

PRAXAIR INC  
Form 10-Q  
July 26, 2006

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 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 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

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

At June 30, 2006, 322,358,375 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<br>June 30, |    |         |
|--|----|---------------------------|----|---------|
|  |    | 2006                      |    | 2005    |
| SALES  | \$ | 2,076                     | \$ | 1,919   |
| Cost of sales, exclusive of<br>depreciation and amortization |    | 1,238                     |    | 1,167   |
| Selling, general and administrative                          |    | 271                       |    | 247     |
| Depreciation and amortization                                |    | 174                       |    | 163     |
| Research and development                                     |    | 22                        |    | 19      |
| Other income (expense) - net                                 |    | 11                        |    | (1)     |
| OPERATING PROFIT   |    | 382                       |    | 322     |
| Interest expense - net                                       |    | 41                        |    | 41      |
| INCOME BEFORE INCOME TAXES                                   |    | 341                       |    | 281     |
| Income taxes   |    | 90                        |    | 64      |
|  |    | 251                       |    | 217     |
| Minority interests   |    | (7)                       |    | (13)    |
| Income from equity investments                               |    | 3                         |    | 5       |
| NET INCOME   | \$ | 247                       | \$ | 209     |
| <br>PER SHARE DATA:  |    |                           |    |         |
| Basic earnings per share                                     | \$ | 0.76                      | \$ | 0.65    |
| Diluted earnings per share                                   | \$ | 0.75                      | \$ | 0.63    |
| Cash dividends per share                                     | \$ | 0.25                      | \$ | 0.18    |
| <br>WEIGHTED AVERAGE SHARES<br>OUTSTANDING (000's):          |    |                           |    |         |
| Basic shares outstanding                                     |    | 323,519                   |    | 323,898 |
| Diluted shares outstanding                                   |    | 329,880                   |    | 329,818 |

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

**PRAXAIR, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(Millions of dollars, except per share data)  
(UNAUDITED)

|  | Six Months Ended<br>June 30, |         |          |
|--|------------------------------|---------|----------|
|  | 2006                         |         | 2005     |
| SALES  | \$                           | 4,102   | \$ 3,746 |
| Cost of sales, exclusive of<br>depreciation and amortization         |                              | 2,445   | 2,276    |
| Selling, general and administrative<br>Depreciation and amortization |                              | 544     | 492      |
| Research and development   |                              | 345     | 325      |
| Other income (expense) - net   |                              | 43      | 39       |
| OPERATING PROFIT   |                              | 9       | 17       |
| Interest expense - net   |                              | 734     | 631      |
| INCOME BEFORE INCOME TAXES   |                              | 79      | 83       |
| Income taxes   |                              | 655     | 548      |
| Minority interests   |                              | 173     | 133      |
| Income from equity investments                                       |                              | 482     | 415      |
| NET INCOME   | \$                           | (15)    | (20)     |
|  |                              | 5       | 9        |
|  | \$                           | 472     | \$ 404   |
| <br>PER SHARE DATA:  |                              |         |          |
| Basic earnings per share   | \$                           | 1.46    | \$ 1.25  |
| Diluted earnings per share   | \$                           | 1.43    | \$ 1.23  |
| Cash dividends per share   | \$                           | 0.50    | \$ 0.36  |
| <br>WEIGHTED AVERAGE SHARES<br>OUTSTANDING (000's):                  |                              |         |          |
| Basic shares outstanding   |                              | 323,661 | 323,858  |
| Diluted shares outstanding   |                              | 329,624 | 329,756  |

