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	**06-1249050**
(Commission File Number)	**(IRS Employer**

Identification No.)

39 OLD RIDGEBURY ROAD, DANBURY, CT	**06810-5113**
(Address of principal executive offices)	**(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 x 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 x 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 x**

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

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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.

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PRAXAIR, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(Millions of dollars, except per share data)

(UNAUDITED)

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 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.

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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

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

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PRAXAIR, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

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

(UNAUDITED)

Activity	Common Stock Shares	Common Stock Amounts	Additional Paid-In Capital	Treasury Stock Shares	Treasury Stock Amounts	Retained Earnings	Accumulated Other Comprehensive Income (Loss)[b]	Total
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, 2006	Quarter Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 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

	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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Pro Forma Information Under SFAS 123 for Periods Prior to 2006

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:

(Millions of dollars, except per share data)	Quarter Ended September 30, 2005[(a)]	Nine Months Ended September 30, 2005[(a)]
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:

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

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5. Debt

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

(Millions of dollars)	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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6. Financial Instruments

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):

(Millions of dollars)	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