumed.

(2) If the preferred stockholders of National Welders convert their preferred stock to Airgas common stock, the 5% preferred stock dividend, recognized as Minority interest in earnings of consolidated affiliate, would no longer be paid to the preferred stockholders, resulting in additional net earnings for Airgas.

(3) The earnings of National Welders for tax purposes are treated as a deemed dividend to Airgas, net of an 80% dividend exclusion. Upon the assumed conversion of National Welders preferred stock to Airgas common stock, National

Welders would become a wholly owned subsidiary of Airgas. As a wholly owned subsidiary, the net earnings of National Welders would not be subject to additional tax at the Airgas level.

AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(5) TRADE RECEIVABLES SECURITIZATION

The Company participates in a securitization agreement with two commercial banks to sell up to $250 million of qualifying trade receivables. The agreement will expire in May 2009, but may be renewed subject to renewal provisions contained in the agreement. During the six months ended September 30, 2006, the Company sold, net of its retained interest, $1,273 million of trade receivables and remitted to bank conduits, pursuant to a servicing agreement, $1,270 million in collections on those receivables. The amount of outstanding receivables under the agreement was $247 million at September 30, 2006 and $244 million at March 31, 2006. Effective October 31, 2006, the Company increased the maximum size of the securitization agreement to $270 million of qualifying trade receivables.

The transaction has been accounted for as a sale under the provisions of SFAS 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. Subordinated retained interests of approximately $74 million and $63 million are included in Trade receivables in the accompanying Consolidated Balance Sheets at September 30, 2006 and March 31, 2006, 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.

(6) INVENTORIES, NET

Inventories, net, consist of:

(In thousands)	September 30, 2006	March 31, 2006
Hardgoods	$ 216,074	$ 202,894
Gases	26,845	26,629
	$ 242,919	$ 229,523

Net inventories determined by the LIFO inventory method totaled $35 million at September 30, 2006 and $37 million at March 31, 2006. If the FIFO inventory method had been used for these inventories, the carrying value would have been approximately $7 million higher at September 30, 2006 and approximately $6 million higher at March 31, 2006. Substantially all of the inventories are finished goods.

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AIRGAS, INC. AND SUBSIDIARIES
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(Unaudited)

(7) ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities include:

(In thousands)	September 30, 2006	March 31, 2006
Accrued payroll and employee benefits	$ 54,718	$ 57,555
Business insurance reserves	24,152	20,930
Health insurance reserves	10,593	9,734
Accrued interest expense	14,112	14,910
Taxes other than income taxes	13,613	13,590
Cash overdraft	46,831	40,155
Other accrued expenses and current liabilities	33,834	43,127
	$ 197,853	$ 200,001

(8) DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company manages its exposure to changes in market interest rates. The Company s involvement with derivative instruments is limited to highly effective fixed interest rate swap agreements used to manage well-defined interest rate risk exposures. The Company monitors its positions and credit ratings of its counterparties and does not anticipate non-performance by the counterparties. Interest rate swap agreements are not entered into for trading purposes.

At September 30, 2006, the Company had six fixed interest rate swap agreements with a notional amount of $150 million. These swaps effectively convert $150 million of variable interest rate debt associated with the Company s credit facilities to fixed rate debt. At September 30, 2006, these swap agreements required the Company to make fixed interest payments based on a weighted average effective rate of 4.98% and receive variable interest payments from its counterparties based on a weighted average variable rate of 5.37%. The remaining terms of each of these swap agreements are between 21 months to 32 months.

National Welders was a party to one interest rate swap agreement with a notional principal amount of $27 million. The counter party to the swap agreement is a major financial institution. National Welders is required to make fixed interest payments of 5.36% and receive variable interest payments from its counterparty based on one month LIBOR, which was 5.33% at September 30, 2006. The remaining term of the swap agreement is 32 months.

During the six months ended September 30, 2006, the Company and National Welders recorded a net decrease in the fair value of the fixed interest rate swap agreements and a corresponding decrease to Accumulated Other Comprehensive Income of approximately $1.3 million. Including the effect of the interest rate swap agreements, the debt of National Welders, and the trade receivables securitization, the Company s ratio of fixed to variable rate debt at September 30, 2006 was 51% fixed to 49% variable. The redemption of $225 million of the 9.125% senior subordinated notes on October 27, 2006 with proceeds from the Company s revolving credit line changed the Company s ratio of fixed to variable rate debt to 30% fixed to 70% variable (See subsequent events note 17).

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AIRGAS, INC. AND SUBSIDIARIES
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(9) GOODWILL AND OTHER INTANGIBLE ASSETS

The valuations of goodwill and other intangible assets of recent acquisitions are based on preliminary estimates of fair value and are subject to revision as the Company finalizes appraisals and other analyses. Changes in the net carrying amount of goodwill for the six months ended September 30, 2006 were as follows:

(In thousands)	Distribution Segment	All Other Operations Segment	Total
Balance at March 31, 2006	$ 402,582	$ 163,492	$ 566,074
Acquisitions	42,125	2,842	44,967
Other adjustments	716	(211)	505
Balance at September 30, 2006	$ 445,423	$ 166,123	$ 611,546

Other intangible assets amounted to $32.4 million and $26.2 million, net of accumulated amortization of $47.4 million and $43.8 million at September 30, 2006 and March 31, 2006, respectively. These intangible assets primarily consist of acquired customer lists which are amortized principally over 5 to 11 years and non-compete agreements entered into in connection with business combinations amortized over the term of the agreements. There are no expected residual values related to these intangible assets. Intangible assets also include a trade name with an indefinite useful life valued at $1 million. Estimated remaining fiscal year amortization expense in millions is as follows: remainder of 2007 $3.6 million; 2008 $6.3 million; 2009 $5.1 million; 2010 $4.4 million; 2011 - $4.0 million; and $8.0 million thereafter.

(10) INDEBTEDNESS

Long-term debt consists of:

(In thousands)	September 30, 2006	March 31, 2006
Revolving credit borrowings	$ 288,381	$ 112,009
Term loan	100,000	81,250
Money market loans	25,000	25,000
Medium-term notes		100,751
Senior subordinated notes	376,419	376,532
Acquisition and other notes	2,702	3,025
National Welders debt	62,144	69,060
Total Long-term debt	854,646	767,627
Less current portion of long-term debt	(257,096)	(131,901)
Long-term debt, excluding current portion	$ 597,550	$ 635,726

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(10) INDEBTEDNESS (Continued)

Debt Refinancing

Effective July 25, 2006, the Company amended and restated its senior credit facility with a syndicate of lenders. Subject to compliance with certain covenants, the $1.6 billion senior unsecured credit facility (the Credit Agreement) permits the Company to borrow up to $966 million under a U.S. dollar revolving credit line, up to C$40 million (U.S. $34 million) under a Canadian dollar revolving credit line and up to $600 million under two or more term loans. Use of the terms loans is restricted to finance the maturity of certain debt and to finance certain contemplated acquisitions. The Company s ability to draw on the term loans under the Credit Agreement expires on May 31, 2007. The Credit Agreement will mature on July 25, 2011.

The Company used borrowings under the term loan provision of the Credit Agreement to finance the $100 million maturity of its 7.75% medium-term notes on September 15, 2006. As of September 30, 2006, the Company had approximately $389 million of borrowings under the credit agreement: $269 million under the U.S. dollar revolver, C$23 million (U.S. $20 million) under the Canadian dollar revolver and a $100 million under a term loan. The term loan is repayable in quarterly installments of $3.75 million between March 31, 2007 and September 30, 2010. The quarterly installments then increase to $11.875 million from September 30, 2010 to maturity on July 25, 2011. The Company also had commitments of $34 million under letters of credit with a financial institution. The U.S. dollar borrowings bear interest at LIBOR plus 75 basis points and the Canadian dollar borrowings bear interest at the Canadian Bankers Acceptance Rate plus 75 basis points. As of September 30, 2006, the effective interest rate on the U.S. dollar borrowings and Canadian dollar borrowings were 6.14% and 5.19%, respectively.

As of September 30, 2006, the financial covenants in the credit agreement permitted the Company to incur $612 million of additional debt. At September 30, 2006, approximately $697 million remained unused under the U.S. dollar revolving credit line, approximately C$17 million (U.S. $14 million) remained unused under the Canadian dollar revolving credit line and $500 million remained unused under the term loans. The Credit Agreement also contains customary events of default, including nonpayment and breach of covenants. In the event of default, repayment of borrowings under the Credit Agreement may be accelerated.

The Company s domestic subsidiaries, exclusive of a bankruptcy remote special purpose entity (the domestic guarantors), guarantee the U.S. and Canadian borrowings. The Canadian borrowings are also guaranteed by the Company s foreign subsidiaries. The guarantees are full and unconditional and are made on a joint and several basis. The Company has pledged 100% of the stock of its domestic subsidiaries and 65% of the stock of its foreign subsidiaries as surety for its obligations under the Credit Agreement. The Credit Agreement provides for the release of the guarantees and collateral if the Company attains an investment grade credit rating and a similar release on all other debt.

Money Market Loan

The Company has an agreement with a financial institution that provides access to short term advances not to exceed $25 million for a maximum term of three months. The agreement expires on April 30, 2007, but may be extended subject to renewal provisions contained in the agreement. The amount, term and interest rate of an advance are established through mutual agreement with the financial institution when the Company requests such an advance. At September 30, 2006, the Company had an outstanding advance under the agreement of $25 million for a term of 91 days bearing interest at 5.89%.

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(10) INDEBTEDNESS (Continued)

Senior Subordinated Notes

At September 30, 2006, the Company had $150 million of senior subordinated notes (the 2004 Notes) outstanding 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. The 2004 notes have an optional redemption provision, which permits the Company, at its option, to call the 2004 Notes at scheduled dates and prices. The first scheduled optional redemption date is July 15, 2009 at a price of 103.125% of the principal amount.

In addition to the 2004 Notes, at September 30, 2006, 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. Under the terms of an optional redemption provision, on October 27, 2006, the Company redeemed the $225 million notes in full at a premium of 104.563% of the principal amount (see Note 17 Subsequent Event). In conjunction with the redemption of the Notes, the Company recognized a charge on the early extinguishment of debt of approximately $12 million ($8 million after tax) in October 2006. The charge relates to the redemption premium and the write-off of unamortized debt issuance costs. Based on current interest rates under the revolving credit facility, interest savings are estimated to be $500 thousand per month.

The 2004 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 are fully and unconditionally guaranteed jointly and severally, on a subordinated basis, by each of the wholly owned domestic guarantors under the revolving credit facilities. The stock of the Company s domestic subsidiaries is also pledged to the note holders on a subordinated basis.

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 September 30, 2006, acquisition and other notes totaled approximately $3 million with interest rates ranging from 5% to 8.5%.

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AIRGAS, INC. AND SUBSIDIARIES
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(10) INDEBTEDNESS (Continued)

Debt of the National Welders Joint Venture

Pursuant to the requirements of FIN 46R, the Company s Consolidated Balance Sheets at September 30, 2006 and March 31, 2006 include the financial obligations of National Welders. National Welders financial obligations 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 financial obligations. The debt of National Welders consists of:

(In thousands)	September 30, 2006	March 31, 2006
Revolving credit borrowings	$ 47,875	$ 51,393
Term loan A	13,517	15,042
Term loan C		1,622
Acquisition and other debt obligations	752	1,003
Total Long-term debt	62,144	69,060
Less current portion of long-term debt	(4,325)	(5,589)
Long-term debt, excluding current portion	$ 57,819	$ 63,471

The National Welders Credit Agreement (the NWS Credit Agreement) provides for a revolving credit line of $74 million, a Term Loan A of $26 million, a Term Loan B of $21 million, and a Term Loan C of $9 million. At September 30, 2006, National Welders had borrowings under its revolving credit line of $48 million and under Term Loan A of $14 million. There were no amounts outstanding under Term loans B or C at September 30, 2006. National Welders also had $752 thousand in acquisition notes and other debt obligations.

The revolving credit agreement matures in August 2008. Term Loan A is repayable in monthly amounts of $254 thousand with a lump-sum payment of the outstanding balance at maturity in August 2008. The variable interest rate on the revolving credit line and Term Loan A ranges from LIBOR plus 70 to 145 basis points varying with National Welders leverage ratio. At September 30, 2006, the effective interest rate for the revolving credit line and Term Loan A was 6.28%. The NWS Credit Agreement also contains certain covenants which, among other things, limit the ability of National Welders to incur and guarantee new indebtedness, and limit its capital expenditures, ownership changes, merger and acquisition activity, and the payment of dividends. National Welders had additional borrowing capacity under the NWS Credit Agreement of approximately $26 million at September 30, 2006.

As of September 30, 2006, the revolving credit line and Term Loan A are secured by certain current assets, principally trade receivables and inventory, totaling $36 million, non-current assets, principally equipment, totaling $103 million, and Airgas common stock with a market value of $33 million classified as treasury stock and carried at cost of $370 thousand.

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(10) INDEBTEDNESS (Continued)

Aggregate Long-term Debt Maturities

The aggregate maturities of long-term debt as of September 30, 2006 are as follows:

(In thousands)	Airgas, Inc.	National Welders	Total
September 30, 2007	$ 252,772	$ 4,325	$ 257,097
March 31, 2008	15,120		15,120
March 31, 2009	15,000	57,819	72,819
March 31, 2010	16,230		16,230
March 31, 2011	31,250		31,250
March 31, 2012	312,130		312,130
Thereafter	150,000		150,000
	$ 792,502	$ 62,144	$ 854,646

(11) MINORITY STOCKHOLDER NOTE PREPAYMENT

In September 2005, National Welders entered into an agreement with its preferred stockholders under which the preferred stockholders prepaid their $21 million note receivable owed to National Welders. National Welders used the proceeds from the prepayment of the preferred stockholders note to repay its $21 million Term Loan B, which had been collateralized by the preferred stockholders note.

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AIRGAS, INC. AND SUBSIDIARIES
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(12) STOCKHOLDERS EQUITY

Changes in stockholders equity were as follows:

(In thousands of shares)	Shares of Common Stock $0.01 Par Value	Treasury Stock
Balance March 31, 2006	78,569	1,292
Common stock issuance (a)	587	
Balance September 30, 2006	79,156	1,292

(In thousands)	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Comprehensive Income
Balance March 31, 2006	$786	$289,598	$665,158	$ 4,751	$(13,134)	
Net earnings.			78,199			78,199
Common stock issuance (a)	6	12,357				
Tax benefit from stock option exercises		2,726				
Foreign currency translation adjustment				1,455		1,455
Dividends paid on common stock ($0.14 per share)			(10,884)			
Stock-based compensation (b)		6,532				
Net change in fair value of interest rate swap agreements				(1,270)		(1,270)
Net tax expense of comprehensive income items				460		460
Balance September 30, 2006	$792	$311,213	$732,473	$ 5,396	$(13,134)	$ 78,844

(a) Issuance of common stock

for stock option exercises and purchases through the Employee Stock Purchase Plan.

(b) In accordance with the adoption of SFAS 123R, the Company recognized compensation expense with a corresponding amount recorded to Capital in Excess of Par Value.

AIRGAS, INC. AND SUBSIDIARIES
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(13) STOCK-BASED COMPENSATION

The Company adopted SFAS 123R effective April 1, 2006 using the modified prospective method. Under the modified prospective method, stock-based compensation recognized since the date of adoption includes: (a) any share-based payments granted subsequent to the date of adoption; and (b) any portion of share-based payments granted prior to the date of adoption that vests subsequent to the date of adoption. Prior periods have not been restated.

The Company recorded stock-based compensation in the three months ended September 30, 2006 of $3.8 million ($2.6 million after tax), or $0.03 per diluted share, and $6.5 million ($4.6 million after tax), or $0.05 per diluted share, for the six months ended September 30, 2006. The pre-tax compensation expense was included in Selling, Distribution and Administrative expenses in the Consolidated Statement of Earnings. The stock-based compensation expense related to stock options and options to purchase common stock under the Employee Stock Purchase Plan.

Prior Period Pro Forma Earnings

The following table presents the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123R in the prior year:

(In thousands, except per share amounts)	Three Months Ended September 30, 2005	Six Months Ended September 30, 2005
Net earnings, as reported	$ 29,622	$ 59,269
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects	(2,291)	(4,429)
Pro forma net earnings	$ 27,331	$ 54,840
Earnings per share:		
Basic as reported	$ 0.39	$ 0.78
Basic pro forma	$ 0.36	$ 0.72
Diluted as reported	$ 0.38	$ 0.76
Diluted pro forma	$ 0.35	$ 0.70

2006 Equity Incentive Plan

At the August 2006 Annual Meeting of Stockholders, the stockholders approved the 2006 Equity Incentive Plan (the 2006 Equity Plan). The 2006 Equity Plan replaced both the Company s 1997 Stock Option Plan for employees and the 1997 Directors Stock Option Plan. Outstanding stock options and stock options available for grant under the prior stock option plans were incorporated into the 2006 Equity Plan. Future grants of stock options to employees and directors will only be issued from the 2006 Equity Plan. A total of 981 thousand options were granted during the six months ended September 30, 2006. A total of 11.8 million shares of common stock are reserved for issuance under the 2006 Equity Plan upon the exercise of stock options, stock appreciation rights, restricted shares or restricted units, of which 4.5 million remained available for grant at September 30, 2006.

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AIRGAS, INC. AND SUBSIDIARIES
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(13) STOCK-BASED COMPENSATION (Continued)

Fair Value

The Company utilizes the Black-Scholes option pricing model to determine the fair value of stock options under SFAS 123R, which is consistent with that used for pro forma disclosures in prior periods. The weighted-average grant date fair value of stock options granted during the six months ended September 30, 2006 and 2005 was $13.74 and $9.45, respectively. In the three and six months ended September 30, 2006, the Company recognized stock-based compensation expense associated with stock options of approximately $3.3 million and $5.2 million, respectively. The following assumptions were used by the Company in valuing the stock option grants issued in the periods presented:

	Six Months Ended September 30, 2006	Six Months Ended September 30, 2005
Expected volatility	36.2%	35.3%
Expected dividend yield	0.80%	0.83%
Expected term	5.43 years	6.43 years
Risk-free interest rate	5.0%	3.9%

The expected volatility was determined based on anticipated changes in the underlying stock price over the expected term using a weighting of historical and implied volatility. The expected dividend yield was based on the Company s history and expectation of future dividend payouts. The expected term represents the period of time that the options are expected to be outstanding prior to exercise or forfeiture. The expected term was determined based on historical exercise patterns. The risk-free interest rate was based on U.S. Treasury rates in effect at the time of grant commensurate with the expected term.

Summary of Stock Option Activity

The following table summarizes the activity of the 2006 Equity Incentive Plan during the six months ended September 30, 2006:

	Number of Stock Options (In thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding at March 31, 2006	6,994	$ 16.36		
Granted	981	$ 36.17		
Exercised	(366)	$ 18.71		
Forfeited	(103)	$ 26.05		
Outstanding at September 30, 2006	7,506	$ 18.70	5.67	$ 131,130
Exercisable at September 30, 2006	5,193	$ 14.71	5.55	$ 111,442

The aggregate intrinsic value represents the difference between the Company s closing stock price on September 30, 2006 of $36.17 and the weighted-average exercise price multiplied by the number of stock options outstanding as of that date. The total intrinsic value of stock options exercised during the six months ended September 30, 2006 was $6.6 million.

As of September 30, 2006, $21.6 million of total unrecognized compensation expense related to non-vested stock options is expected to be recognized over a weighted-average vesting period of 2.9 years.

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AIRGAS, INC. AND SUBSIDIARIES
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(Unaudited)

(13) STOCK-BASED COMPENSATION (Continued)

Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan (the ESPP) to encourage and assist employees in acquiring an equity interest in the Company. The ESPP is authorized to issue up to 3.5 million shares of Company common stock, of which 2 million shares were available for issuance at September 30, 2006.

Under the terms of the ESPP, eligible employees may elect to have up to 15% of their annual gross earnings withheld to purchase common stock at 85% of the market value. Employee purchases are limited in any calendar year to an aggregate market value of $25,000. Market value under the ESPP is defined as either the closing share price on the New York Stock Exchange as of an employee s enrollment date or the closing price on the first business day of a fiscal quarter when the shares are purchased, whichever is lower. An employee may lock-in a purchase price for up to 12 months. The ESPP effectively resets at the beginning of each fiscal year at which time employees are re-enrolled in the plan and a new 12-month purchase price is established. The ESPP is designed to comply with the requirements of Sections 421 and 423 of the Internal Revenue Code. During the six months ended September 30, 2006 and 2005, the Company granted 385 thousand and 533 thousand options to purchase common stock under the ESPP, respectively.

Compensation expense under SFAS 123 is measured based on the fair value of the employees option to purchase shares of common stock at the grant date and is recognized over the future periods in which the related employee service is rendered. The fair value per share of options granted under the ESPP was $8.31 and $5.57 for the six months ended September 30, 2006 and 2005, respectively. In the three and six months ended September 30, 2006, the Company recognized stock-based compensation expense associated with the ESPP of $542 thousand and $1.3 million, respectively. The fair value of the employees option to purchase shares of common stock was estimated using the Black-Scholes model. The following assumptions were used by the Company in valuing the employees option to purchase shares of common stock under the ESPP:

	Six Months Ended September 30,	
	2006	2005
Expected volatility	30.8%	27.1%
Expected dividend yield	0.73%	0.90%
Expected term	2 to 8 months	3 to 12 months
Risk-free interest rate	5.0%	3.1%

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(13) STOCK-BASED COMPENSATION (Continued)

The following table summarizes the activity of the ESPP during the six months ended September 30, 2006:

	Number of Purchase Options (In thousands)	Weighted Average Exercise Price	Aggregate Intrinsic Value (In thousands)
Outstanding at March 31, 2006	138	$ 20.14	
Granted	385	$ 31.06	
Exercised	(232)	$ 25.02	
Forfeited			
Outstanding at September 30, 2006	291	$ 30.75	$ 1,577

(14) COMMITMENTS, CONTINGENCIES AND UNCERTAINTIES

Litigation

The Company is involved in various legal and regulatory proceedings that have arisen in the ordinary course of its business and have not been fully adjudicated. These actions, when ultimately concluded and determined, will not, in the opinion of management, have a material adverse effect upon the Company s consolidated financial position, results of operations or liquidity.

Supply Agreements

In September and October 2006, the Company entered into 10-year take-or-pay supply agreements with The BOC Group, Inc. (BOC) to purchase helium. The total annual commitment amount for these agreements is approximately $23 million. These new agreements replace the previous two helium supply agreements that were to expire in February 2007 and July 2019.

The 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 within the Company s normal product purchases.

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(15) SUMMARY BY BUSINESS SEGMENT

As disclosed in Note (1) *Basis of Presentation* and Note (3) *Acquisitions and Divestiture,* the Company sold its subsidiary Rutland Tool in December 2005. The results of Rutland Tool were previously reflected in the Distribution business segment. For the three and six month periods ended September 30, 2005, the operating results of Rutland Tool have been reclassified in the Consolidating Statement of Earnings as discontinued operations. Information related to the Company s continuing operations by business segment for the three and six months ended September 30, 2006 and 2005 is as follows:

	Three Months Ended September 30, 2006				Three Months Ended September 30, 2005			
(In thousands)	Dist.	All Other Ops.	Elim	Combined	Dist.	All Other Ops.	Elim	Combined
Gas and rent	$ 342,976	$ 124,586	$ (13,505)	$ 454,057	$ 300,437	$ 113,520	$ (12,979)	$ 400,978
Hardgoods	314,351	23,485	(1,146)	336,690	284,261	18,565	(1,622)	301,204
Total net sales	657,327	148,071	(14,651)	790,747	584,698	132,085	(14,601)	702,182
Cost of products sold, excluding deprec. expense	329,758	71,270	(14,651)	386,377	297,171	65,287	(14,601)	347,857
Selling, distribution and administrative expenses	235,616	48,308		283,924	216,593	43,216		259,809
Depreciation expense	26,721	7,431		34,152	23,519	6,666		30,185
Amortization expense	1,569	462		2,031	1,150	158		1,308
Operating income	63,663	20,600		84,263	46,265	16,758		63,023

	Six Months Ended September 30, 2006				Six Months Ended September 30, 2005			
(In thousands)	Dist.	All Other Ops.	Elim	Combined	Dist.	All Other Ops.	Elim	Combined
Gas and rent	$ 674,980	$ 241,769	$ (27,991)	$ 888,758	$ 600,294	$ 206,200	$ (26,596)	$ 779,898
Hardgoods	631,600	46,087	(2,662)	675,025	565,922	37,376	(2,889)	600,409
Total net sales	1,306,580	287,856	(30,653)	1,563,783	1,166,216	243,576	(29,485)	1,380,307
Cost of products sold, excluding	661,353	138,896	(30,653)	769,596	594,129	118,076	(29,485)	682,720

deprec. expense						
Selling, distribution and administrative expenses	465,499	94,402	559,901	428,677	80,981	509,658
Depreciation expense	52,546	14,768	67,314	46,332	12,963	59,295
Amortization expense	2,878	925	3,803	2,311	296	2,607
Operating income	124,304	38,865	163,169	94,767	31,260	126,027

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(16) SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest and income taxes was as follows:

	Six Months Ended September 30,	
(In thousands)	2006	2005
Interest paid	$ 28,785	$ 27,275
Discount on securitization	6,788	3,999
Income taxes (net of refunds)	12,953	6,759

Cash flows, in excess of a management fee, associated with the Company s consolidated affiliate, National Welders, are not available for the general use of the Company. Rather these cash flows are used by National Welders for operations, capital expenditures, acquisitions, and to satisfy financial obligations, which are non-recourse to the Company. The following reflects the sources and uses of cash associated with National Welders for each period presented:

	Six Months Ended September 30,	
(In thousands)	2006	2005
Net cash provided by operating activities	$ 15,258	$ 8,761
Net cash used in investing activities	(7,458)	(12,265)
Net cash provided by (used in) financing activities	(7,334)	3,553
Change in cash	466	49
Management fee paid to the Company, which is eliminated in consolidation	$ 693	$ 607

(17) SUBSEQUENT EVENT

Redemption of Senior Subordinated Notes

On September 27, 2006, the Company announced that it elected to redeem its 9.125% senior subordinated notes due October 1, 2011 (the Notes). On October 27, 2006, the Company redeemed the $225 million notes in full at a premium of 104.563% of the principal amount with proceeds from the Company s revolving credit line. In conjunction with the redemption of the Notes, the Company recognized a charge on the early extinguishment of debt of approximately $12 million ($8 million after tax, or $0.10 per diluted share) in October 2006. The charge relates to the redemption premium and the write-off of unamortized debt issuance costs. Under existing covenant restrictions, liquidity will not be significantly affected by the redemption of the notes. Based on current interest rates under the revolving credit facility, interest savings are estimated to be $500 thousand per month.

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(18) SUPPLEMENTARY CONDENSED CONSOLIDATING FINANCIAL INFORMATION OF SUBSIDIARY GUARANTORS

The obligations of the Company under its senior subordinated notes (the Notes) are guaranteed by the Company s domestic subsidiaries (the Guarantors). The guarantees are made fully and unconditionally on a joint and several basis. The Company s consolidated affiliate, foreign holdings and bankruptcy remote special purpose entity (the Non-guarantors) are not guarantors of the Notes. The claims of the creditors of the Non-guarantors have priority over the rights of the Company to receive dividends or distributions from the Non-guarantors.

Presented below is supplementary condensed consolidating financial information for the Company, the Guarantors and the Non-guarantors as of September 30, 2006 and March 31, 2006 and for the six months ended September 30, 2006 and 2005. As disclosed in Note (3*) Acquisitions and Divestiture*, the Company sold its subsidiary Rutland Tool in December 2005. Accordingly, the operating results of Rutland Tool, which was a guarantor of the Company s senior subordinated notes, have been reclassified in the Consolidating Statements of Earnings as discontinued operations for the six months ended September 30, 2005. Intercompany receivables and payables as of March 31, 2006 have been reclassified to conform to the current period presentation.

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Condensed Consolidating Balance Sheet
September 30, 2006

(In thousands)	Parent	Guarantors	Non-Guarantors	Elimination Entries	Consolidated
ASSETS					
Current Assets					
Cash	$	$ 29,927	$ 1,852	$	$ 31,779
Trade receivables, net		7,716	154,998		162,714
Intercompany receivable/(payable)		2,184	(2,184)		
Inventories, net		223,779	19,140		242,919
Deferred income tax asset, net	20,557	4,781	(1,048)		24,290
Prepaid expenses and other current assets	8,031	23,431	3,167		34,629
Total current assets	28,588	291,818	175,925		496,331
Plant and equipment, net	16,753	1,289,216	189,672		1,495,641
Goodwill		532,424	79,122		611,546
Other intangible assets, net		29,246	3,160		32,406
Investments in subsidiaries	2,051,239			(2,051,239)	
Other non-current assets	13,399	12,168	2,922		28,489
Total assets	$ 2,109,979	$ 2,154,872	$ 450,801	$ (2,051,239)	$ 2,664,413
LIABILITIES AND STOCKHOLDERS EQUITY					
Current Liabilities					
Accounts payable, trade	$ 2,089	$ 118,859	$ 17,160	$	$ 138,108
Accrued expenses and other current liabilities	75,167	103,452	19,234		197,853
Current portion of long-term debt	251,419	1,353	4,324		257,096
Total current liabilities	328,675	223,664	40,718		593,057
Long-term debt, excluding current portion	518,400	1,381	77,769		597,550
Deferred income tax liability, net	4,107	296,643	43,859		344,609
Intercompany (receivable)/payable	217,290	(108,934)	(108,356)		
Other non-current liabilities	4,767	22,278	8,221		35,266
Minority interest in affiliate			57,191		57,191
Commitments and contingencies					

Stockholders Equity					
Preferred stock, no par value					
Common stock, par value $0.01 per share	792				792
Capital in excess of par value	311,213	898,051	71,956	(970,007)	311,213
Retained earnings	732,473	820,856	255,578	(1,076,434)	732,473
Accumulated other comprehensive income	5,396	933	4,235	(5,168)	5,396
Treasury stock	(13,134)		(370)	370	(13,134)
Total stockholders equity	1,036,740	1,719,840	331,399	(2,051,239)	1,036,740
Total liabilities and stockholders equity	$ 2,109,979	$ 2,154,872	$ 450,801	$ (2,051,239)	$ 2,664,413

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Condensed Consolidating Balance Sheet
March 31, 2006

(In thousands)	Parent	Guarantors	Non-Guarantors	Elimination Entries	Consolidated
ASSETS					
Current Assets					
Cash	$	$ 30,061	$ 4,924	$	$ 34,985
Trade receivables, net		7,149	125,096		132,245
Intercompany receivable/(payable)		(4,113)	4,113		
Inventories, net		211,319	18,204		229,523
Deferred income tax asset, net	21,988	9,239	(1,086)		30,141
Prepaid expenses and other current assets	7,289	20,713	3,620		31,622
Total current assets	29,277	274,368	154,871		458,516
Plant and equipment, net	18,285	1,194,523	185,949		1,398,757
Goodwill		488,317	77,757		566,074
Other intangible assets, net		22,362	3,886		26,248
Investments in subsidiaries	1,940,670			(1,940,670)	
Other non-current assets	15,491	6,394	2,932		24,817
Total assets	$ 2,003,723	$ 1,985,964	$ 425,395	$ (1,940,670)	$ 2,474,412
LIABILITIES AND STOCKHOLDERS EQUITY					
Current Liabilities					
Accounts payable, trade	$ 3,057	$ 122,078	$ 18,617	$	$ 143,752
Accrued expenses and other current liabilities	112,396	66,241	21,364		200,001
Current portion of long-term debt	125,751	561	5,589		131,901
Total current liabilities	241,204	188,880	45,570		475,654
Long-term debt, excluding current portion	549,382	2,450	83,894		635,726
Deferred income tax liability, net	4,372	280,404	43,042		327,818
Intercompany (receivable)/payable	257,995	(148,123)	(109,872)		
Other non-current liabilities	3,611	25,242	2,011		30,864
Minority interest in affiliate			57,191		57,191
Commitments and contingencies					

Stockholders Equity					
Preferred stock, no par value					
Common stock, par value $0.01 per share	786				786
Capital in excess of par value	289,598	894,898	71,955	(966,853)	289,598
Retained earnings	665,158	741,623	228,662	(970,285)	665,158
Accumulated other comprehensive income	4,751	590	3,312	(3,902)	4,751
Treasury stock	(13,134)		(370)	370	(13,134)
Total stockholders equity	947,159	1,637,111	303,559	(1,940,670)	947,159
Total liabilities and stockholders equity	$ 2,003,723	$ 1,985,964	$ 425,395	$ (1,940,670)	$ 2,474,412

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Consolidating Statement of Earnings
Six Months Ended
September 30, 2006

(In thousands)	Parent	Guarantors	Non-Guarantors	Elimination Entries	Consolidated
Net Sales	$	$ 1,433,586	$ 130,197	$	$ 1,563,783
Costs and Expenses					
Costs of products sold (excluding depreciation)		713,210	56,386		769,596
Selling, distribution and administrative expenses	4,911	503,732	51,258		559,901
Depreciation	3,267	55,135	8,912		67,314
Amortization		3,444	359		3,803
Operating Income (Loss)	(8,178)	158,065	13,282		163,169
Interest (expense) income, net	(34,244)	8,195	(2,281)		(28,330)
(Discount) gain on securitization of trade receivables		(39,796)	32,914		(6,882)
Other income (expense), net	(56)	(40)	860		764
Earnings (loss) before income taxes and minority interest	(42,478)	126,424	44,775		128,721
Income tax benefit (expense)	14,528	(47,191)	(16,437)		(49,100)
Minority interest in earnings of consolidated affiliate			(1,422)		(1,422)
Equity in earnings of subsidiaries	106,149			(106,149)	
Net Earnings	$ 78,199	$ 79,233	$ 26,916	$ (106,149)	$ 78,199

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Consolidating Statement of Earnings
Six Months Ended
September 30, 2005

(In thousands)	Parent	Guarantors	Non-Guarantors	Elimination Entries	Consolidated
Net Sales	$	$ 1,274,063	$ 106,244	$	$ 1,380,307
Costs and Expenses					
Costs of products sold (excluding depreciation)		636,991	45,729		682,720
Selling, distribution and administrative expenses	12,416	448,452	48,790		509,658
Depreciation	3,869	47,693	7,733		59,295
Amortization		2,563	44		2,607
Operating Income (Loss)	(16,285)	138,364	3,948		126,027
Interest (expense) income, net	(35,818)	10,934	(2,313)		(27,197)
(Discount) gain on securitization of trade receivables		(37,498)	33,403		(4,095)
Other income (expense), net	9,846	(9,244)	891		1,493
Earnings (loss) before income taxes and minority interest	(42,257)	102,556	35,929		96,228
Income tax benefit (expense)	14,790	(37,838)	(13,130)		(36,178)
Minority interest in earnings of consolidated affiliate			(1,234)		(1,234)
Equity in earnings of subsidiaries	86,736			(86,736)	
Income from discontinued operations, net of tax		453			453
Net Earnings	$ 59,269	$ 65,171	$ 21,565	$ (86,736)	$ 59,269

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Condensed Consolidating Statement of Cash Flows
Six Months Ended
September 30, 2006

(In thousands)	Parent	Guarantors	Non-Guarantors	Elimination Entries	Consolidated
Net cash provided by (used in) operating activities	$ (61,716)	$ 175,586	$ 14,380	$	$ 128,250
CASH FLOWS FROM INVESTING ACTIVITIES					
Capital expenditures	(1,878)	(107,146)	(12,524)		(121,548)
Proceeds from sale of plant and equipment	87	2,789	611		3,487
Business acquisitions, holdbacks and other settlements of acquisition related liabilities		(100,586)	1,420		(99,166)
Other, net	644	387	(874)		157
Net cash used in investing activities	(1,147)	(204,556)	(11,367)		(217,070)
CASH FLOWS FROM FINANCING ACTIVITIES					
Proceeds from borrowings	490,859	2,363	32,428		525,650
Repayment of debt	(396,059)	(2,641)	(39,817)		(438,517)
Financing costs	(5,103)				(5,103)
Minority interest			(1,422)		(1,422)
Exercise of stock options	6,517				6,517
Tax benefit realized from the exercise of stock options	2,726				2,726
Dividends paid to stockholders	(10,884)				(10,884)
Cash overdraft	5,644		1,003		6,647
Inter-company	(30,837)	29,114	1,723		
Net cash provided by (used in) financing activities	62,863	28,836	(6,085)		85,614
CHANGE IN CASH	$	$ (134)	$ (3,072)	$	$ (3,206)
Cash Beginning of year		30,061	4,924		34,985
Cash End of year	$	$ 29,927	$ 1,852	$	$ 31,779

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AIRGAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Condensed Consolidating Statement of Cash Flows
Six Months Ended
September 30, 2005

(In thousands)	Parent	Guarantors	Non-Guarantors	Elimination Entries	Consolidated
Net cash provided by (used in) operating activities	$ (712)	$ 89,614	$ 49,191	$	$ 138,093
CASH FLOWS FROM INVESTING ACTIVITIES					
Capital expenditures	(1,228)	(89,189)	(15,464)		(105,881)
Proceeds from sale of plant and equipment		2,201	445		2,646
Business acquisitions, holdbacks and other settlements of acquisition related liabilities		(75,258)	(344)		(75,602)
Other, net	384	51	(116)		319
Net cash used in investing activities	(844)	(162,195)	(15,479)		(178,518)
CASH FLOWS FROM FINANCING ACTIVITIES					
Proceeds from borrowings	241,989	2,069	35,266		279,324
Repayment of debt	(230,449)	(2,662)	(50,948)		(284,059)
Minority interest			(1,234)		(1,234)
Minority stockholder note prepayment			21,000		21,000
Exercise of stock options	11,210				11,210
Dividends paid to stockholders	(9,290)				(9,290)
Cash overdraft	23,465		398		23,863
Inter-company	(35,369)	68,563	(33,194)		
Net cash provided by (used in) financing activities	1,556	67,970	(28,712)		40,814
CHANGE IN CASH	$	$ (4,611)	$ 5,000	$	$ 389
Cash Beginning of year		29,340	3,300		32,640
Cash End of year	$	$ 24,729	$ 8,300	$	$ 33,029

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AIRGAS, INC. AND SUBSIDIARIES
MANAGEMENT S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

Airgas, Inc. (the Company) had net sales for the quarter ended September 30, 2006 (current quarter) of $791 million compared to $702 million for the quarter ended September 30, 2005 (prior year quarter). Net sales increased by 13% in the current quarter driven by strong same-store sales growth and the impact of current and prior year acquisitions. Sales momentum continued in the current quarter generating same-store sales growth of 11%, with pricing and volume contributing about equally. Acquisitions also added 2% to overall sales growth. Sales growth related to pricing reflected gas price increases implemented in June 2006 and November 2005. Sales volume gains in the quarter reflected broad demand with the strongest sales gains driven by industrial, energy infrastructure (power plants, oil and natural gas), and non-residential construction markets. Strategic product lines, including bulk gases, medical gases and safety products, were solid contributors to the sales gains. Operating margins increased in the current quarter to 10.7% from 9% of sales in the prior year quarter. The significant margin improvement was driven by continued operating profit leverage on sales growth and effective management of costs and pricing. Net earnings per diluted share grew 29% to $0.49 in the current quarter versus $0.38 in the prior year quarter.

Effective April 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*, (SFAS 123R) using the modified prospective method. The new standard requires the Company to estimate the value of stock options issued to employees, including options to purchase shares under its Employee Stock Purchase Plan, and recognize the estimated cost in earnings over the period in which the options vest. Prior to the adoption of SFAS 123R, the Company used the intrinsic value method outlined in Accounting Principles Board Opinion No. 25 to account for stock-based compensation. For the three months ended September 30, 2006, the Company recognized stock-based compensation expense of $3.8 million ($2.6 million after tax), or $0.03 per diluted share. For the six months ended September 30, 2006, the Company recognized stock-based compensation expense of $6.5 million ($4.6 million after tax), or $0.05 per diluted share. Since the Company adopted SFAS 123R prospectively, no stock-based compensation expense was reflected in earnings prior to April 1, 2006.

During the six months ended September 30, 2006, the Company completed four acquisitions with combined annual sales of approximately $80 million. The largest of these acquisitions was the September 2006 purchase of the assets and operations of Houston, Texas-based Aeriform Corporation, a distributor of industrial gases and related hardgoods products with 29 locations in Texas, Louisiana, Oklahoma and Kansas.

In December 2005, the Company divested its subsidiary, Rutland Tool & Supply Co., Inc. (Rutland Tool). As a result of the divestiture, the Company classified the operating results of Rutland Tool as discontinued operations for the three and six month periods ended September 30, 2005. Rutland Tool generated annual sales of approximately $50 million and an insignificant amount of operating income. The results of Rutland Tool were previously reflected in the Distribution business segment.

Effective July 25, 2006, the Company amended and restated its senior credit facility with a syndicate of lenders. The $1.6 billion senior unsecured credit facility (the Credit Agreement) consists of a US$966 million and C$40 million (US$34 million) revolving credit line and two deferred draw term loans totaling $600 million. The Company intends to use borrowings under the revolving credit line for working capital, acquisitions and general corporate purposes. The Company utilized a $100 million term loan to refinance the Company s 7.75% medium-term notes in September 2006. The Company intends to use borrowings of up to $500 million from the second term loan to finance certain contemplated acquisitions. If the contemplated acquisitions are not completed, the outstanding commitment for the unused portion of the second term loan will expire no later than May 2007.

AIRGAS, INC. AND SUBSIDIARIES
MANAGEMENT S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

On September 27, 2006, the Company announced that it elected to redeem its 9.125% senior subordinated notes due October 1, 2011 (the Notes). On October 27, 2006, the Company redeemed the $225 million notes in full at a premium of 104.563% of the principal amount. In conjunction with the redemption of the Notes, the Company will recognize a charge on the early extinguishment of debt of approximately $12 million ($8 million after tax, or $0.10 per diluted share) in October 2006. The charge relates to the redemption premium and the write-off of unamortized debt issuance costs. Based on current interest rates under the revolving credit facility, interest savings are estimated to be $500 thousand per month.

Looking forward, the Company expects net earnings to range from $0.37 to $0.39 per diluted share in its fiscal third quarter ending December 31, 2006 and $1.83 to $1.88 per diluted share for the full 2007 fiscal year. The earnings guidance for the third quarter and fiscal 2007 include a $0.10 per diluted share charge related to the early extinguishment of debt, noted above.

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AIRGAS, INC. AND SUBSIDIARIES
MANAGEMENT S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS: THREE MONTHS ENDED SEPTEMBER 30, 2006 COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2005

STATEMENT OF EARNINGS COMMENTARY

Net Sales

Net sales increased 13% in the quarter ended September 30, 2006 compared to the quarter ended September 30, 2005 reflecting continued strong same-store sales growth and acquisitions. Same-store sales growth reflected pricing initiatives, volume growth and strategic product sales gains, all benefiting from the continued strength of the industrial economy. On a same-store basis, sales increased 11% versus the prior year quarter. Acquisitions completed during the current and prior fiscal years also contributed to sales growth.

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 the All Other Operations segment to the Distribution segment.

	Three Months Ended September 30,			
(In thousands)	2006	2005	Increase	
Net Sales				
Distribution	$ 657,327	$ 584,698	$ 72,629	12%
All Other Operations	148,071	132,085	15,986	12%
Intercompany eliminations	(14,651)	(14,601)	(50)	
	$ 790,747	$ 702,182	$ 88,565	13%

The Distribution segment s principal products include industrial, medical and specialty gases; cylinder and equipment rental; process chemicals; and hardgoods. Industrial, medical and specialty gases and process chemicals are distributed in cylinders and 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 consumables and equipment, safety products, and maintenance, repair and operating (MRO) supplies.

Distribution segment sales increased 12% during the current quarter compared to the prior year quarter driven by same-store sales growth of $59 million (11%) and incremental sales contributed by acquisitions of $14 million. An increase in hardgoods sales of $24 million (9%) and gas and rent sales of $35 million (12%) drove the Distribution same-store sales growth. Sales gains of the Company s core gas and welding hardgoods business reflected continued strong demand from industrial, energy infrastructure and non-residential construction sectors. Hardgoods same-store sales growth reflected higher sales of safety and Radnor® private-label products. Same-store sales of safety products grew 9% in the current quarter, despite strong post-hurricane sales in the prior year quarter. Radnor products continued to generate above-market sales growth of 12%, which was helped by the publication of a new Radnor products catalog.

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The Distribution segment s same-store sales for gas and rent increased 12% reflecting price increases and volume growth. The impact of price increases reflects pricing actions implemented in June 2006 and November 2005. Sales of industrial gases during the current quarter remained strong reflecting continued momentum in the Company s core industrial markets. Sales of strategic gas products, including bulk and medical gases, were also significant contributors to sales growth in the current quarter. Bulk gas sales volumes were up due to growth in micro-bulk and higher demand in merchant bulk gases. Medical gas sales growth was attributable to continued success in the hospital sector as well as with the Walk-O_2-Bout medical cylinder program. Rental revenues benefited from the Company s rental welder business that generated over 40% same-store sales growth in the current period. Power plant construction projects and the strengthening non-residential construction market contributed to the increase in demand for welding machines, gases and consumables.

The All Other Operations segment consists of the Company s Gas Operations Division and its National Welders joint venture. The Gas Operations Division consists of producers and distributors of gas products, principally of carbon dioxide, dry ice, nitrous oxide, specialty gases, and process chemicals, including anhydrous ammonia. National Welders is a producer and distributor of industrial, medical and specialty gases. All Other Operations sales increased $16 million (12%) compared to the prior year quarter resulting from same-store sales growth and acquisitions. Same-store sales growth of 10% was driven by continued sales gains at National Welders and sales growth of dry ice and liquid carbon dioxide. Strong dry ice sales reflect success in the food processing market as well as the Company s nationwide network of Penguin Brand dry ice retail locations. Acquisitions primarily consisted of the March 2006 acquisition of a packaged gas distributor completed by National Welders.

Gross Profits

Gross profits do not reflect depreciation expense and distribution costs. 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. Since some companies may report certain or all of these costs as elements of their Cost of Products Sold, the Company s gross profits discussed below may not be comparable to those of other entities.

Gross profits increased 14% resulting principally from sales growth and acquisitions. The gross profit margin increased 60 basis points to 51.1% compared to 50.5% in the prior year quarter.

	Three Months Ended September 30,			
(In thousands)	2006	2005	Increase	
Gross Profits				
Distribution	$ 327,569	$ 287,527	$ 40,042	14%
All Other Operations	76,801	66,798	10,003	15%
	$ 404,370	$ 354,325	$ 50,045	14%

The Distribution segment s gross profits increased $40 million (14%) compared to the prior year quarter. The Distribution segment s gross profit margin in the current quarter of 49.8% increased 60 basis points versus 49.2% in the prior year quarter. The improvement in the gross profit margin reflects gas price increases as well as a favorable shift in product mix between gas and rent and hardgoods. Gas and rent carry a higher gross profit than hardgoods products. The mix of gas and rent as a percentage of the Distribution segment s sales was 52.2% as compared to 51.4% in the prior year quarter. The Company intends to continue to raise prices as necessary to offset rising product, operating and delivery costs.

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The All Other Operations segment s gross profits increased $10 million (15%) primarily from strong sales at National Welders and sales volume growth of carbon dioxide products. The gross profit margin increased 130 basis points to 51.9% from 50.6% in the prior year quarter driven by improved pricing and lower product costs associated with the anhydrous ammonia product line, which was acquired in June 2005.

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. As a percentage of net sales, SD&A expense decreased 110 basis points to 35.9% compared to 37% in the prior year quarter reflecting improved cost leverage on sales growth and effective cost management. SD&A expenses increased $24 million (9%) primarily from variable operating costs associated with the growth in sales volumes and acquisitions. The increase in SD&A expense is primarily attributable to salaries and wages and distribution-related expenses. The increase in salary and wages reflected increased operational headcounts and overtime to fill cylinders, deliver products and operate facilities to meet the increased customer demand. In addition to normal wage inflation, salaries and wages reflected $3.8 million of stock-based compensation expense in the current quarter. There was no stock-based compensation expense in the prior year quarter. The increase in distribution expenses was attributable to higher fuel and vehicle repair and maintenance costs, which were up approximately $4 million versus the prior year quarter. Higher fuel costs were directly related to the rise in diesel fuel prices over the past year and the increase in miles driven to source gas products and meet customer demand. Operating expenses in the prior year quarter include a loss of $2.8 million associated with hurricanes Katrina and Rita. As compared with the prior year quarter, acquisitions added an estimated $5 million of SD&A expense.

Depreciation expense of $34 million increased $4 million (13%) compared to the prior year quarter. The increase primarily reflects the current and prior year s capital investments in revenue generating assets to support customer demand, including cylinders, bulk tanks and rental welders, as well as branch expansions and a new fill plant. Amortization expense of approximately $2 million was $723 thousand higher than the prior year quarter driven by the amortization of customer lists and non-compete agreements associated with acquisitions.

Operating Income

Operating income increased 34% in the current quarter compared to the prior year quarter. Pricing actions, discussed above, and improved cost leverage on sales growth were the primary contributors to a 170 basis point increase in the operating income margin to 10.7% compared to 9% in the prior year quarter.

	Three Months Ended September 30,			
(In thousands)	2006	2005	Increase	
Operating Income				
Distribution	$ 63,663	$ 46,265	$ 17,398	38%
All Other Operations	20,600	16,758	3,842	23%
	$ 84,263	$ 63,023	$ 21,240	34%

Operating income in the Distribution segment increased 38% in the current quarter. The Distribution segment s operating income margin increased 180 basis points to 9.7% compared to 7.9% in the prior year quarter.

Operating income in the All Other Operations segment increased 23% primarily benefiting from the strong business momentum of National Welders as well as the improved anhydrous ammonia business. The segment s operating income margin increased 120 basis points to 13.9% compared to 12.7% in the prior year quarter.

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Interest Expense and Discount on Securitization of Trade Receivables

Interest expense, net, and the discount on securitization of trade receivables totaled $18 million representing an increase of 17% compared to the prior year quarter. The increase primarily resulted from higher weighted-average interest rates related to the Company s variable rate debt instruments and higher average debt levels associated with acquisitions.

The Company participates in a securitization agreement with two commercial banks to sell up to $250 million of qualifying trade receivables. The amount of outstanding receivables under the agreement was $247 million at September 30, 2006 versus $244 million at March 31, 2006. 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 and in Item 3, Quantitative and Qualitative Disclosures about Market Risk, the Company manages its exposure to interest rate risk of certain borrowings through participation in interest rate swap agreements. Including the effect of the interest rate swap agreements and the trade receivables securitization, the Company s ratio of fixed to variable rate debt at September 30, 2006 was 51% fixed to 49% variable. On October 27, 2006, the Company redeemed its 9.125% senior subordinated notes. The redemption was financed with the revolving credit agreement. Subsequent to redeeming the 9.125% senior subordinated notes, the Company s ratio of fixed to variable rate debt was 30% fixed to 70% 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 fixed to variable interest rate ratio subsequent to the redemption of the senior subordinated notes, for every 25 basis point increase in LIBOR, the Company estimates that its annual interest expense would increase approximately $2 million.

Income Tax Expense

The effective income tax rate was 39.6% of pre-tax earnings in current quarter compared to 37.5% in the prior year quarter. The lower tax rate in the prior year quarter resulted from favorable changes in valuation allowances associated with state tax net operating loss carryforwards and the realization of state tax credits.

Income from Continuing Operations

Income from continuing operations for the quarter ended September 30, 2006 was $40 million, or $0.49 per diluted share, compared to $29 million, or $0.37 per diluted share, in the prior year quarter.

Income from Discontinued Operations

In December 2005, the Company divested Rutland Tool. Consequently, the prior period operating results of Rutland Tool were classified as discontinued operations. For the three months ended September 30, 2005, income from discontinued operations, net of tax, was $273 thousand.

Net Earnings

Net earnings for the quarter ended September 30, 2006 were $40 million, or $0.49 per diluted share, compared to $30 million, or $0.38 per diluted share, in the prior year quarter.

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RESULTS OF OPERATIONS: SIX MONTHS ENDED SEPTEMBER 30, 2006 COMPARED TO THE SIX MONTHS ENDED SEPTEMBER 30, 2005

STATEMENT OF EARNINGS COMMENTARY

Net Sales

Net sales increased 13% in the six months ended September 30, 2006 (current period) compared to the six months ended September 30, 2005 (prior year period) reflecting strong same-store sales growth and acquisitions. Sales growth in the current period reflected the continued strength of the industrial production, energy and non-residential construction markets served by the Company. On a same-store basis, sales increased 10% versus the prior year period with pricing and volume contributing about equally.

	Six Months Ended September 30,			
(In thousands)	2006	2005	Increase	
Net Sales				
Distribution	$ 1,306,580	$ 1,166,216	$ 140,364	12%
All Other Operations	287,856	243,576	44,280	18%
Intercompany eliminations	(30,653)	(29,485)	(1,168)	
	$ 1,563,783	$ 1,380,307	$ 183,476	13%

Distribution segment sales increased $140 million (12%) during the current period driven by same-store sales growth of $113 million (10%) and incremental sales contributed by current and prior year acquisitions of $27 million. An increase in higher hardgoods sales of $54 million (10%) and gas and rent sales of $59 million (10%) drove the Distribution same-store sales growth. Broad demand from industrial, energy infrastructure and non-residential construction sectors helped the Company s core gas and welding hardgoods business. Hardgoods same-store sales growth reflected continued volume and pricing gains. The Company s successful Radnor private label brand of products generated sales growth of 13% in the current period. Same-store sales of safety products also increased 11% reflecting the success of the telemarketing operations (telesales) and effective cross-selling of safety products to new and existing customers.

The Distribution segment s same-store sales for gas and rent increased 10% reflecting price increases and volume growth. The impact of price increases reflects pricing actions implemented in June 2006 and November 2005. Sales of industrial gases during the current period remained strong reflecting demand from the Company s core industrial markets. Sales of strategic gas products increased 9% in the current period driven by bulk and medical gas sales gains. Bulk gas sales volumes were up related to growth in micro-bulk and the signing of new bulk customer contracts. Medical gas sales growth was attributable to higher demand from the hospital sector as well as success of the Walk-O_2-Bout medical cylinder program. Rental revenues benefited from the Company s rental welder business that generated over 40% same-store sales growth in the current period. The rebuilding effort in the Gulf Coast area, power plant construction projects and the strengthening non-residential construction market contributed to the increase in demand for welding machines, gases and consumables.

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All Other Operations sales increased $44 million (18%) compared to the prior year period resulting from same-store sales growth and acquisitions. Same-store sales growth of 10% was driven by continued sales gains of National Welders and growth in carbon dioxide products. Sales of dry ice and liquid carbon dioxide were strong contributors to sales growth in the current period reflecting success in the food processing and industrial carbon dioxide markets and the Company s nationwide network of Penguin dry ice retail locations. Acquisitions primarily consisted of the June 2005 acquisition of the anhydrous ammonia business, as well as a March 2006 acquisition of a packaged gas distributor by National Welders.

Gross Profits

Gross profits do not reflect depreciation expense and distribution costs. 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. Since some companies may report certain or all of these costs as elements of their Cost of Products Sold, the Company s gross profits discussed below may not be comparable to those of other entities.

Gross profits increased 14% principally from sales growth and acquisitions. The gross profit margin in the current period was 50.8% compared to 50.5% in the prior year period.

	Six Months Ended September 30,			
(In thousands)	2006	2005	Increase	
Gross Profits				
Distribution	$ 645,227	$ 572,087	$ 73,140	13%
All Other Operations	148,960	125,500	23,460	19%
	$ 794,187	$ 697,587	$ 96,600	14%

The Distribution segment s gross profits increased $73 million (13%) compared to the prior year period. The Distribution segment s gross profit margin was 49.4% versus 49.1% in the prior year period. The increase in the gross profit margin reflected the impact of price increases as well as a favorable shift in product mix between gas and rent and hardgoods. Gas and rent carry a higher gross profit than hardgoods products. The mix of gas and rent as a percentage of the Distribution segment s sales was 51.7% as compared to 51.5% in the prior year period.

The All Other Operations segment s gross profits increased $23 million (19%) primarily from strong sales momentum of National Welders and acquisitions. The segment s gross profit margin increased 20 basis points to 51.7% versus 51.5% in the prior year period. Improvement in pricing and lower product costs associated with the anhydrous ammonia product line contributed to the higher gross profit margin in the current period.

Operating Expenses

As a percentage of net sales, SD&A expense decreased 110 basis points to 35.8% compared to 36.9% in the prior year period reflecting improved cost leverage and effective cost management. SD&A expenses increased $50 million (10%) primarily from higher variable expenses associated with the growth in sales volumes and the operating costs of acquired businesses. The increase in SD&A expense was primarily attributable to salaries and wages and distribution-related expenses. The increase in salaries and wages reflected increased operational headcounts and overtime to fill cylinders, deliver products and operate facilities to meet increased customer demand. In addition to normal wage inflation, salaries and wages reflected $6.5 million of stock-based compensation expense in the current period. There was no stock-based compensation expense in the prior year period. The increase in distribution expenses was attributable to higher fuel and vehicle repair and maintenance costs, which were up approximately $6 million versus the prior year period. Higher fuel costs were directly related to the rise in diesel fuel prices over the past year and the increase in miles driven to source gas products and meet customer demand. Operating expenses in the prior year period include a loss of $2.8 million associated with hurricanes Katrina and Rita. Acquisitions contributed estimated

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incremental SD&A expenses of $13 million in the current period.

Depreciation expense of $67 million increased $8 million (14%) compared to the prior year period. Acquired businesses contributed depreciation expense of approximately $1 million. The remainder of the increase primarily reflects the current and prior year s capital investments in revenue generating assets to support customer demand, primarily cylinders, bulk tanks and rental welders, as well as the addition of a new fill plant and branch stores. Amortization expense of $3.8 million was $1.2 million higher than the prior year period driven by the amortization of customer lists and non-compete agreements associated with acquisitions.

Operating Income

Operating income increased 29% in the current period driven by higher sales levels. Improved cost leverage on sales growth was the primary contributor to a 130 basis point increase in the operating income margin to 10.4% compared to 9.1% in the prior year period.

	Six Months Ended September 30,			
(In thousands)	2006	2005	Increase	
Operating Income				
Distribution	$ 124,304	$ 94,767	$ 29,537	31%
All Other Operations	38,865	31,260	7,605	24%
	$ 163,169	$ 126,027	$ 37,142	29%

Operating income in the Distribution segment increased 31% in the current period. The Distribution segment s operating income margin increased 140 basis points to 9.5% compared to 8.1% in the prior year period. The significant margin improvement was driven by continued operating profit leverage on sales growth, the completion of the BOC integration, and effective management of costs and pricing.

Operating income in the All Other Operations segment increased 24% compared to the prior year period. The segment s operating income margin of 13.5% was 70 basis points higher than 12.8% in the prior year period. The increases in operating income and operating margin were driven by the strong business momentum of National Welders and the improved anhydrous ammonia business.

Interest Expense and Discount on Securitization of Trade Receivables

Interest expense, net, and the discount on securitization of trade receivables totaled $35 million representing an increase of 13% compared to the prior year period. The increase primarily resulted from higher weighted-average interest rates related to the Company s variable rate debt instruments and higher average debt levels associated with acquisitions.

Income Tax Expense

The effective income tax rate was 38.1% of pre-tax earnings in the current period compared to 37.6% in the prior year period. The effective income tax rate in the current period reflects a $1.8 million, or $0.02 per diluted share, one-time tax benefit associated with a recent change in state income tax law in Texas. The one-time benefit reflects the reduction of deferred tax liabilities previously established for timing differences under the prior state tax law. The tax rate in the prior year period reflects favorable changes in valuation allowances associated with state tax net operating loss carryforwards and the realization of state tax credits. The Company expects the overall effective tax rate for fiscal 2007, including the one-time tax benefit above, to range from 38% to 39% of pre-tax earnings.

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Income from Continuing Operations

Income from continuing operations for the current period ended September 30, 2006 was $78 million, or $0.97 per diluted share, compared to $59 million, or $0.75 per diluted share, in the prior year period.

Income from Discontinued Operations

In December 2005, the Company divested Rutland Tool. Consequently, the prior period operating results of Rutland Tool were classified as discontinued operations. For the six months ended September 30, 2005, income from discontinued operations, net of tax, was $453 thousand.

Net Earnings

Net earnings for the six months ended September 30, 2006 were $78 million, or $0.97 per diluted share, compared to $59 million, or $0.76 per diluted share, in the prior year period.

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LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

Net cash provided by operating activities was $128 million for the six months ended September 30, 2006 compared to $138 million in the comparable prior year period. Net earnings adjusted for non-cash items provided cash of $185 million versus $149 million in the prior year period. Working capital resulted in a use of cash of $63 million in the current period versus $37 million in the prior year period. The use of cash for working capital in the current period principally reflects lower accounts payable associated with the timing of payments to vendors, lower accrued expenses and higher trade receivables from sales growth. The trade receivables securitization provided cash of $3 million versus $20 million in the prior year period. Cash flows of National Welders, in excess of a management fee paid by National Welders to the Company, are not available to the Company. Cash provided by operating activities in the current period included $15 million of cash provided by National Welders versus $9 million in the prior year period. Cash flows provided by operating activities were principally used to fund investing activities.

Net cash used in investing activities totaled $217 million during the current period and primarily consisted of cash used for capital expenditures and acquisitions. Capital expenditures were $122 million in the current period (including $9 million at National Welders) and primarily relate to spending for cylinders, bulk tanks, rental welding machines and new fill plants. These capital expenditures reflect investments to support the Company s sales growth initiatives. Cash of $99 million was also used for acquisitions and holdback settlements.

Financing activities provided net cash of $86 million primarily from net borrowings under the Company s credit agreement. The additional borrowing was principally used to fund acquisitions. Other sources of cash effectively offset the uses of cash within financing activities.

Dividends

On May 23, 2006, the Company s Board of Directors declared a regular quarterly cash dividend of $0.07 per share, which was paid on June 30, 2006 to stockholders of record as of June 15, 2006. On August 9, 2006, the Company s Board of Directors declared a regular quarterly cash dividend of $0.07 per share, which was paid on September 29, 2006 to stockholders of record as of September 15, 2006. 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.

Stock Repurchase Plan

Due to certain contemplated acquisitions, in July 2006, the Company suspended the three-year share repurchase plan that it initiated in November 2005. No shares of Company common stock were repurchased during the six months ended September 30, 2006. The Company continues to focus on using its cash flow for investing in growth opportunities, including future acquisitions, paying down debt and growing its dividend.

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Financial Instruments

Debt Refinancing

Effective July 25, 2006, the Company amended and restated its senior credit facility with a syndicate of lenders. Subject to compliance with certain covenants, the $1.6 billion senior unsecured credit facility (the Credit Agreement) permits the Company to borrow up to $966 million under a U.S. dollar revolving credit line, up to C$40 million (U.S. $34 million) under a Canadian dollar revolving credit line and up to $600 million under two or more term loans. Use of the terms loans is restricted to finance the maturity of certain debt and to finance certain contemplated acquisitions. The Company s ability to draw on the term loans under the Credit Agreement expires on May 31, 2007. The Credit Agreement will mature on July 25, 2011.

The Company used borrowings under the term loan provision of the Credit Agreement to finance the $100 million maturity of its 7.75% medium-term notes on September 15, 2006. As of September 30, 2006, the Company had approximately $389 million of borrowings under the credit agreement: $269 million under the U.S. dollar revolver, C$23 million (U.S. $20 million) under the Canadian dollar revolver and a $100 million under a term loan. The term loan is repayable in quarterly installments of $3.75 million between March 31, 2007 and September 30, 2010. The quarterly installments then increase to $11.875 million from September 30, 2010 to maturity on July 25, 2011. The Company also had commitments of $34 million under letters of credit with a financial institution. The U.S. dollar borrowings bear interest at LIBOR plus 75 basis points and the Canadian dollar borrowings bear interest at the Canadian Bankers Acceptance Rate plus 75 basis points. As of September 30, 2006, the effective interest rate on the U.S. dollar borrowings and Canadian dollar borrowings were 6.14% and 5.19%, respectively.

As of September 30, 2006, the financial covenants in the credit agreement permitted the Company to incur $612 million of additional debt. At September 30, 2006, approximately $697 million remained unused under the U.S. dollar revolving credit line, approximately C$17 million (U.S. $14 million) remained unused under the Canadian dollar revolving credit line and $500 million remained unused under the term loans. The Credit Agreement also contains customary events of default, including nonpayment and breach of covenants. In the event of default, repayment of borrowings under the Credit Agreement may be accelerated.

The Company s domestic subsidiaries, exclusive of a bankruptcy remote special purpose entity (the domestic guarantors), guarantee the U.S. and Canadian borrowings. The Canadian borrowings are also guaranteed by the Company s foreign subsidiaries. The guarantees are full and unconditional and are made on a joint and several basis. The Company has pledged 100% of the stock of its domestic subsidiaries and 65% of the stock of its foreign subsidiaries as surety for its obligations under the Credit Agreement. The Credit Agreement provides for the release of the guarantees and collateral if the Company attains an investment grade credit rating and a similar release on all other debt.

Money Market Loan

The Company has an agreement with a financial institution that provides access to short term advances not to exceed $25 million for a maximum term of three months. The agreement expires on April 30, 2007, but may be extended subject to renewal provisions contained in the agreement. The amount, term and interest rate of an advance are established through mutual agreement with the financial institution when the Company requests such an advance. At September 30, 2006, the Company had an outstanding advance under the agreement of $25 million for a term of 91 days bearing interest at 5.89%.

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Senior Subordinated Notes

At September 30, 2006, the Company had $150 million of senior subordinated notes (the 2004 Notes) outstanding 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. The 2004 notes have an optional redemption provision, which permits the Company, at its option, to call the 2004 Notes at scheduled dates and prices. The first scheduled optional redemption date is July 15, 2009 at a price of 103.125% of the principal amount.

In addition to the 2004 Notes, at September 30, 2006, 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. Under the terms of an optional redemption provision, on October 27, 2006, the Company redeemed the $225 million notes in full at a premium of 104.563% of the principal amount with proceeds from the Company s revolving credit line. In conjunction with the redemption of the Notes, the Company will recognize a charge on the early extinguishment of debt of approximately $12 million ($8 million after tax) in October 2006. The charge relates to the redemption premium and the write-off of unamortized debt issuance costs. Based on current interest rates under the revolving credit facility, interest savings are estimated to be $500 thousand per month.

The 2004 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 are fully and unconditionally guaranteed jointly and severally, on a subordinated basis, by each of the wholly owned domestic guarantors under the revolving credit facilities. The stock of the Company s domestic subsidiaries is also pledged to the note holders on a subordinated basis.

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 September 30, 2006, acquisition and other notes totaled approximately $3 million with interest rates ranging from 5% to 8.5%.

Financial Instruments of the National Welders Joint Venture

Pursuant to the requirements of FASB s Financial Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, (FIN 46R), the Company s Consolidated Balance Sheets at September 30, 2006 and March 31, 2006 include the financial obligations of National Welders. National Welders financial obligations are non-recourse to the Company, meaning that the creditors of National Welders do not have a claim on the assets of Airgas, Inc.

The National Welders Credit Agreement (the NWS Credit Agreement) provides for a revolving credit line of $74 million, a Term Loan A of $26 million, a Term Loan B of $21 million, and a Term Loan C of $9 million. At September 30, 2006, National Welders had borrowings under its revolving credit line of $48 million and under Term Loan A of $14 million. There were no amounts outstanding under Term loans B or C at September 30, 2006. National Welders also had $752 thousand in acquisition notes and other debt obligations.

The revolving credit agreement matures in August 2008. Term Loan A is repayable in monthly amounts of $254 thousand with a lump-sum payment of the outstanding balance at maturity in August 2008. The variable interest rate on the revolving credit line and Term Loan A ranges from LIBOR plus 70 to 145 basis points varying with National Welders leverage ratio. At September 30, 2006, the effective interest rate for the revolving credit line and Term Loan A was 6.28%. The NWS Credit Agreement also contains certain covenants which, among other things, limit the ability of National Welders to incur and guarantee new indebtedness, and limit its capital expenditures, ownership

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changes, merger and acquisition activity, and the payment of dividends. National Welders had additional borrowing capacity under the NWS Credit Agreement of approximately $26 million at September 30, 2006.

As of September 30, 2006, the revolving credit line and Term Loan A are secured by certain current assets, principally trade receivables and inventory, totaling $36 million, non-current assets, principally equipment, totaling $103 million, and Airgas common stock with a market value of $33 million classified as treasury stock and carried at cost of $370 thousand.

Trade Receivables Securitization

The Company participates in a securitization agreement with two commercial banks to sell up to $250 million of qualifying trade receivables. The agreement expires in May 2009, but may be renewed subject to provisions contained in the agreement. During the six months ended September 30, 2006, the Company sold, net of its retained interest, $1,273 million of trade receivables and remitted to bank conduits, pursuant to a servicing agreement, $1,270 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 $247 million at September 30, 2006 and $244 million at March 31, 2006, respectively. Effective October 31, 2006, the Company increased the maximum size of the securitization agreement to $270 million of qualifying trade receivables.

Interest Rate Swap Agreements

The Company manages its exposure to changes in market interest rates. At September 30, 2006, the Company was party to six interest rate swap agreements. The swap agreements are with major financial institutions and aggregate $150 million in notional principal amount. At September 30, 2006, these swap agreements required the Company to make fixed interest payments based on a weighted average effective rate of 4.98% and receive variable interest payments from its counterparties based on a weighted average variable rate of 5.37%. The remaining terms of each of these swap agreements are between 21 months to 32 months. The Company monitors its positions and the credit ratings of its counterparties and does not anticipate non-performance by the counterparties.

National Welders was a party to one interest rate swap agreement with a major financial institution with a notional principal amount of $27 million. National Welders is required to make fixed interest payments of 5.36% and receive variable interest payments from its counterparty based on one month LIBOR, which was 5.33% at September 30, 2006. The remaining term of the swap agreement is 32 months.

Including the effect of the interest rate swap agreements, the debt of National Welders, and the trade receivables securitization, the Company s ratio of fixed to variable rate debt at September 30, 2006 was 51% fixed to 49% variable. The redemption of 9.125% senior subordinated notes on October 27, 2006 changed the Company s ratio of fixed to variable rate debt to 30% fixed to 70% variable. A majority of the Company s variable rate debt is based on a spread over LIBOR. Based on the Company s fixed to variable interest rate ratio subsequent to the redemption of the 2001 Notes, for every 25 basis point increase in LIBOR, the Company estimates that its annual interest expense would increase approximately $2 million.

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Contractual Obligations and Off-Balance Sheet Arrangements

The following table presents the Company obligations and off-balance sheet arrangements as of September 30, 2006.

(In thousands)			*Payments Due by Period*		
Contractual and Off-Balance Sheet Obligations	**Total**	**Remainder of fiscal 2007 (a)**	**1 to 3 Years (a)**	**3 to 5 Years (a)**	**More than 5 Years (a)**
Obligations reflected on the September 30, 2006 Balance Sheet:					
Long-term debt (1)	$ 854,646	$ 27,477	$ 90,971	$ 47,219	$ 688,979
Off-balance sheet obligations as of September 30, 2006:					
Estimated interest payments on long-term debt (2)	252,957	25,779	98,090	89,058	40,030
Estimated payments (receipts) on interest rate swap agreements (3)	(1,269)	(293)	(878)	(98)	
Operating leases (4)	161,455	27,913	79,892	41,532	12,118
Trade receivables securitization (5)	247,100			247,100	
Estimated discount on securitization (6)	35,780	6,709	26,835	2,236	
Letters of credit (7)	34,426	34,426			
Purchase obligations*:*					
Liquid bulk gas supply agreements (8)	782,393	42,358	150,639	144,270	445,126
Liquid carbon dioxide supply agreements (9)	154,002	6,630	18,416	15,456	113,500
Ammonia supply agreements (10)	4,978	4,978			
Other purchase commitments (11)	8,247	7,830	278	139	
Total	**$2,534,715**	**$ 183,807**	**$ 464,243**	**$ 586,912**	**$1,299,753**

(a) The remainder of Fiscal 2007 column relates to obligations due during the period October 1, 2006 through March 31, 2007. The 1 to 3 years column relates to obligations due in fiscal years ended March 31, 2008 and 2009. The 3 to 5 years column relates to obligations due in fiscal years ended March 31, 2010 and 2011. The more than 5 years column relates to obligations due in fiscal years ended March 31, 2012 and beyond.

(1) Aggregate long-term debt instrument maturities are reflected as of September 30, 2006, as adjusted to reflect the October 27, 2006 early extinguishment of $225 million of senior subordinated notes originally due October 1, 2011. Maturities were adjusted to provide more meaningful information about the Company s obligations and commitments to make future payments under its debt instruments. The senior subordinated

notes were redeemed by borrowing under the revolving credit facility which matures in July 2011. 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.

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(2) The future interest payments on the Company s long-term debt obligations were estimated based on the maturities reflected in the contractual obligation table as described in (1) above and interest rates as of September 30, 2006. The estimated interest payments may differ materially from those presented above based on actual amounts of long-term debt outstanding and actual interest rates in future periods.

(3) Payments or receipts under interest rate swap agreements result from changes in market interest rates compared to contractual payments to be exchanged between the parties to the agreements. The estimated receipts in future periods were determined based on interest rates as of September 30, 2006. Actual

receipts or payments may differ materially from those presented above based on actual interest rates in future periods.

(4) The Company s operating leases at September 30, 2006 includes approximately $123 million in fleet vehicles under long-term operating leases. The Company guaranteed a residual value of $15 million related to its leased vehicles.

(5) The Company participates in a securitization agreement with two commercial banks to sell up to $250 million of qualifying trade receivables. Effective October 31, 2006, the Company increased the maximum size of the securitization agreement to $270 million of qualifying trade receivables. The agreement expires in May 2009, but may be renewed subject to 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 5 to the Consolidated Financial Statements.

(6) 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 interest rates. The estimated discount in future periods is based on receivables sold and interest rates as of September 30, 2006. The actual discount

recognized in future periods may differ materially from those presented above based on actual amounts of receivables sold and market rates.

(7) 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. These claims are supported by an arrangement with a financial institution.

(8) The Company has a 15-year take-or-pay supply agreement, expiring September 1, 2017, under which Air Products and Chemicals, Inc. will supply at least 35% of the Company s bulk liquid nitrogen, oxygen and argon requirements, exclusive of the volumes produced by the Company and those

purchased under The BOC Group, Inc. (BOC) supply agreements noted below. Additionally, the Company purchases helium under the terms of the supply agreement. Based on the volume of fiscal 2006 purchases, the Air Products supply agreement represents approximately $47 million in annual liquid bulk gas purchases. The purchase commitments for future periods contained in the table above reflect estimates based on fiscal 2006 purchases.

In July 2004, the Company entered into a 15-year take-or-pay supply agreement with BOC to purchase oxygen, nitrogen and argon. The agreement was entered into in conjunction with the July 2004 acquisition of BOC s U.S. packaged gas business. The agreement will expire in July 2019. The 2004 BOC agreement represents approximately $3 million in annual bulk gas purchases. Prior to the acquisition, the Company purchased oxygen, nitrogen and argon under an agreement with BOC which expires in May 2007. Minimum purchases through May 2007 under the pre-acquisition supply agreement are approximately $2.4 million.

In September and October 2006, the Company entered into 10-year take-or-pay supply agreements with BOC to purchase helium. The total annual commitment amount for these agreements is approximately $23

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million. These new agreements replace the previous two helium supply agreements that were to expire in February 2007 and July 2019.

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 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.

(9) 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 2006 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.

(10) The Company purchases ammonia from a variety of sources. With one of those sources, the Company has minimum purchase commitments under supply agreements, which is perpetual pending a 180-day written notification of termination from either party.

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

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OTHER

New Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140*. SFAS 155 addresses the application of SFAS 133 to beneficial interests in securitized financial assets. SFAS 155 is effective for fiscal years beginning after September 15, 2006. The Company is currently evaluating the requirements of SFAS 155 and has not yet determined the impact on its consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140*. SFAS 156 requires that an entity recognize a servicing asset or liability each time it undertakes an obligation to service a financial asset by entering into a service contract under certain situations. SFAS 156 is effective for fiscal years beginning after September 15, 2006. The Company is currently evaluating the requirements of SFAS 156 and has not yet determined the impact on its consolidated financial statements.

In June 2006, the FASB issued EITF No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement*. EITF 06-3 requires companies to disclose the presentation of any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer (e.g. sales and use tax) as either gross or net in the accounting principles included in the notes to the financial statements. EITF 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. The Company will disclose its policy when the EITF is adopted.

In July 2006, the FASB issued FASB Interpretation (FIN) 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*. The interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. It prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. The interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the requirements of FIN 48 and has not yet determined the impact on its consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when quantifying Misstatements in Current Year Financial Statements (SAB 108)*. The new Staff Accounting Bulletin addresses the methods to be used when assessing the materiality of identified, unadjusted errors or differences between Generally Accepted Accounting Principles (GAAP) and company policies on the financial statements. Prior to SAB 108, either a balance sheet approach or an income statement approach was used to make such assessments. Although either approach could result in a different conclusion about materiality, both approaches were acceptable under generally accepted accounting principles. Under SAB 108, both the balance sheet and the income statement approach must now be used to evaluate the materiality of identified errors. SAB 108 is effective for fiscal years ending after November 15, 2006.

Historically, the Company used the income statement or rollover approach when assessing the materiality of differences between GAAP and Company policies. The Company is currently re-evaluating its materiality assessment using the guidance of SAB 108. The SAB 108 approach may change the previous conclusions about the materiality of certain of these differences. In such cases, SAB 108 permits the Company to change its policies to those specified by GAAP and to record the impact of such changes as a cumulative effect adjustment to beginning retained earnings. The Company is evaluating the impact of SAB 108.

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In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* This standard defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America, and expands disclosure about fair value measurements. This pronouncement applies to the fair value requirements as applicable in other accounting standards that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurement. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the requirements of SFAS No. 157 and has not yet determined the impact on the consolidated financial statements.

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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 intention to use up to $500 million in term loan borrowings to finance certain contemplated acquisitions; the Company s intent to use borrowings under the revolving credit line for working capital, acquisitions and general corporate purposes; interest savings of $500 thousand per month resulting from the redemption of its 9.125% senior subordinated notes; the Company s expectation that net earnings in the fiscal 2007 third quarter will range from $0.37 to $0.39 per diluted share; the Company s expectation that net earnings in fiscal 2007 will range from $1.83 to $1.88 per diluted share; the Company s intention to continue to raise prices as necessary to offset rising product, operating and delivery costs; the Company s ability to manage its exposure to interest rate risk through the use of interest rate swap agreements; the performance of counterparties under interest rate swap agreements; based on the fixed to variable interest rate ratio subsequent to the redemption of the 9.125% senior subordinated notes, the Company s estimate that for every 25 basis point increase in LIBOR, annual interest expense will increase approximately $2 million; the Company s expectation that its overall effective tax rate for fiscal 2007, including the one-time tax benefit, will range from 38% to 39% of pre-tax earnings; the Company s focus on using its cash flow for growth opportunities, including future acquisitions, paying down debt and growing its dividend; the future payment of dividends; the estimate of future interest payments on the Company s long-term debt obligations; the estimate of future payments or receipts under interest rate swap agreements; the estimate of future purchase commitments; and the Company s belief that the minimum product purchases under supply agreements are well within the Company s normal product purchases.

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: the inability to close certain contemplated acquisitions and the resulting expiration of the $500 million term loan; fluctuations in interest rates; higher or lower overall tax rates in fiscal 2007 than that estimated by the Company; an increase in debt in future periods and the impact on the Company s ability to grow its dividend; a lack of available financing necessary to invest in growth opportunities and future acquisitions; a decline in demand from markets served by the Company; adverse customer response to the Company s strategic product sales initiatives; underlying market conditions; customers acceptance of price increases; adverse changes in customer buying patterns; an economic downturn (including adverse changes in the specific markets for the Company s products); the Company s inability to meet its earnings estimates; a rise in product costs and/or operating expenses at a rate faster than the Company s ability to increase prices; higher than estimated interest expense resulting from increases in LIBOR; potential disruption to the Company s business from integration problems associated with acquisitions; the inability of management to control expenses; a lack of available cash flow necessary to pay future dividends; the inability to pay dividends as a result of loan covenant restrictions; the inability to manage interest rate exposure; unanticipated non-performance by counterparties related to interest rate swap agreements; 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; changes in customer demand resulting in the inability to meet minimum product purchases under supply agreements; and the effects of, and changes in, the economy, monetary and fiscal policies, laws and regulations, inflation and monetary fluctuations, 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.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

The Company manages its exposure to changes in market interest rates. The interest rate exposure arises primarily from the interest payment terms of the Company s borrowing agreements. Interest rate swap agreements are used to adjust the interest rate risk exposures that are inherent in its portfolio of funding sources. The Company has not, and will not establish any interest rate risk positions for purposes other than managing the risk associated with its portfolio of funding sources. The Company maintains the ratio of fixed to variable rate debt within parameters established by management under policies approved by the Board of Directors. Including the effect of interest rate swap agreements on the Company s debt and off-balance sheet financing arrangements, the Company s ratio of fixed to variable rate debt was 51% fixed and 49% variable at September 30, 2006. The redemption of $225 million 9.125% senior subordinated notes on October 27, 2006 changed the Company s ratio of fixed to variable rate debt to 30% fixed to 70% variable. The ratio includes the effect of the fixed to variable rate debt of National Welders. Counterparties to interest rate swap agreements are major financial institutions. The Company has established counterparty credit guidelines and only enters into transactions with financial institutions with long-term credit ratings of A or better. In addition, the Company monitors its position and the credit ratings of its counterparties, thereby minimizing the risk of non-performance by the counterparties.

The table below summarizes the Company s market risks associated with debt obligations, interest rate swaps and the trade receivables securitization. To provide a more meaningful assessment of those risks, the $225 million fixed rate senior subordinated notes redeemed October 27, 2006 are reflected as borrowings under the variable rate revolving credit facilities used to fund the redemption. For debt obligations and the trade receivables securitization, the table presents cash flows related to payments of principal, interest and the discount on the securitization program by fiscal year of maturity. For interest rate swaps, the table presents the notional amounts underlying the agreements by year of maturity. The notional amounts are used to calculate contractual payments to be exchanged and are not actually paid or received. Fair values were computed using market quotes, if available, or based on discounted cash flows using market interest rates as of the end of the period.

	Fiscal Year of Maturity								
(In millions)	2007 (a)	2008	2009	2010	2011	2012	Thereafter	Total	Fair Value
Fixed Rate Debt:									
Acquisition and other notes	$	$ 1	$	$ 2	$	$	$	$ 3	$ 3
Interest expense	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$	$	$	$ 0.4	
Average interest rate	5.55%	5.82%	5.67%	8.50%					
Senior subordinated Notes due 2014	$	$	$	$	$	$	$ 150	$150	$141
Interest expense	$ 5	$ 9	$ 9	$ 9	$ 9	$ 9	$ 19	$ 69	
Interest rate	6.25%	6.25%	6.25%	6.25%	6.25%	6.25%	6.25%		
National Welders:									
Acquisition and other notes	$ 0.8	$	$	$	$	$	$	$ 0.8	$ 0.8
Interest expense	$	$	$	$	$	$	$	$	
Interest rate	7.00%								

(In millions)	2007 (a)	2008	2009	2010	2011	2012	Thereafter	Total	Fair Value
	Fiscal Year of Maturity								
Variable Rate Debt:									
Revolving credit facilities	$	$	$	$	$	$ 514	$	$514	$514
Interest expense	$ 16	$ 31	$ 31	$ 31	$ 31	$ 11	$	$151	
Interest rate (b)	6.07%	6.07%	6.07%	6.07%	6.07%	6.07%			
Term loan	$	$ 15	$ 15	$ 15	$ 31	$ 24	$	$100	$100
Interest expense	$ 3	$ 6	$ 5	$ 4	$ 3	$ 1	$	$ 22	
Interest rate (b)	6.14%	6.14%	6.14%	6.14%	6.14%	6.14%			
Money Market Loan	$ 25	$	$	$	$	$	$	$ 25	$ 25
Interest expense	$ 0.4	$	$	$	$	$	$	$ 0.4	
Interest rate (b)	5.89%								
National Welders:									
Revolving credit facility	$	$	$ 48	$	$	$	$	$ 48	$ 48
Interest expense	$ 1.6	$ 3.0	$ 1.2	$	$	$	$	$ 5.8	
Interest rate (b)	6.28%	6.28%	6.28%						
Term loan A	$ 2	$ 3	$ 9	$	$	$	$	$ 14	$ 14
Interest expense	$ 0.4	$ 0.8	$ 0.2	$	$	$	$	$ 1.4	
Interest rate (b)	6.28%	6.28%	6.28%						

(In millions)	2007 (a)	2008	2009	2010	2011	2012	Thereafter	Total	Fair Value
	Fiscal Year of Maturity								
Interest Rate Swaps:									
6 Swaps (Receive Variable)/Pay Fixed									
Notional amounts	$	$	$ 100	$ 50	$	$	$	$ 150	$ (0.5)
Swap payments/(receipts)	$(0.3)	$(0.6)	$(0.3)	$(0.1)	$	$	$	$(1.3)	
Variable receive rate = 5.37%									
Weighted average pay rate = 4.98%									
National Welders:									

1 Swap (Receive Variable)/Pay Fixed									
Notional amount	$	$	$	$ 27	$	$	$	$ 27	$
Variable receive rate = 5.33%	$	$	$	$	$	$	$		
Weighted average pay rate = 5.36%									
Other Off-Balance Sheet LIBOR-based agreement:									
Trade receivables securitization (c)	$	$	$	$ 247	$	$	$	$ 247	$ 247
Discount on securitization	$ 7	$ 14	$ 14	$ 2	$	$	$	$ 37	

(a) Fiscal 2007 financial instrument maturities and interest expense relate to the period October 1, 2006 through March 31, 2007.

(b) The variable rate of U.S. revolving credit facilities and term loan is based on the average LIBOR rate of outstanding contracts as of September 30, 2006. The variable rate of the Canadian dollar portion of the revolving credit facilities is the rate on Canadian Bankers acceptances as of September 30, 2006.

(c) The trade receivables securitization agreement expires in May 2009, but may be renewed subject to renewal provisions contained in the agreement.

Limitations of the tabular presentation

As the table incorporates only those interest rate risk exposures that exist as of September 30, 2006, it does not consider those exposures or positions that could arise after that date. In addition, actual cash flows of financial instruments in future periods may differ materially from prospective cash flows presented in the table due to future fluctuations in variable interest rates, debt levels and the Company s credit rating.

Foreign Currency Rate Risk

Canadian subsidiaries of the Company are funded in part with local currency debt. The Company does not otherwise hedge its exposure to translation gains and losses relating to foreign currency net asset exposures. The Company considers its exposure to foreign currency exchange fluctuations to be immaterial to its consolidated financial position and results of operations.

Item 4. Controls and Procedures

(a) *Evaluation of Disclosure Controls and Procedures*

The Company carried out an evaluation, under the supervision and with the participation of the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company s disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of September 30, 2006. Based on that evaluation, the Company s Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, the Company s disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported in the periods specified in the Securities and Exchange Commission s rules and forms.

(b) *Changes in Internal Control*

There were no changes in internal control over financial reporting that occurred during the quarter ended September 30, 2006 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is involved in various legal and regulatory proceedings that have arisen in the ordinary course of its business and have not been fully adjudicated. These actions, when ultimately concluded will not, in the opinion of management, have a material adverse effect upon the Company s consolidated financial position, results of operations or liquidity.

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in Part I, Item 1A, Risk Factors, of the Company s Annual Report on Form 10-K for the year ended March 31, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Not applicable

(b) Not applicable

(c) Purchase of Equity Securities by the Issuer and Affiliated Purchasers

As a result of certain acquisitions under consideration, the Company suspended its three-year share repurchase plan initiated in November 2005. Accordingly, no shares of the Company s common stock were repurchased during the six months ended September 30, 2006.

Item 4. Submission of Matters to a Vote of Security Holders

The annual meeting of the stockholders of the Company was held on August 9, 2006, where the following actions were taken:

(a) The stockholders voted to elect James W. Hovey, Paula A. Sneed and David M. Stout to the Board of Directors. The votes cast for each Director were as follows:

	No. of Shares	
	For	Withheld/Against
James W. Hovey	71,325,927	1,386,175
Paula A. Sneed	68,160,503	4,551,599
David M. Stout	67,633,408	5,078,694

(b) The stockholders voted to approve the 2006 Equity Incentive Plan. The votes cast in regard to the action were as follows:

No. of Shares			
For	Withheld/Against	Abstain	Broker Non-Votes
41,649,506	24,210,132	338,357	6,514,107

(c) The stockholders voted to approve the Amended and Restated 2003 Employee Stock Purchase Plan. The votes cast in regard to the action were as follows:

No. of Shares			
For	Withheld/Against	Abstain	Broker Non-Votes
64,994,509	1,114,470	89,016	6,514,107

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(d) The stockholders voted to ratify the selection of KPMG LLP as the Company s independent registered public accounting firm for the fiscal year ending March 31, 2007. The votes cast in regard to the action were as follows:

	No. of Shares	
For	Withheld/Against	Abstain
72,071,789	476,570	163,743

Item 6. Exhibit Listing

The following exhibits are being filed or furnished as part of this Quarterly Report on Form 10-Q:

Exhibit No.	Description
4	Twelfth Amended and Restated Credit Agreement, dated as of July 25, 2006, among Airgas, Inc., Airgas Canada, Inc., Red-D-Arc Limited, Bank of America, N.A., as U.S. Agent and The Bank of Nova Scotia, as Canadian Agent.
31.1	Certification of Peter McCausland as Chairman and Chief Executive Officer of Airgas, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Robert M. McLaughlin as Senior Vice President and Chief Financial Officer of Airgas, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Peter McCausland as Chairman and Chief Executive Officer of Airgas, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Robert M. McLaughlin as Senior Vice President and Chief Financial Officer of Airgas, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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Signatures

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant and Co-Registrants have duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

AIRGAS, INC.
(Registrant)

BY: /s/ Robert M. McLaughlin
Robert M. McLaughlin
Senior Vice President & Chief Financial Officer
(Principal Financial Officer)
(Principal Accounting Officer)

AIRGAS EAST, INC.
AIRGAS GREAT LAKES, INC.
AIRGAS MID AMERICA, INC.
AIRGAS NORTH CENTRAL, INC.
AIRGAS SOUTH, INC.
AIRGAS GULF STATES, INC.
AIRGAS MID SOUTH, INC.
AIRGAS INTERMOUNTAIN, INC.
AIRGAS NORPAC, INC.
AIRGAS NORTHERN CALIFORNIA NEVADA, INC.
AIRGAS SOUTHWEST, INC.
AIRGAS WEST, INC.
AIRGAS SAFETY, INC.
AIRGAS CARBONIC, INC.
AIRGAS SPECIALTY GASES, INC.
NITROUS OXIDE CORP.
RED-D-ARC, INC.
AIRGAS DATA, LLC

(Co-Registrant)

BY: /s/ Robert M. McLaughlin
Robert M. McLaughlin
Vice President

ATNL, INC.

(Co-Registrant)

BY: /s/ Melanie Andrews
Melanie Andrews
President

DATED: November 9, 2006

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