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

**PRAXAIR, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(Millions of dollars)  
(UNAUDITED)

|  | June 30,<br>2006 |           | December<br>31,<br>2005 |
|--|------------------|-----------|-------------------------|
| <b>ASSETS</b>  |                  |           |                         |
| Cash and cash equivalents  | \$ 21            | \$        | 173                     |
| Accounts receivable - net  | 1,453            |           | 1,386                   |
| Inventories  | 396              |           | 373                     |
| Prepaid and other current assets   | 216              |           | 201                     |
| <b>TOTAL CURRENT ASSETS</b>  | <b>2,086</b>     |           | <b>2,133</b>            |
| Property, plant and equipment (less accumulated depreciation of \$6,965 at June 30, 2006 and \$6,553 at December 31, 2005) | 6,417            |           | 6,108                   |
| Goodwill   | 1,590            |           | 1,545                   |
| Other intangible assets - net  | 74               |           | 81                      |
| Other long-term assets   | 672              |           | 624                     |
| <b>TOTAL ASSETS</b>  | <b>\$ 10,839</b> | <b>\$</b> | <b>10,491</b>           |
| <b>LIABILITIES AND EQUITY</b>  |                  |           |                         |
| Accounts payable   | \$ 576           | \$        | 639                     |
| Short-term debt  | 587              |           | 231                     |
| Current portion of long-term debt  | 288              |           | 290                     |
| Other current liabilities  | 882              |           | 841                     |
| <b>TOTAL CURRENT LIABILITIES</b>   | <b>2,333</b>     |           | <b>2,001</b>            |
| Long-term debt   | 2,579            |           | 2,926                   |
| Other long-term obligations  | 1,455            |           | 1,460                   |
| <b>TOTAL LIABILITIES</b>   | <b>6,367</b>     |           | <b>6,387</b>            |
| Commitments and contingencies (Note 10)  |                  |           |                         |
| Minority interests   | 203              |           | 202                     |
| Shareholders' equity   | 4,269            |           | 3,902                   |
| <b>TOTAL LIABILITIES AND EQUITY</b>  | <b>\$ 10,839</b> | <b>\$</b> | <b>10,491</b>           |

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





**PRAXAIR, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Millions of dollars)  
(UNAUDITED)

|   | Six Months Ended<br>June 30, |        |
|---|------------------------------|--------|
|   | 2006                         | 2005   |
| <b>OPERATIONS</b>   |                              |        |
| Net income  | \$ 472                       | \$ 404 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |        |
| Depreciation and amortization   | 345                          | 325    |
| Deferred income taxes   | 54                           | 33     |
| Stock option expense  | 22                           | -      |
| Accounts receivable   | (76)                         | (59)   |
| Inventory   | (20)                         | (23)   |
| Prepaid and other current assets  | (13)                         | (30)   |
| Payables and accruals   | (15)                         | 74     |
| Pension contributions   | (118)                        | (72)   |
| Other   | (16)                         | 27     |
| Net cash provided by operating activities   | 635                          | 679    |
| <b>INVESTING</b>  |                              |        |
| Capital expenditures  | (526)                        | (363)  |
| Acquisitions  | (6)                          | (5)    |
| Divestitures and asset sales  | 13                           | 13     |
| Net cash used for investing activities  | (519)                        | (355)  |
| <b>FINANCING</b>  |                              |        |
| Short-term debt borrowings - net  | 128                          | 33     |
| Long-term debt borrowings   | 66                           | 21     |
| Long-term debt repayments   | (248)                        | (185)  |
| Excess tax benefit on stock option exercises                                      | 12                           | -      |
| Minority interest transactions and other  | (5)                          | (7)    |
| Issuances of common stock   | 156                          | 126    |
| Purchases of common stock   | (217)                        | (192)  |
| Cash dividends  | (161)                        | (116)  |
| Net cash used for financing activities  | (269)                        | (320)  |
| Effect of exchange rate changes on cash and cash equivalents                      | 1                            | (1)    |
| Change in cash and cash equivalents   | (152)                        | 3      |
| Cash and cash equivalents, beginning-of-period                                    | 173                          | 25     |
| Cash and cash equivalents, end-of-period  | \$ 21                        | \$ 28  |

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



**PRAXAIR, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
(Dollar amounts in millions, except share data, shares in thousands)  
(UNAUDITED)

| Activity  | Common Stock |         | Additional         | Treasury Stock |            | Retained | Accumulated   | Total    |
|---|--------------|---------|--------------------|----------------|------------|----------|---|----------|
|   | Shares       | Amounts | Paid-In<br>Capital | Shares         | Amounts    | Earnings | Other<br>Comprehensive<br>Income<br>(Loss) <sup>(b)</sup> |          |
| Balance, January 1, 2006  | 363,713      | \$ 4    | \$ 2,489           | 41,374         | \$ (1,356) | \$ 4,022 | (1,257)   | \$ 3,902 |
| Net income  |              |         |                    |                |            | 472      |   | 472      |
| Translation adjustments   |              |         |                    |                |            |          | 94  | 94       |
| Minimum pension liability, net of \$8 million of taxes                              |              |         |                    |                |            |          | (11)  | (11)     |
| Comprehensive income <sup>(a)</sup>   |              |         |                    |                |            |          |   | 555      |
| Dividends on common stock (\$0.50 per share)  |              |         |                    |                |            | (161)    |   | (161)    |
| Issuances of common stock:<br>For the dividend reinvestment and stock purchase plan | 49           |         | 3                  |                |            |          |   | 3        |
| For employee savings and incentive plans  | 1,882        |         | 82                 | (2,063)        | 70         |          |   | 152      |
| Purchases of common stock   |              |         |                    | 3,975          | (220)      |          |   | (220)    |
| Tax benefit from stock options  |              |         | 16                 |                |            |          |   | 16       |

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|                        |            |      |       |           |            |          |                  |
|------------------------|------------|------|-------|-----------|------------|----------|------------------|
| Stock option expense   |            |      | 22    |           |            |          | 22               |
| Balance, June 30, 2006 | 365,644 \$ | 4 \$ | 2,612 | 43,286 \$ | (1,506) \$ | 4,333 \$ | (1,174) \$ 4,269 |

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

|                           | Quarter Ended June 30, |         | Six Months Ended June 30, |         |
|---------------------------|------------------------|---------|---------------------------|---------|
|                           | 2006                   | 2005    | 2006                      | 2005    |
| Net income                | \$ 247                 | \$ 209. | \$ 472                    | \$ 404. |
| Translation adjustments   | 21                     | 47      | 94                        | (22)    |
| Derivative instruments    | -                      | (1)     | -                         | -       |
| Minimum pension liability | -                      | -       | (11)                      | (2)     |
|                           | \$ 268                 | \$ 255  | \$ 555                    | \$ 380  |

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

|                                       | June 30, 2006 | December 31, 2005 |
|---------------------------------------|---------------|-------------------|
| Accumulated translation adjustments   | \$ (956)      | \$ (1,050)        |
| Accumulated minimum pension liability | (217)         | (206)             |
| Accumulated derivatives               | (1)           | (1)               |
|                                       | \$ (1,174)    | \$ (1,257)        |

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

## 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 will be 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 six months ended June 30, 2006, approximately \$12 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 are 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.

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### 3. Stock-Based Compensation

The company adopted SFAS No. 123R effective January 1, 2006, resulting in the recognition of stock option expense of \$11 million, \$7 million after tax, for the quarter ended June 30, 2006. Stock option expense recognized for the six months ended June 30, 2006 was \$22 million, \$14 million after tax. The impact to both basic and diluted earnings per share was \$0.02 and \$0.04 for the quarter and six months ended June 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 June 30, 2006, 13,625,018 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 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.

The weighted-average fair value of options granted during the quarter and six months ended June 30, 2006 was \$11.57 and \$10.85, respectively, (\$11.32 and \$10.15 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<br>June 30, | Six Months Ended<br>June 30, |
|---------------------------|------------------------------|
|---------------------------|------------------------------|

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|                         |        |        |        |        |
|-------------------------|--------|--------|--------|--------|
|                         | 2006   | 2005   | 2006   | 2005   |
| Dividend yield          | 1.83%  | 1.51%  | 1.85%  | 1.63%  |
| Volatility              | 17.67% | 22.69% | 17.64% | 22.69% |
| Risk-free interest rate | 5.07%  | 4.16%  | 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 June 30, 2006 and changes during the six-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<br>of<br>Options | Average<br>Exercise<br>Price | Average           | Aggregate          |
|----------------------------------|-------------------------|------------------------------|-------------------|--------------------|
|                                  |                         |                              | Remaining<br>Life | Intrinsic<br>Value |
| Outstanding at December 31, 2005 | 21,644                  | \$ 30.04                     |                   |                    |
| Granted                          | 4,006                   | \$ 53.99                     |                   |                    |
| Exercised                        | 1,832                   | \$ 25.99                     |                   |                    |
| Cancelled or expired             | 28                      | \$ 34.72                     |                   |                    |
| Outstanding at June 30, 2006     | 23,790                  | \$ 34.38                     | 6.7               | \$ 466,747         |
| Exercisable at June 30, 2006     | 15,820                  | \$ 27.56                     | 5.5               | \$ 418,338         |

The aggregate intrinsic value represents the difference between the company's closing stock price of \$54 as of June 30, 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 six months ended June 30, 2006 was \$15 million and \$53 million, respectively (\$22 million and \$49 million for the same time periods in 2005, respectively).

Cash received from option exercises under all share-based payment arrangements for the quarter and six months ended June 30, 2006 was \$14 million and \$48 million, respectively. The actual tax benefit realized from stock option exercises totaled \$5 million and \$17 million, respectively, for the quarter and six months ended June 30, 2006.

As of June 30, 2006, \$56 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 is currently in the process of evaluating the alternative methods.



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:

| <i>(Millions of dollars, except per share data)</i>   | Quarter<br>Ended<br>June 30,<br>2005 <sup>(a)</sup> | Six<br>Months<br>Ended<br>June 30,<br>2005 <sup>(a)</sup> |
|---|---|---|
| <b>NET INCOME:</b>  |   |   |
| As reported   | \$ 209  | \$ 404  |
| Less: total stock-based employee compensation expense determined under fair value based method for all awards, net of \$4 million and \$7 million of income taxes in the quarter and six months, respectively | (7)   | (13)  |
| Pro forma net income  | \$ 202  | \$ 391  |
| <b>BASIC EARNINGS PER SHARE:</b>  |   |   |
| As reported   | \$ 0.65   | \$ 1.25   |
| Pro forma   | \$ 0.63   | \$ 1.21   |
| <b>DILUTED EARNINGS PER SHARE:</b>  |   |   |
| As reported   | \$ 0.63   | \$ 1.23   |
| Pro forma   | \$ 0.61   | \$ 1.19   |

(a) Pro forma net income amounts for the quarter and six months ended June 30, 2005 have 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:

| <i>(Millions of dollars)</i> | June 30,<br>2006 | December<br>31,<br>2005 |
|------------------------------|------------------|-------------------------|
| Raw materials and supplies   | \$ 111           | \$ 90                   |
| Work in process              | 54               | 67                      |
| Finished goods               | 231              | 216                     |
|                              | \$ 396           | \$ 373                  |



**5. Debt**

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

| <i>(Millions of dollars)</i>            | June 30,<br>2006 | December<br>31,<br>2005 |
|---|------------------|-------------------------|
| <b>SHORT-TERM</b>                       |                  |                         |
| Commercial paper and U.S. borrowings    | \$ 107           | \$ -                    |
| Canadian borrowings                     | 174              | 91                      |
| South American borrowings               | 36               | 32                      |
| Asian borrowings                        | 88               | 95                      |
| European borrowings                     | 163              | 9                       |
| Other international borrowings          | 19               | 4                       |
| Total short-term debt                   | 587              | 231                     |
| <b>LONG-TERM</b>                        |                  |                         |
| U.S. borrowings                         |                  |                         |
| 6.90% Notes due 2006                    | 250              | 250                     |
| 4.75% Notes due 2007                    | 250              | 250                     |
| 6.625% Notes due 2007                   | 250              | 250                     |
| 6.50% Notes due 2008                    | 250              | 250                     |
| 2.75% Notes due 2008 <sup>(a)</sup>     | 299              | 299                     |
| 6.375% Notes due 2012 <sup>(a, b)</sup> | 527              | 529                     |
| 3.95% Notes due 2013 <sup>(a)</sup>     | 349              | 349                     |
| Other                                   | 8                | 9                       |
| European borrowings <sup>(c)</sup>      | 565              | 786                     |
| Canadian borrowings <sup>(c)</sup>      | -                | 140                     |
| South American borrowings               | 76               | 54                      |
| Asian borrowings                        | 26               | 34                      |
| Other international borrowings          | 5                | 4                       |
| Obligations under capital leases        | 12               | 12                      |
|   | 2,867            | 3,216                   |
| Less: current portion of long-term debt | (288)            | (290)                   |
| Total long-term debt                    | 2,579            | 2,926                   |
| Total debt                              | \$ 3,454         | \$ 3,447                |

(a) Amounts are net of unamortized discounts.

(b) June 30, 2006 and December 31, 2005 include a \$28 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 the respective agreements.

## 6. Financial Instruments

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

| <i>(Millions of dollars)</i> | June 30,<br>2006 | December 31,<br>2005 |
|------------------------------|------------------|----------------------|
| <b>CURRENCY CONTRACTS</b>    |                  |                      |
| Balance sheet items          | \$ 534           | \$ 749               |
| Anticipated net income       | -                | 12                   |
| Forecasted transactions      | 8                | 7                    |
|                              | \$ 542           | \$ 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 June 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 June 30, 2006 (\$104 million at December 31, 2005).

At June 30, 2006, the fair value of all derivative instruments was recorded in the condensed consolidated balance sheet as \$2 million in current assets and \$2 million in current liabilities (\$6 million in current assets at December 31, 2005). There were no interest-rate derivatives outstanding at June 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 June 30, |         | Six Months Ended June 30, |         |
|--|------------------------|---------|---------------------------|---------|
|  | 2006                   | 2005    | 2006                      | 2005    |
| <b>NUMERATOR (MILLIONS OF DOLLARS)</b>   |                        |         |                           |         |
| Net income used in basic and diluted EPS | \$ 247                 | \$ 209  | \$ 472                    | \$ 404  |
| <b>DENOMINATOR (THOUSANDS OF SHARES)</b> |                        |         |                           |         |
| Weighted average shares outstanding      | 322,470                | 322,802 | 322,620                   | 322,756 |
| Shares earned and issuable under         |                        |         |                           |         |

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|  |                |                |                |                |
|--|----------------|----------------|----------------|----------------|
| compensation plans   | 1,049          | 1,096          | 1,041          | 1,102          |
| Weighted average shares used in basic earnings per share   | 323,519        | 323,898        | 323,661        | 323,858        |
| Effect of dilutive securities                              |                |                |                |                |
| Convertible debt   | -              | 163            | -              | 181            |
| Employee stock options                                     | 6,361          | 5,757          | 5,963          | 5,717          |
| Weighted average shares used in diluted earnings per share | 329,880        | 329,818        | 329,624        | 329,756        |
| <b>BASIC EARNINGS PER COMMON SHARE</b>                     | <b>\$ 0.76</b> | <b>\$ 0.65</b> | <b>\$ 1.46</b> | <b>\$ 1.25</b> |
| <b>DILUTED EARNINGS PER COMMON SHARE</b>                   | <b>\$ 0.75</b> | <b>\$ 0.63</b> | <b>\$ 1.43</b> | <b>\$ 1.23</b> |

There were 25,100 stock options for shares excluded in the computation of diluted earnings per share for the quarter ended June 30, 2006 because the exercise prices were greater than the average market price of the common stock. Stock options for 65,000 shares were excluded in the computation for the quarter ended June 30, 2005. Stock options for 3,999,180 and 65,000 shares for the six months ended June 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 six months ended June 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         | 2             | -             | -      | -     | -                    | 2        |
| Foreign currency translation | 2             | 15            | 18     | 1     | 3                    | 39       |
| Other                        | -             | -             | 2      | -     | -                    | 2        |
| Balance, June 30, 2006       | \$ 996        | \$ 177        | \$ 313 | \$ 27 | \$ 77                | \$ 1,590 |

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

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|                                | License/Use<br>Agreements | Non-Compete<br>Agreements | Patents<br>&<br>Other | Total   |
|--------------------------------|---------------------------|---------------------------|-----------------------|---------|
| Cost:                          |                           |                           |                       |         |
| Balance, December 31, 2005     | \$ 71                     | \$ 38                     | \$ 17                 | \$ 126  |
| Additions                      | -                         | 1                         | -                     | 1       |
| Foreign currency translation   | 1                         | 1                         | -                     | 2       |
| Other                          | (5)                       | (2)                       | -                     | (7)     |
| Balance, June 30, 2006         | \$ 67                     | \$ 38                     | \$ 17                 | \$ 122  |
| Less: Accumulated amortization |                           |                           |                       |         |
| Balance, December 31, 2005     | \$ (22)                   | \$ (18)                   | \$ (5)                | \$ (45) |
| Amortization expense           | (3)                       | (4)                       | (1)                   | (8)     |
| Foreign currency translation   | -                         | -                         | -                     | -       |
| Other                          | 3                         | 2                         | -                     | 5       |
| Balance, June 30, 2006         | \$ (22)                   | \$ (20)                   | \$ (6)                | \$ (48) |
| Net balance at June 30, 2006   | \$ 45                     | \$ 18                     | \$ 11                 | \$ 74   |

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 \$8 million for the remainder of 2006; \$12 million, \$9 million, \$7 million and \$6 million for the years ended December 31, 2007, 2008, 2009 and 2010, respectively; and \$32 million thereafter.

## 9. Pension and OPEB

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

| <i>(Millions of dollars)</i>   | Quarter Ended June 30, |       |      |      | Six Months Ended June 30, |       |       |       |
|--------------------------------|------------------------|-------|------|------|---------------------------|-------|-------|-------|
|                                | Pensions               |       | OPEB |      | Pensions                  |       | OPEB  |       |
|                                | 2006                   | 2005  | 2006 | 2005 | 2006                      | 2005  | 2006  | 2005  |
| Service cost                   | \$ 11                  | \$ 9  | \$ 2 | \$ 2 | \$ 21                     | \$ 18 | \$ 4  | \$ 3  |
| Interest cost                  | 24                     | 22    | 4    | 4    | 48                        | 44    | 8     | 8     |
| Expected return on plan assets | (29)                   | (25)  | -    | -    | (57)                      | (50)  | -     | -     |
| Net amortization and deferral  | 7                      | 5     | -    | (1)  | 14                        | 10    | -     | (1)   |
| Net periodic benefit cost      | \$ 13                  | \$ 11 | \$ 6 | \$ 5 | \$ 26                     | \$ 22 | \$ 12 | \$ 10 |

Praxair estimates that 2006 contributions to its pension plans will be in the area of \$125 million, including required contributions. Contributions of \$118 million have been made through June 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 June 30, 2006, Praxair was a co-defendant with many other companies in 2,008 lawsuits alleging personal injury caused by manganese contained in welding fumes. There were a total of 6,995 individual claimants in these cases. The cases were pending in state or federal courts in Alabama, