

PRAXAIR INC
Form 10-Q
October 25, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF**

THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2006

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF**

THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

PRAXAIR, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation)

1-11037
(Commission File Number)

06-1249050
(IRS Employer)

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Identification No.)

39 OLD RIDGEBURY ROAD, DANBURY, CT
(Address of principal executive offices)

06810-5113
(Zip Code)

(203) 837-2000

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. **Yes** ☒ **No** ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ **Accelerated filer** ☐ **Non-accelerated filer** ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). **Yes** ☐ **No** ☒

At September 30, 2006, 322,898,901 shares of common stock (\$0.01 par value) of the Registrant were outstanding.

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Table of Contents**PART I - FINANCIAL INFORMATION***Praxair, Inc. and Subsidiaries***Item 1. Financial Statements****PRAXAIR, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(Millions of dollars, except per share data)

(UNAUDITED)

| | Quarter Ended September 30, | |
|---|--|-----------------|
| | 2006 | 2005 |
| SALES | \$ 2,099 | \$ 1,890 |
| Cost of sales, exclusive of depreciation and amortization | 1,259 | 1,144 |
| Selling, general and administrative | 272 | 243 |
| Depreciation and amortization | 173 | 165 |
| Research and development | 21 | 19 |
| Other income (expense) net | 18 | (2) |
| OPERATING PROFIT | 392 | 317 |
| Interest expense net | 38 | 40 |
| INCOME BEFORE INCOME TAXES | 354 | 277 |
| Income taxes | 101 | 163 |
| | 253 | 114 |
| Minority interests | (7) | (8) |
| Income from equity investments | 1 | 2 |
| NET INCOME | \$ 247 | \$ 108 |
| PER SHARE DATA: | | |
| Basic earnings per share | \$ 0.76 | \$ 0.33 |
| Diluted earnings per share | \$ 0.75 | \$ 0.33 |
| Cash dividends per share | \$ 0.25 | \$ 0.18 |
| WEIGHTED AVERAGE SHARES OUTSTANDING (000 s): | | |
| Basic shares outstanding | 323,582 | 324,137 |
| Diluted shares outstanding | 329,498 | 329,993 |

The accompanying notes are an integral part of these financial statements.

Table of Contents**PRAXAIR, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(Millions of dollars, except per share data)

(UNAUDITED)

| | Nine Months Ended September 30, | |
|---|--|-----------------|
| | 2006 | 2005 |
| SALES | \$ 6,201 | \$ 5,636 |
| Cost of sales, exclusive of depreciation and amortization | 3,704 | 3,420 |
| Selling, general and administrative | 816 | 735 |
| Depreciation and amortization | 518 | 490 |
| Research and development | 64 | 58 |
| Other income (expense) net | 27 | 15 |
| OPERATING PROFIT | 1,126 | 948 |
| Interest expense net | 117 | 123 |
| INCOME BEFORE INCOME TAXES | 1,009 | 825 |
| Income taxes | 274 | 296 |
| | 735 | 529 |
| Minority interests | (22) | (28) |
| Income from equity investments | 6 | 11 |
| NET INCOME | \$ 719 | \$ 512 |
| PER SHARE DATA: | | |
| Basic earnings per share | \$ 2.22 | \$ 1.58 |
| Diluted earnings per share | \$ 2.18 | \$ 1.55 |
| Cash dividends per share | \$ 0.75 | \$ 0.54 |
| WEIGHTED AVERAGE SHARES OUTSTANDING (000 s): | | |
| Basic shares outstanding | 323,635 | 323,951 |
| Diluted shares outstanding | 329,512 | 329,853 |

The accompanying notes are an integral part of these financial statements.

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PRAXAIR, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(Millions of dollars)

(UNAUDITED)

| | September 30, 2006 | December 31, 2005 |
|---|-----------------------|----------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 22 | \$ 173 |
| Accounts receivable - net | 1,469 | 1,386 |
| Inventories | 400 | 373 |
| Prepaid and other current assets | 213 | 201 |
| TOTAL CURRENT ASSETS | 2,104 | 2,133 |
| Property, plant and equipment (less accumulated depreciation of \$7,107 at September 30, 2006 and \$6,553 at December 31, 2005) | 6,516 | 6,108 |
| Goodwill | 1,598 | 1,545 |
| Other intangible assets - net | 71 | 81 |
| Other long-term assets | 636 | 624 |
| TOTAL ASSETS | \$ 10,925 | \$ 10,491 |
| LIABILITIES AND EQUITY | | |
| Accounts payable | \$ 603 | \$ 639 |
| Short-term debt | 303 | 231 |
| Current portion of long-term debt | 47 | 290 |
| Other current liabilities | 940 | 841 |
| TOTAL CURRENT LIABILITIES | 1,893 | 2,001 |
| Long-term debt | 2,824 | 2,926 |
| Other long-term obligations | 1,505 | 1,460 |
| TOTAL LIABILITIES | 6,222 | 6,387 |
| Commitments and contingencies (Note 10) | | |
| Minority interests | 209 | 202 |
| Shareholders' equity | 4,494 | 3,902 |
| TOTAL LIABILITIES AND EQUITY | \$ 10,925 | \$ 10,491 |

The accompanying notes are an integral part of these financial statements.

Table of Contents**PRAXAIR, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Millions of dollars)

(UNAUDITED)

| | Nine Months Ended September 30, | |
|---|--|-------------|
| | 2006 | 2005 |
| OPERATIONS | | |
| Net income | \$ 719 | \$ 512 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 518 | 490 |
| Deferred income taxes | 105 | 125 |
| Stock option expense | 32 | |
| Accounts receivable | (98) | (115) |
| Inventory | (33) | (41) |
| Prepaid and other current assets | (5) | (24) |
| Payables and accruals | 109 | 257 |
| Pension contributions | (119) | (78) |
| Other | (39) | (27) |
| Net cash provided by operating activities | 1,189 | 1,099 |
| INVESTING | | |
| Capital expenditures | (800) | (598) |
| Acquisitions | (7) | (8) |
| Divestitures and asset sales | 112 | 25 |
| Net cash used for investing activities | (695) | (581) |
| FINANCING | | |
| Short-term debt repayments - net | (161) | (29) |
| Long-term debt borrowings | 78 | 35 |
| Long-term debt repayments | (263) | (198) |
| Excess tax benefit on stock option exercises | 18 | |
| Minority interest transactions and other | (18) | (18) |
| Issuances of common stock | 203 | 192 |
| Purchases of common stock | (262) | (332) |
| Cash dividends | (242) | (174) |
| Net cash used for financing activities | (647) | (524) |
| Effect of exchange rate changes on cash and cash equivalents | 2 | |
| Change in cash and cash equivalents | (151) | (6) |
| Cash and cash equivalents, beginning-of-period | 173 | 25 |
| Cash and cash equivalents, end-of-period | \$ 22 | \$ 19 |

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The accompanying notes are an integral part of these financial statements.

Table of Contents**PRAXAIR, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**

(Dollar amounts in millions, except share data, shares in thousands)

(UNAUDITED)

| Activity | Common Stock | | | Treasury Stock | | Retained Earnings | Accumulated Other Comprehensive Income (Loss) ^(b) | Total |
|--|--------------|---------|----------------------------|----------------|------------|-------------------|--|----------|
| | Shares | Amounts | Additional Paid-In Capital | Shares | Amounts | | | |
| Balance, January 1, 2006 | 363,713 | \$ 4 | \$ 2,489 | 41,374 | \$ (1,356) | \$ 4,022 | \$ (1,257) | \$ 3,902 |
| Net income | | | | | | 719 | | 719 |
| Translation adjustments | | | | | | | 130 | 130 |
| Minimum pension liability, net of \$8 million of taxes | | | | | | | (11) | (11) |
| Comprehensive income ^(a) | | | | | | | | 838 |
| Dividends on common stock (\$0.75 per share) | | | | | | (242) | | (242) |
| Issuances of common stock: | | | | | | | | |
| For the dividend reinvestment and stock purchase plan | 71 | | 4 | | | | | 4 |
| For employee savings and incentive plans | 2,817 | | 116 | (2,455) | 83 | | | 199 |
| Purchases of common stock | | | | 4,783 | (264) | | | (264) |
| Tax benefit from stock options | | | 25 | | | | | 25 |
| Stock option expense | | | 32 | | | | | 32 |
| Balance, September 30, 2006 | 366,601 | \$ 4 | \$ 2,666 | 43,702 | \$ (1,537) | \$ 4,499 | \$ (1,138) | \$ 4,494 |

(a) The components of comprehensive income are as follows:

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------|-----------------------------|--------|---------------------------------|--------|
| | 2006 | 2005 | 2006 | 2005 |
| Net income | \$ 247 | \$ 108 | \$ 719 | \$ 512 |
| Translation adjustments | 36 | 67 | 130 | 45 |
| Minimum pension liability | | | (11) | (2) |
| | \$ 283 | \$ 175 | \$ 838 | \$ 555 |

(b) The components of accumulated other comprehensive income (loss) are as follows:

September 30, December 31,
2005

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2006

| | | |
|---------------------------------------|------------|------------|
| Accumulated translation adjustments | \$ (920) | \$ (1,050) |
| Accumulated minimum pension liability | (217) | (206) |
| Accumulated derivatives | (1) | (1) |
| | \$ (1,138) | \$ (1,257) |

The accompanying notes are an integral part of these financial statements.

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PRAXAIR, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Summary of Significant Accounting Policies

Presentation of Condensed Consolidated Financial Statements - In the opinion of Praxair, Inc. (Praxair) management, the accompanying condensed consolidated financial statements include all adjustments necessary for a fair presentation of the results for the interim periods presented and such adjustments are of a normal recurring nature. The accompanying condensed consolidated financial statements should be read in conjunction with the Notes to the consolidated financial statements of Praxair, Inc. and subsidiaries in Praxair's 2005 Annual Report. There have been no material changes to the company's significant accounting policies during 2006 with the exception of the expensing of stock options as required by Statement of Financial Accounting Standard No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R).

Stock-Based Compensation - Effective January 1, 2006, the company adopted SFAS No. 123R and related interpretations which require the measurement and recognition of compensation expense for all share-based payments to employees and directors based on their fair value. Prior to 2006, the company accounted for stock options using the intrinsic value method under Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees* as permitted under SFAS No. 123, *Accounting for Stock-Based Compensation*. Accordingly, stock option expense was not recognized in net income as the exercise price of options granted was equal to the market value of the stock at the date of grant. The company provided pro forma net income and earnings per share amounts in the footnotes as if stock option expense had been recognized based on fair value, as required.

The company has elected the modified prospective transition method as permitted by SFAS No. 123R. Prior periods have not been restated to reflect the impact of stock option expense. Stock option expense is recorded for all new and unvested stock options that are expected to vest over the service period beginning on January 1, 2006.

Prior to the adoption of SFAS No. 123R, the company presented tax benefits resulting from the exercise of stock options as operating cash flows in the Condensed Consolidated Statements of Cash Flows. SFAS No. 123R requires that cash flows resulting from tax deductions in excess of recognized compensation cost be classified as financing cash flows. For the nine months ended September 30, 2006, approximately \$18 million in excess tax benefits were classified as financing cash flows.

Stock option expense is generally recognized on a straight-line basis over the stated vesting period. For stock option awards granted to full-retirement-eligible employees, expense is recognized over the period from the grant date to the date retirement eligibility is achieved.

Refer to Note 3 to the condensed consolidated financial statements for further stock-based compensation disclosures.

Reclassifications - Certain prior year amounts have been reclassified to conform to the current year's presentation.

2. Recently Issued Accounting Standards

In July 2006, the FASB issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement 109 which clarifies the accounting for uncertainty in income taxes recognized in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 is a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. If an income tax position exceeds a more likely than not (greater than 50%) probability of success upon tax audit, the company will recognize an income tax benefit in its financial statements. Additionally, companies will be required to accrue interest and related penalties, if applicable, on all tax exposures consistent with jurisdictional tax laws. This interpretation is effective on January 1, 2007 for Praxair and the company is currently in the process of evaluating the impact of this interpretation on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* which provides a single definition of fair value, and requires additional disclosure about the use of fair value to measure assets and liabilities. The Statement emphasizes that fair value is a market-based measurement and should be determined based on the assumptions that market participants would use in valuing assets or liabilities. This interpretation is effective on January 1, 2008 for Praxair and the company is currently in the process of evaluating the impact of this interpretation on the consolidated financial statements.

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In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires the quantification of misstatements based on their impact to both the balance sheet and the income statement to determine materiality. The guidance provides for a one-time cumulative-effect adjustment to correct for misstatements for errors that were not deemed material under a company's prior approach but are material under the SAB 108 approach. SAB 108 is effective for the fiscal year ending December 31, 2006 for Praxair and at this time, is not expected to impact the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," an amendment of FASB Statements No. 87, 88, 106, 132(R), effective during the fourth quarter of 2006. Under the new standard, companies will be required to recognize the funded status of their pension and other postretirement plans on their balance sheet beginning in the fourth quarter 2006 using the projected benefit obligation and accumulated benefit obligation. Using the December 31, 2005 balance sheet information for Praxair's pension and other post-retirement benefit plans, the estimated impact of adopting SFAS No. 158 would be an increase to other long-term obligations of \$127 million, an increase to deferred tax assets of \$44 million and a decrease to accumulated other comprehensive income (loss) within shareholders' equity of \$83 million. At this time, Praxair does not expect the December 31, 2006 amounts to be significantly different.

3. Stock-Based Compensation

The company adopted SFAS No. 123R effective January 1, 2006, resulting in the recognition of stock option expense of \$10 million, \$7 million after tax, for the quarter ended September 30, 2006. Stock option expense recognized for the nine months ended September 30, 2006 was \$32 million, \$21 million after tax. The impact to both basic and diluted earnings per share was \$0.02 and \$0.06 for the quarter and nine months ended September 30, 2006, respectively. The expense for both periods was primarily recorded in selling, general and administrative expenses. There was no share-based compensation cost that was capitalized.

Summary of Plans

The company currently has two share-based compensation programs, the 2002 Praxair, Inc. Long-Term Incentive Plan (the 2002 Plan) and the 2005 Equity Compensation Plan for Non-Employee Directors of Praxair, Inc. (the 2005 Plan). Exercise prices for options granted under the 2002 and 2005 Plans may not be less than the closing market price of the company's common stock on the date of grant and granted options may not be repriced or exchanged without shareholder approval. Options granted under the 2002 and 2005 Plans become exercisable after a minimum of one year after the date of grant and have a maximum duration of ten years. The aggregate number of shares available for option and other equity grants is limited to 31,600,000 shares for the 2002 Plan and 500,000 shares for the 2005 Plan. As of September 30, 2006, 13,632,003 and 425,220 shares remained available for equity grants under the 2002 and 2005 Plans, respectively.

The company has the ability to repurchase shares on the open market to satisfy share option exercises and issues shares from treasury stock upon the exercise of certain stock options.

For further detail regarding the company's share-based compensation plans, refer to Note 17 to the consolidated financial statements included on page 58 of Praxair's 2005 Annual Report.

Fair Value

The company utilizes the Black-Scholes Options-Pricing Model to determine the fair value of stock options under SFAS No. 123R consistent with that used for pro forma disclosures in prior years. Management is required to make certain assumptions with respect to selected model inputs, including anticipated changes in the underlying stock price (i.e., expected volatility) and option exercise activity (i.e., expected life). Expected volatility is based on the historical volatility of the company's stock over the most recent period commensurate with the estimated expected life of the company's stock options and other factors. The expected life of options granted, which represents the period of time that the options are expected to be outstanding, is based primarily on historical data. The expected dividend yield is based on the company's most recent history and expectation of dividend payouts. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for a period commensurate with the estimated expected life. If factors change and result in different assumptions in the application of SFAS No. 123R in future periods, the stock option expense that the company records for future grants may differ significantly from what the company has recorded in the current period.

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The weighted-average fair value of options granted during the quarter and nine months ended September 30, 2006 was \$11.61 and \$10.85, respectively, (\$10.41 and \$10.16 for the same time periods in 2005, respectively) based on the Black-Scholes Options-Pricing model. The following weighted-average assumptions were used for grants in 2006 and 2005:

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------|--------------------------------|--------|------------------------------------|--------|
| | 2006 | 2005 | 2006 | 2005 |
| Dividend yield | 1.82% | 1.49% | 1.85% | 1.63% |
| Volatility | 17.20% | 19.87% | 17.64% | 22.69% |
| Risk-free interest rate | 5.20% | 4.07% | 4.65% | 3.93% |
| Expected term years | 5 | 5 | 5 | 5 |

Stock Option Activity

The following table summarizes option activity under the plans as of September 30, 2006 and changes during the nine-month period then ended (options are expressed in thousands; averages are calculated on a weighted basis; life in years; intrinsic value expressed in thousands):

| Activity | Number of Options | Average Exercise Price | Average Remaining Life | Aggregate Intrinsic Value |
|-----------------------------------|----------------------|---------------------------|------------------------------|---------------------------------|
| Outstanding at December 31, 2005 | 21,644 | \$ 30.04 | | |
| Granted | 4,017 | \$ 53.99 | | |
| Exercised | (2,768) | \$ 26.04 | | |
| Cancelled or expired | (65) | \$ 34.51 | | |
| Outstanding at September 30, 2006 | 22,828 | \$ 34.73 | 6.5 | \$ 557,726 |
| Exercisable at September 30, 2006 | 14,869 | \$ 27.66 | 5.3 | \$ 468,371 |

The aggregate intrinsic value represents the difference between the company's closing stock price of \$59.16 as of September 29, 2006 and the exercise price multiplied by the number of options outstanding as of that date. The total intrinsic value of stock options exercised during the quarter and nine months ended September 30, 2006 was \$29 million and \$82 million, respectively (\$25 million and \$74 million for the same time periods in 2005, respectively).

Cash received from option exercises under all share-based payment arrangements for the quarter and nine months ended September 30, 2006 was \$24 million and \$72 million, respectively. The actual tax benefit realized from stock option exercises totaled \$8 million and \$25 million, respectively, for the quarter and nine months ended September 30, 2006.

As of September 30, 2006, \$46 million of unrecognized compensation cost related to non-vested stock options is expected to be recognized over a weighted-average period of approximately 1.5 years.

In November 2005, the FASB issued FSP No. FAS 123(R)-3, Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards. This FSP provides an elective alternative simplified method for calculating the pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123R and reported in the Condensed Consolidated Statements of Cash Flows. Companies may take up to one year from the effective date of the FSP to evaluate the available transition alternatives and make a one-time election as to which method to adopt. The company will complete this evaluation and elect the appropriate transition method in the fourth quarter of 2006.

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The following table, which addresses the disclosure requirements of SFAS No. 148, illustrates the effect on net income and earnings per share as if the fair value recognition provisions of SFAS No. 123 had been applied to all outstanding and unvested awards in the prior year comparable periods:

| | Quarter Ended September 30, 2005 ^(a) | Nine Months Ended September 30, 2005 ^(a) |
|---|---|---|
| <i>(Millions of dollars, except per share data)</i> | | |
| NET INCOME: | | |
| As reported | \$ 108 | \$ 512 |
| Less: total stock-based employee compensation expense determined under fair value based method for all awards, net of \$3 million and \$10 million of income taxes in the quarter and nine months, respectively | (7) | (20) |
| Pro forma net income | \$ 101 | \$ 492 |
| BASIC EARNINGS PER SHARE: | | |
| As reported | \$ 0.33 | \$ 1.58 |
| Pro forma | \$ 0.31 | \$ 1.52 |
| DILUTED EARNINGS PER SHARE: | | |
| As reported | \$ 0.33 | \$ 1.55 |
| Pro forma | \$ 0.31 | \$ 1.49 |

- (a) Pro forma net income amounts for the quarter and nine months ended September 30, 2005 have each been reduced by \$1 million (\$0.00 per diluted share) from amounts previously reported, reflecting a change in expense recognition methodology related to full-retirement eligible employees. See Note 1 on page 47 of the 2005 Annual Report.

4. Inventories

The following is a summary of Praxair's consolidated inventories:

| | September 30, 2006 | December 31, 2005 |
|------------------------------|-----------------------|----------------------|
| <i>(Millions of dollars)</i> | | |
| Raw materials and supplies | \$ 108 | \$ 90 |
| Work in process | 54 | 67 |
| Finished goods | 238 | 216 |
| | \$ 400 | \$ 373 |

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The following is a summary of Praxair's outstanding debt at September 30, 2006 and December 31, 2005:

| <i>(Millions of dollars)</i> | September 30, 2006 | December 31, 2005 |
|---|-----------------------|----------------------|
| SHORT-TERM | | |
| Commercial paper and U.S. borrowings | \$ 42 | \$ |
| Canadian borrowings | 107 | 91 |
| South American borrowings | 36 | 32 |
| Asian borrowings | 91 | 95 |
| European borrowings | 10 | 9 |
| Other international borrowings | 17 | 4 |
| Total short-term debt | 303 | 231 |
| LONG-TERM | | |
| U.S. borrowings | | |
| 6.90% Notes due 2006 ^(c) | 250 | 250 |
| 4.75% Notes due 2007 ^(c) | 250 | 250 |
| 6.625% Notes due 2007 | 250 | 250 |
| 6.50% Notes due 2008 | 250 | 250 |
| 2.75% Notes due 2008 ^(a) | 300 | 299 |
| 6.375% Notes due 2012 ^(a, b) | 526 | 529 |
| 3.95% Notes due 2013 ^(a) | 349 | 349 |
| Other | 8 | 9 |
| European borrowings ^(c) | 572 | 786 |
| Canadian borrowings ^(c) | | 140 |
| South American borrowings | 80 | 54 |
| Asian borrowings | 21 | 34 |
| Other international borrowings | 4 | 4 |
| Obligations under capital leases | 11 | 12 |
| | 2,871 | 3,216 |
| Less: current portion of long-term debt | (47) | (290) |
| Total long-term debt | 2,824 | 2,926 |
| Total debt | \$ 3,174 | \$ 3,447 |

(a) Amounts are net of unamortized discounts.

(b) September 30, 2006 and December 31, 2005 amounts include a \$27 million and \$30 million fair value increase, respectively, related to SFAS 133 hedge accounting. See Note 14 on page 57 of the 2005 Annual Report.

(c) Classified as long-term because of the company's intent to refinance this debt on a long-term basis and the availability of such financing under the terms of existing agreements.

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The following table is a summary of the notional amount of currency derivatives outstanding at September 30, 2006 and December 31, 2005 (all maturities within one year):

| <i>(Millions of dollars)</i> | September 30, 2006 | December 31, 2005 |
|------------------------------|-----------------------|----------------------|
| CURRENCY CONTRACTS | | |
| Balance sheet items | \$ 650 | \$ 749 |
| Anticipated net income | | 12 |
| Forecasted transactions | 5 | 7 |
| | \$ 655 | \$ 768 |

Praxair enters into currency exchange forward contracts to manage its exposure to fluctuations in foreign currency exchange rates. Hedges of balance-sheet items are related to recorded balance-sheet exposures, including intercompany transactions. Hedges of forecasted transactions are for the purchase of equipment related to in-progress construction projects and have been designated as hedges for accounting purposes. The impact of the hedges of forecasted transactions will not be significant. There were no net income hedges outstanding at September 30, 2006 (\$12 million at December 31, 2005 related to anticipated net income in South America which settled January 2, 2006). Additionally, there were no notional value currency-exchange contracts that effectively offset each other at September 30, 2006 (\$104 million at December 31, 2005).

At September 30, 2006, the fair value of all derivative instruments was recorded in the condensed consolidated balance sheet as \$1 million in current assets and \$1 million in current liabilities (\$6 million in current assets at December 31, 2005). There were no interest-rate derivatives outstanding at September 30, 2006 or December 31, 2005.

7. Earnings Per Share

Basic earnings per share is computed by dividing net income for the period by the weighted average number of Praxair common shares outstanding. Diluted earnings per share is computed by dividing net income for the period by the weighted average number of Praxair common shares outstanding and dilutive common stock equivalents, as follows:

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|--|--------------------------------|---------|------------------------------------|---------|
| | 2006 | 2005 | 2006 | 2005 |
| NUMERATOR (MILLIONS OF DOLLARS) | | | | |
| Net income used in basic and diluted EPS | \$ 247 | \$ 108 | \$ 719 | \$ 512 |
| DENOMINATOR (THOUSANDS OF SHARES) | | | | |
| Weighted average shares outstanding | 322,524 | 323,027 | 322,588 | 322,846 |
| Shares earned and issuable under compensation plans | 1,058 | 1,110 | 1,047 | 1,105 |
| Weighted average shares used in basic earnings per share | 323,582 | 324,137 | 323,635 | 323,951 |
| Effect of dilutive securities | | | | |
| Convertible debt | | 114 | | 158 |
| Employee stock options | 5,916 | 5,742 | 5,877 | 5,744 |
| Weighted average shares used in diluted earnings per share | 329,498 | 329,993 | 329,512 | 329,853 |
| BASIC EARNINGS PER COMMON SHARE | \$ 0.76 | \$ 0.33 | \$ 2.22 | \$ 1.58 |
| DILUTED EARNINGS PER COMMON SHARE | \$ 0.75 | \$ 0.33 | \$ 2.18 | \$ 1.55 |

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There were 1,000 stock options and no stock options for shares excluded in the computation of diluted earnings per share for the quarters ended September 30, 2006 and 2005, respectively, because the exercise prices were greater than the average market price of the common stock. Stock options for 36,100 and 65,000 shares for the nine months ended September 30, 2006 and 2005, respectively, were excluded in the computation of diluted earnings per share because the exercise prices were greater than the average market price of the common stock.

8. Goodwill and Other Intangible Assets

SFAS No. 142, Goodwill and Other Intangible Assets, requires the company to perform an assessment at least annually as to whether there is an indication that the carrying value of goodwill is impaired at the reporting unit level. The annual impairment tests for 2005 and 2006 were performed during the second quarter of each year and no impairments were indicated.

Changes in the carrying amount of goodwill for the nine months ended September 30, 2006 were as follows:

| <i>(Millions of dollars)</i> | North America | South America | Europe | Asia | Surface Technologies | Total |
|------------------------------|------------------|------------------|--------|-------|-------------------------|----------|
| Balance, December 31, 2005 | \$ 991 | \$ 161 | \$ 293 | \$ 26 | \$ 74 | \$ 1,545 |
| Acquisitions | 1 | 1 | | | | 2 |
| Purchase adjustments | 3 | | | | | 3 |
| Foreign currency translation | 5 | 14 | 21 | 2 | 4 | 46 |
| Other | | | 2 | | | 2 |
| Balance, September 30, 2006 | \$ 1,000 | \$ 176 | \$ 316 | \$ 28 | \$ 78 | \$ 1,598 |

Changes in the carrying amount of other intangibles for the nine months ended September 30, 2006 were as follows:

| | Customer & License/Use Agreements | Non-compete Agreements | Patents & Other | Total |
|-----------------------------------|---|---------------------------|--------------------|---------|
| Cost: | | | | |
| Balance, December 31, 2005 | \$ 71 | \$ 38 | \$ 17 | \$ 126 |
| Additions | 3 | 1 | | 4 |
| Foreign currency translation | 1 | 1 | | 2 |
| Other | (6) | (2) | (1) | (9) |
| Balance, September 30, 2006 | \$ 69 | \$ 38 | \$ 16 | \$ 123 |
| Less: Accumulated amortization | | | | |
| Balance, December 31, 2005 | \$ (22) | \$ (18) | \$ (5) | \$ (45) |
| Amortization expense | (5) | (6) | (1) | (12) |
| Foreign currency translation | | | | |
| Other | 3 | 2 | | 5 |
| Balance, September 30, 2006 | \$ (24) | \$ (22) | \$ (6) | \$ (52) |
| Net balance at September 30, 2006 | \$ 45 | \$ 16 | \$ 10 | \$ 71 |

There are no expected residual values related to these intangible assets. The remaining weighted-average amortization period for intangible assets is approximately 12 years. Total estimated annual amortization expense is \$4 million for the remainder of 2006; \$13 million, \$9 million, \$7 million and \$6 million for the years ended December 31, 2007, 2008, 2009 and 2010, respectively; and \$32 million thereafter.

Table of Contents**9. Pension and OPEB**

The components of net pension and postretirement benefits other than pensions (OPEB) costs for the quarters and nine-month periods ended September 30, 2006 and 2005 are shown below:

| <i>(Millions of dollars)</i> | Quarter Ended September 30, | | | | Nine Months Ended September 30, | | | |
|--------------------------------|--------------------------------|-------|------|------|---------------------------------|-------|-------|-------|
| | Pensions | | OPEB | | Pensions | | OPEB | |
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Service cost | \$ 11 | \$ 8 | \$ 1 | \$ 1 | \$ 32 | \$ 26 | \$ 5 | \$ 4 |
| Interest cost | 24 | 22 | 4 | 4 | 72 | 66 | 12 | 12 |
| Expected return on plan assets | (29) | (25) | | | (86) | (75) | | |
| Net amortization and deferral | 7 | 5 | | | 21 | 15 | | (1) |
| Net periodic benefit cost | \$ 13 | \$ 10 | \$ 5 | \$ 5 | \$ 39 | \$ 32 | \$ 17 | \$ 15 |

Praxair estimates that 2006 contributions to its pension plans will be in the area of \$125 million, including required contributions. Contributions of \$119 million have been made through September 2006.

10. Legal Proceedings

Praxair is subject to various lawsuits and government investigations from time to time. These actions are based upon alleged environmental, tax, antitrust and personal injury claims, among others. While Praxair may incur a loss in connection with some of these actions, management does not anticipate that they will have a material adverse effect on the company's consolidated financial position, results of operations or cash flows in any given year (see Note 19 on page 63 of the 2005 Annual Report).

Among such matters are claims brought by welders alleging that exposure to manganese contained in welding fumes caused neurological injury. Praxair has never manufactured welding consumables. Such products were manufactured prior to 1985 by a predecessor company of Praxair. As of September 30, 2006, Praxair was a co-defendant with many other companies in 1,911 lawsuits alleging personal injury caused by manganese contained in welding fumes. There were a total of 6,284 individual claimants in these cases. The cases were pending in several state and federal courts. The federal cases are being transferred to the U.S. District Court for the Northern District of Ohio for coordinated pretrial proceedings. The plaintiffs seek unspecified compensatory and, in most instances, punitive damages. Eight of the cases are proposed class actions seeking medical monitoring on behalf of welders. None of the class actions have been certified. In the past, Praxair has either been dismissed from the cases with no payment or has settled a few cases for nominal amounts. No reserves have been recorded for these cases as management does not believe that a loss from them is probable or reasonably estimable.

Praxair has strong defenses in these cases and intends to defend itself vigorously.

Table of Contents**11. Segments**

Sales and operating profit by segment for the quarters and nine-month periods ended September 30, 2006 and 2005 are shown below. Effective in 2006, Praxair changed its presentation of segment sales to reflect external sales only. Segment operating profit was not impacted. Prior period information has been reclassified to conform to current period presentation (for a description of Praxair's operating segments, see Note 4 on page 49 of the 2005 Annual Report):

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|--------------------------------|----------|------------------------------------|----------|
| | 2006 | 2005 | 2006 | 2005 |
| <i>(Dollar amounts in millions)</i> | | | | |
| SALES^(a) | | | | |
| North America | \$ 1,187 | \$ 1,087 | \$ 3,514 | \$ 3,244 |
| Europe | 293 | 258 | 857 | 830 |
| South America | 340 | 292 | 997 | 810 |
| Asia | 165 | 136 | 467 | 395 |
| Surface Technologies ^(b) | 114 | 117 | 366 | 357 |
| | \$ 2,099 | \$ 1,890 | \$ 6,201 | \$ 5,636 |
| OPERATING PROFIT | | | | |
| North America | \$ 204 | \$ 165 | \$ 619 | \$ 492 |
| Europe | 69 | 63 | 193 | 202 |
| South America | 69 | 52 | 184 | 146 |
| Asia | 27 | 24 | 78 | 70 |
| Surface Technologies ^(b) | 23 | 13 | 52 | 38 |
| | \$ 392 | \$ 317 | \$ 1,126 | \$ 948 |

(a) Represents external sales. Intersegment sales, primarily from North America, totaled \$19 million and \$51 million for the quarter and nine months ended September 30, 2006, respectively, versus \$16 million and \$43 million for the respective 2005 periods.

(b) On July 3, 2006, Praxair completed the sale of its aviation services business, which contributed full year 2005 sales of approximately \$80 million (\$67 million of which was reflected in the Surface Technologies segment).

12. Income Taxes

During the 2005 third quarter, Praxair recorded a \$92 million, or \$0.28 per diluted share, income tax charge for the repatriation of foreign earnings and other tax adjustments (see Note 7 on page 50 of the 2005 Annual Report).

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Consolidated Results**

The following table provides summary data for the quarters and nine-month periods ended September 30, 2006 and 2005:

| <i>(Dollar amounts in millions)</i> | Quarter Ended September 30, | | | Nine Months Ended September 30, | | |
|-------------------------------------|-----------------------------|----------|----------|---------------------------------|----------|----------|
| | 2006 | 2005 | Variance | 2006 | 2005 | Variance |
| Sales | \$ 2,099 | \$ 1,890 | +11% | \$ 6,201 | \$ 5,636 | +10% |
| Gross margin ^(a) | \$ 840 | \$ 746 | +13% | \$ 2,497 | \$ 2,216 | +13% |
| As a percent of sales | 40.0% | 39.5% | | 40.3% | 39.3% | |
| Selling, general and administrative | \$ 272 | \$ 243 | +12% | \$ 816 | \$ 735 | +11% |
| As a percent of sales | 13.0% | 12.9% | | 13.2% | 13.0% | |
| Depreciation and amortization | \$ 173 | \$ 165 | +5% | \$ 518 | \$ 490 | +6% |
| Other income (expenses) net | \$ 18 | \$ (2) | | \$ 27 | \$ 15 | |
| Operating profit | \$ 392 | \$ 317 | +24% | \$ 1,126 | \$ 948 | +19% |
| Interest expense net | \$ 38 | \$ 40 | -5% | \$ 117 | \$ 123 | -5% |
| Income tax expense | \$ 101 | \$ 163 | -38% | \$ 274 | \$ 296 | -7% |
| Effective tax rate | 28.5% | 58.8% | | 27.2% | 35.9% | |
| Net income | \$ 247 | \$ 108 | +129% | \$ 719 | \$ 512 | +40% |

(a) Gross margin excludes depreciation and amortization expense.

Sales increased \$209 million, or 11%, for the third quarter and \$565 million, or 10%, for the nine months ended September 30, 2006 versus the respective 2005 periods. Volume growth of 6% for the quarter and 4% year-to-date reflects continued strong volumes to the manufacturing, electronics, and metals end-markets. Price increases of 4% for the quarter and year-to-date periods, respectively, were predominantly realized in North America due to pricing actions, the pass-through of higher power costs and surcharges. Currency favorably impacted sales growth by 2% for the quarter and year-to-date periods. The pass-through of natural gas costs to on-site hydrogen customers decreased sales by 1% for the quarter and was neutral to sales year-to-date with minimal impact on operating profit.

Gross margin in 2006 improved \$94 million, or 13%, for the third quarter and \$281 million, or 13%, for the nine months ended September 30, 2006 versus the respective 2005 periods. The 50 and 100 basis point increases in the third quarter and year-to-date gross margin percentages, to 40.0% and 40.3%, respectively, were due primarily to realized price increases and cost reduction programs which continued to outpace underlying inflationary cost pressures.

Selling, general and administrative expenses for the third quarter were \$272 million, or 13.0% of sales, versus \$243 million for the respective 2005 period. Selling, general and administrative expenses for the nine-month period were \$816 million, or 13.2% of sales, versus \$735 million for the respective 2005 period. Stock option expense increased selling, general and administrative expenses by \$9 million and \$29 million for the quarter and nine months ended September 30, 2006, respectively. Including pro forma stock option expense of \$9 million and \$28 million in the quarter and nine months ended September 25, 2005, respectively, selling, general and administrative expenses were 13.3% and 13.5% of sales, respectively. The underlying increase was due to currency, acquisitions, and inflationary pressures partially offset by productivity initiatives.

Depreciation and amortization expense increased \$8 million, or 5%, for the third quarter and \$28 million, or 6%, for the nine months ended September 30, 2006 versus the respective 2005 periods. The increase was principally due to the incremental impact of capital spending and currency effects.

Other income (expenses) net for the quarter ended September 30, 2006 included a gain of \$14 million relating to two divestitures, the aviation services business and a Turkish joint venture. The 2005 quarter included an \$8 million charge for fixed asset write-offs and insurance matters related to Hurricanes Katrina and Rita. The 2006 year-to-date includes the impact of the two divestitures and a \$15 million gain resulting from insurance recoveries in the second quarter. Included in 2005 year-to-date other income is a benefit of \$11 million recorded in the first quarter associated with a \$20 million favorable settlement of a customer obligation net of a \$9 million charge for various legal matters and insurance accruals, an \$8 million charge in the second quarter associated with a fire at the St. Louis distribution facility and the third quarter hurricane charge. Higher partnership income also contributed to the increase in the quarter and year to date periods.

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Operating profit increased \$75 million or 24% for the third quarter and \$178 million or 19% for the nine months ended September 30, 2006 versus the respective 2005 periods. Stock option expense reduced operating profit by \$10 million and \$32 million for the quarter and nine months ended September 30, 2006, respectively. Including pro forma stock option expense of \$10 million and \$30 million in the quarter and nine months ended September 30, 2005, respectively, underlying operating profit increased \$85 million, or 28%, for the quarter and \$208 million, or 23% for the nine-month period. Increased volumes and the continued impact of focused productivity initiatives were the primary drivers of growth in both the quarter and year-to-date periods. The 2006 quarter included a \$14 million gain relating to two divestitures and the 2005 quarter included a \$15 million adverse impact of Hurricanes Katrina and Rita.

Interest expense net decreased \$2 million, or 5% for the third quarter and decreased \$6 million, or 5%, for the nine-month period ended September 30, 2006 versus 2005 as a result of lower debt balances in the second and third quarters of 2006.

The effective tax rate was 28.5% for the third quarter and 27.2% for the nine-month period versus 58.8% and 35.9%, respectively, for the same periods in 2005. The 2006 quarter and year to date periods include \$11 million of income tax charges related to the divestiture of its aviation services business and a Turkish joint venture. The 2005 third quarter and year to date periods included an income tax charge of \$92 million for the repatriation of foreign earnings and other tax adjustments (see Note 12 to the condensed consolidated financial statements). Excluding these and other discrete tax items, the underlying effective tax rates for the quarter and year-to-date periods were approximately 26.5% in 2006 and 26% in 2005.

Net income increased \$139 million, or 129%, for the third quarter and \$207 million, or 40%, for the nine months ended September 30, 2006 versus the respective 2005 periods. Stock option expense reduced net income by \$7 million and \$21 million for the quarter and nine months ended September 30, 2006, respectively. The 2005 quarter and year to date periods include the impact of the \$92 million income tax charge. Excluding the impact of the income tax charge in the 2005 periods, and including pro forma stock option expense of \$7 million and \$20 million in the quarter and nine months ended September 30, 2005, net income increased \$54 million, or 28% for the quarter and \$135 million or 23% on a year to date basis. Operating profit growth was the primary driver of the net income improvement.

The number of employees at September 30, 2006 was 26,926, reflecting a decrease of 380 employees from December 31, 2005, primarily due to the divestiture of the aviation services business.

Table of Contents**Segment Discussion**

The following summary of sales and operating profit by segment provides a basis for the discussion that follows:

| <i>(Dollar amounts in millions)</i> | Quarter Ended September 30, | | | Nine Months Ended September 30, | | |
|-------------------------------------|------------------------------------|-----------------|-----------------|--|-----------------|-----------------|
| | 2006 | 2005 | Variance | 2006 | 2005 | Variance |
| SALES^(a) | | | | | | |
| North America | \$ 1,187 | \$ 1,087 | +9% | \$ 3,514 | \$ 3,244 | +8% |
| Europe | 293 | 258 | +14% | 857 | 830 | +3% |
| South America | 340 | 292 | +16% | 997 | 810 | +23% |
| Asia | 165 | 136 | +21% | 467 | 395 | +18% |
| Surface Technologies | 114 | 117 | -3% | 366 | 357 | +3% |
| | \$ 2,099 | \$ 1,890 | +11% | \$ 6,201 | \$ 5,636 | +10% |
| OPERATING PROFIT | | | | | | |
| North America | \$ 204 | \$ 165 | +24% | \$ 619 | \$ 492 | +26% |
| Europe | 69 | 63 | +10% | 193 | 202 | -4% |
| South America | 69 | 52 | +33% | 184 | 146 | +26% |
| Asia | 27 | 24 | +13% | 78 | 70 | +11% |
| Surface Technologies | 23 | 13 | +77% | 52 | 38 | +37% |
| | \$ 392 | \$ 317 | +24% | \$ 1,126 | \$ 948 | +19% |

(a) 2005 sales have been reclassified to conform to the 2006 presentation. See Note 11 to the condensed consolidated financial statements.

North America

Sales increased \$100 million, or 9%, for the third quarter and \$270 million, or 8%, for the nine months ended September 30, 2006 versus the respective 2005 periods. Sales increased 11% for the quarter and 8% for the year-to-date period excluding the impact of the pass-through of lower natural gas costs to on-site hydrogen customers, which has a minimal impact on operating profit. Pricing increased sales by 5% for the quarter and year-to-date periods due to the contractual pass-through of higher power costs to on-site customers, surcharges for higher power and transportation fuel costs for merchant and packaged gases, and the impact of pricing actions. Overall volume increased 5% and 2% for the quarter and year-to-date periods reflecting higher on-site, liquid and packaged gases volumes as well as increased sales to the metals, manufacturing and electronics end-markets. Currency contributed 1% to sales growth for the quarter and year-to-date periods.

Operating profit increased \$39 million, or 24%, for the third quarter and \$127 million, or 26%, for the nine months ended September 30, 2006 versus the respective 2005 periods. The quarter and nine months ended September 30, 2006 included \$6 million and \$18 million of stock option expense, respectively. Including pro forma stock option expense of \$6 million and \$17 million in the quarter and nine months ended September 30, 2005, respectively, underlying operating profit increased \$45 million, or 28%, for the quarter and \$129 million, or 27%, for the nine-month period. Year-to-date operating profit growth includes a \$15 million benefit from insurance recoveries in the second quarter 2006. Increased volumes to the metals, electronics and manufacturing markets and productivity initiatives were the primary drivers to the underlying operating profit growth in the quarter and year-to-date periods. Favorable currency increased operating profit 2% in the quarter and year-to-date periods. The 2005 quarter included the adverse effect of Hurricanes Katrina and Rita.

Europe

Sales increased \$35 million, or 14%, for the third quarter and \$27 million, or 3%, for the nine months ended September 30, 2006 versus the respective 2005 periods. Excluding the impact of currency, sales increased 10% for the quarter and 6% for the year-to-date period, principally due to higher volumes in Spain and Italy and sales growth to the electronics and healthcare end-markets.

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Operating profit increased \$6 million, or 10%, for the third quarter and decreased \$9 million, or 4%, for the nine months ended September 30, 2006 versus the respective 2005 periods. The quarter and nine months ended September 30, 2006 included a gain of \$5 million from the divestiture of a Turkish joint venture, and \$2 million and \$4 million of stock option expense, respectively. Excluding the impact of the divestiture from the 2006 periods and including pro forma stock option expense of \$1 million and \$3 million in the quarter and nine months ended September 30, 2005, respectively, underlying operating profit increased \$2 million, or 3%, for the quarter and decreased \$11 million, or 6%, for the nine-month period. Currency contributed 5% growth for the quarter and decreased operating profit 3% for the year-to-date period. Increased price competition in the merchant liquid market limited the pass through of higher power costs the impact of which was partially offset by productivity and cost reduction initiatives.

South America

Sales increased \$48 million, or 16%, for the third quarter and \$187 million, or 23%, for the nine months ended September 30, 2006 versus the respective 2005 periods. Excluding the impact of currency, sales increased 10% for the quarter and 12% year-to-date primarily due to higher volumes due to three plant start-ups in the quarter and increased volumes to the metals, energy and healthcare markets. Additionally, an equipment sale to a Venezuela customer contributed to 2% sales growth in the third quarter and 3% sales growth on a year-to-date basis.

Operating profit increased \$17 million, or 33%, for the third quarter and \$38 million, or 26%, for the nine months ended September 30, 2006 versus the respective 2005 periods. The quarter and nine months ended September 30, 2006 included \$1 million and \$5 million of stock option expense, respectively. Including pro forma stock option expense of \$1 million and \$4 million in the quarter and nine months ended September 30, 2005, respectively, underlying operating profit increased \$18 million, or 35%, for the quarter and \$42 million, or 30%, for the nine-month period. Favorable currency contributed 15% growth for the quarter and 16% for the year-to-date period. Increased volumes and cost-reduction programs continued to outpace inflationary pressures, favorably contributing to operating profit growth.

Asia

Sales increased \$29 million, or 21%, for the third quarter and \$72 million, or 18%, for the nine months ended September 30, 2006 versus the respective 2005 periods. Sales growth was principally due to strong volumes of gases and electronic materials to the electronics end-markets as demand for specialty gas in the semiconductor and LCD markets and sputtering targets remained strong, as well as increased volumes to the metals end-market.

Operating profit increased \$3 million, or 13%, for the third quarter and \$8 million, or 11%, for the nine months ended September 30, 2006 versus the respective 2005 periods. The quarter and nine months ended September 30, 2006 included \$1 million and \$3 million of stock option expense, respectively. Including pro forma stock option expense of \$1 million and \$3 million in the quarter and nine months ended September 30, 2005, respectively, underlying operating profit increased \$4 million, or 17%, for the quarter and \$11 million, or 16%, for the nine-month period. Increased sales volumes and productivity initiatives were the primary drivers of operating profit growth.

Surface Technologies

On July 3, 2006, Praxair completed the previously announced sale of its aviation services business, which contributed full year 2005 sales of approximately \$67 million to the Surface Technologies segment.

Sales decreased \$3 million, or 3%, for the third quarter and increased \$9 million, or 3%, for the nine months ended September 30, 2006 versus the respective 2005 periods. Excluding the impact of the aviation services divestiture, sales increased 11% for the quarter and 8% for the year-to-date period. Volume contributed 5% growth for the quarter and 4% year-to-date driven by higher coatings volumes for OEM aircraft engine parts, oil field service components, and power turbines. Realized price increases were 4% for the quarter and 5% year-to-date. Currency increased sales 2% for the quarter and decreased sales 1% for the year-to-date period.

Operating profit increased \$10 million, or 77%, for the third quarter and \$14 million, or 37%, for the nine months ended September 30, 2006 versus the respective 2005 periods. The quarter and nine months ended September 30, 2006 included a gain of approximately \$7 million from the aviation services divestiture, and less than \$1 million and \$2 million of stock option expense, respectively. Excluding the gain on the sale of a business from the 2006 periods and including pro forma stock option expense of \$1 million and \$3 million in the quarter and nine months ended September 30, 2005, respectively, underlying operating profit increased \$4 million, or 33%, for the quarter and \$10 million, or 29%, for the nine-month period. The increase was principally driven by higher sales volumes and the favorable benefits of ongoing cost reduction actions.

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Currency

The results of Praxair's non-U.S. operations are translated to the company's reporting currency, the U.S. dollar, from the functional currencies used in the countries in which the company operates. For most foreign operations, Praxair uses the local currency as its functional currency. There is inherent variability and unpredictability in the relationship of these functional currencies to the U.S. dollar and such currency movements may materially impact Praxair's results of operations in any given period.

To help understand the reported results, the following is a summary of the significant currencies underlying Praxair's consolidated results and the exchange rates used to translate the financial statements (rates of exchange expressed in units of local currency per U.S. dollar):

| Currency | Percent of YTD 2006 Consolidated Sales ^(a) | Income Statement Year-To-Date Average | | Balance Sheet | |
|--------------------|--|--|-------|-----------------------|----------------------|
| | | 2006 | 2005 | September 30, 2006 | December 31, 2005 |
| Brazilian real | 14% | 2.18 | 2.49 | 2.17 | 2.34 |
| European euro | 13% | 0.81 | 0.79 | 0.79 | 0.85 |
| Canadian dollar | 9% | 1.14 | 1.23 | 1.12 | 1.17 |
| Mexican peso | 5% | 10.91 | 11.02 | 10.99 | 10.68 |
| Chinese RMB | 2% | 8.02 | 8.24 | 7.90 | 8.07 |
| Indian rupee | 2% | 45.41 | 43.69 | 45.93 | 45.20 |
| Korean won | 2% | 966 | 1,022 | 945 | 1,013 |
| Argentinean peso | 1% | 3.07 | 2.90 | 3.10 | 3.03 |
| Venezuelan bolivar | 1% | 2,150 | 2,093 | 2,150 | 2,150 |

(a) Certain Surface Technologies segment sales are included in European and Brazilian sales.

Table of Contents**Liquidity, Capital Resources and Other Financial Data**

The following selected cash flow information provides a basis for the discussion that follows:

| <i>(Millions of dollars)</i> | Nine Months Ended September 30, | |
|--|--|-------------|
| | 2006 | 2005 |
| NET CASH PROVIDED BY (USED FOR): | | |
| OPERATING ACTIVITIES | | |
| Net income | \$ 719 | \$ 512 |
| Depreciation and amortization | 518 | 490 |
| Accounts receivable | (98) | (115) |
| Inventory | (33) | (41) |
| Payables and accruals | 109 | 257 |
| Pension contributions | (119) | (78) |
| Other net | 93 | 74 |
| Net cash provided by operating activities | \$ 1,189 | \$ 1,099 |
| INVESTING ACTIVITIES | | |
| Capital expenditures | \$ (800) | \$ (598) |
| Acquisitions | (7) | (8) |
| Divestitures and asset sales | 112 | 25 |
| Net cash used for investing activities | \$ (695) | \$ (581) |
| FINANCING ACTIVITIES | | |
| Debt reductions - net | \$ (346) | \$ (192) |
| Excess tax benefit on stock option exercises | 18 | |
| Issuances of common stock | 203 | 192 |
| Purchases of common stock | (262) | (332) |
| Cash dividends | (242) | (174) |
| Minority transactions and other | (18) | (18) |
| Net cash used for financing activities | \$ (647) | \$ (524) |

Cash Flow from Operations

Cash provided by operations of \$1,189 million for the nine months ended September 30, 2006 increased \$90 million, or 8%, versus 2005. The increase was principally the result of strong cash flow generated from higher sales and net income partially offset by increases in U.S. pension contributions and U.S. income tax payments.

Investing

Net cash used for investing of \$695 million for the nine months ended September 30, 2006 increased \$114 million, or 20%, versus 2005 primarily due to an increase in capital expenditures in North America and Asia versus the year ago periods. This was partially offset by cash received from the divestiture of the aviation services business and a Turkish joint venture during the third quarter 2006.

Financing

Cash used for financing activities of \$647 million for the nine months ended September 30, 2006 increased \$123 million versus the respective 2005 period. For the nine months ended September 30, 2006, cash dividends were \$0.75 per share compared to \$0.54 per share for 2005,

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resulting in a \$68 million, or 39%, increase in cash dividends paid. At September 30, 2006, Praxair's total debt

outstanding was \$3,174 million, \$273 million lower than \$3,447 million at December 31, 2005 primarily due to net cash repayments of \$346 million and currency. These increases were partially offset by a decrease in purchases of common stock activity of \$70 million. During the fourth quarter of 2006, Praxair intends to issue new debt of at least \$250 million, subject to market conditions, to be used in the refinancing of existing maturing debt and other general corporate purposes.

Table of Contents**Legal Proceedings**

See Note 10 to the condensed consolidated financial statements for a description of current legal proceedings.

Other Financial Data

Definitions of the following non-GAAP measures may not be comparable to similar definitions used by other companies. Praxair believes that its debt-to-capital ratio is appropriate for measuring its financial leverage. The company believes that its after-tax return on invested capital ratio is an appropriate measure for judging performance as it reflects the approximate after-tax profit earned as a percentage of investments by all parties in the business (debt, minority interests and shareholders' equity).

| <i>(Dollar amounts in millions)</i> | September 30, 2006 | | December 31, 2005 | |
|--|---|-------------|---|-------------|
| <u>TOTAL CAPITAL</u> | | | | |
| Debt | \$ | 3,174 | \$ | 3,447 |
| Minority interests | | 209 | | 202 |
| Shareholders' equity | | 4,494 | | 3,902 |
| | \$ | 7,877 | \$ | 7,551 |
| DEBT-TO-CAPITAL RATIO | | 40.3% | | 45.6% |
| | | | | |
| | Quarter Ended September 30, 2006 | | Nine Months Ended September 30, 2006 | |
| | | 2005 | | 2005 |
| <u>AFTER-TAX RETURN ON CAPITAL (ROC)</u> | | | | |
| Adjusted operating profit ^(a) | \$ | 392 | \$ | 1,126 |
| Less: adjusted taxes ^(a,c) | | (101) | | (274) |
| Less: tax benefit on interest expense ^(b) | | (10) | | (31) |
| Add: equity income | | 1 | | 6 |
| | | 2 | | 11 |
| Net operating profit after-tax (NOPAT) | \$ | 282 | \$ | 827 |
| | | 231 | | 703 |
| Beginning capital | \$ | 7,926 | \$ | 7,551 |
| Ending capital | \$ | 7,877 | \$ | 7,877 |
| Average capital | \$ | 7,902 | \$ | 7,714 |
| ROC % | | 3.6% | | 10.7% |
| ROC % (annualized) | | 14.3% | | 12.7% |

(a) The quarter and nine months ended September 30, 2005 have been adjusted to include pro forma stock option expense of \$10 million (\$7 million net of tax) and \$30 million (\$20 million net of tax), respectively.

(b) Tax benefit on interest expense is based on Praxair's underlying effective tax rates of 26.5% for 2006 and 26% for 2005.

(c) The third quarter 2005 excludes the impact of a \$92 million income tax charge for the repatriation of foreign earnings and other tax adjustments (see Note 12 to the condensed consolidated financial statements).

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New Accounting Standards

Refer to Note 2 to the condensed consolidated financial statements for information concerning new accounting standards.

Outlook

For the fourth quarter of 2006, diluted earnings per share are expected to be in the range of \$0.75 to \$0.78.

For the full year of 2006, Praxair expects year-over-year sales growth in the area of 10%. Diluted earnings per share are expected to be in the range of \$2.93 to \$2.96, including an estimated stock option expense of \$0.08 per share. Full-year capital expenditures are expected to be in the range of \$1.05 billion to \$1.10 billion, supporting a growing backlog of new projects and new business in all geographic regions. Praxair expects an effective tax rate in the range of 26% to 27% for 2006.

Praxair provides quarterly updates on operating results, material trends that may affect financial performance, and financial earnings guidance via quarterly earnings releases and investor teleconferences. These updates are available on the company's website: www.praxair.com, but are not incorporated herein.

Forward-looking Statements

This document contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on management's reasonable expectations and assumptions as of the date the statements are made but involve risks and uncertainties. These risks and uncertainties include, without limitation: the performance of stock markets generally; developments in worldwide and national economies and other international events and circumstances; changes in foreign currencies and in interest rates; the cost and availability of electric power, natural gas and other raw materials; the ability to achieve price increases to offset cost increases; catastrophic events; the ability to attract, hire, and retain qualified personnel; the impact of changes in financial accounting standards; the impact of tax and other legislation and government regulation in jurisdictions in which the company operates; the cost and outcomes of litigation and regulatory agency actions; continued timely development and market acceptance of new products and applications; the impact of competitive products and pricing; future financial and operating performance of major customers and industries served; and the effectiveness and speed of integrating new acquisitions into the business. These risks and uncertainties may cause actual future results or circumstances to differ materially from the projections or estimates contained in the forward-looking statements. The company assumes no obligation to update or provide revisions to any forward-looking statement in response to changing circumstances. The above listed risks and uncertainties are further described in Item 1A (Risk Factors) in the company's latest Annual Report on Form 10-K filed with the SEC which should be reviewed carefully. Please consider the company's forward-looking statements in light of those risks.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Refer to the Market Risks and Sensitivity Analyses discussion on page 43 in the Management's Discussion and Analysis section of Praxair's 2005 Annual Report.

Item 4. Controls and Procedures

- (a) Based on an evaluation of the effectiveness of Praxair's disclosure controls and procedures (the Evaluation), which evaluation was made under the supervision and with the participation of management, including Praxair's principal executive officer and principal financial officer, the principal executive officer and principal financial officer have each concluded that, as of the end of the quarterly period covered by this report, such disclosure controls and procedures are effective in ensuring that information required to be disclosed by Praxair in reports that it files under the Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.
- (b) There were no changes in Praxair's internal control over financial reporting that occurred during the quarterly period covered by this report that have materially affected, or are reasonably likely to materially affect, Praxair's internal control over financial reporting.

Table of Contents**PART II - OTHER INFORMATION***Praxair, Inc. and Subsidiaries***Item 1. Legal Proceedings**

See Note 10 to the condensed consolidated financial statements for a description of current legal proceedings.

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A. to Part I of Praxair's 2005 Form 10-K.

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

Purchases of Equity Securities - Certain information regarding purchases made by or on behalf of the company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, as amended) of its common stock during the quarter ended September 30, 2006 is provided below:

| Period | Total Number of Shares Purchased (Thousands) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾ (Thousands) | Maximum Number of Shares that May Yet be Purchased Under the Program ⁽²⁾ |
|--------------------|---|---------------------------------------|---|--|
| July 2006 | | | | N/A |
| August 2006 | 575 | \$ 54.39 | 575 | N/A |
| September 2006 | 233 | \$ 59.39 | 233 | N/A |
| Third Quarter 2006 | 808 | \$ 55.83 | 808 | N/A |

- (1) On January 20, 1997, the company's Board of Directors approved a share repurchase program which authorized the company to repurchase shares of its common stock from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to the company in order to offset some or all of such shares issued pursuant to the company's employee benefit plans and its Dividend Reinvestment and Stock Purchase Plan. The company announced this program on January 21, 1997. The program has no expiration date.

- (2) The Board-approved program does not contain any quantitative limit on the total number of shares, or dollar value, that may be purchased.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits:

12.01 Computation of Ratio of Earnings to Fixed Charges

31.01 Rule 13a-14(a) Certification

31.02 Rule 13a-14(a) Certification

32.01 Section 1350 Certification (such certifications are furnished for the information of the Commission and shall not be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act)

32.02 Section 1350 Certification (such certifications are furnished for the information of the Commission and shall not be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act)

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SIGNATURE

Praxair, Inc. and Subsidiaries

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PRAXAIR, INC.

(Registrant)

Date: October 25, 2006

By: /s/ Patrick M. Clark
Patrick M. Clark
Vice President and Controller
(On behalf of the Registrant
and as Chief Accounting Officer)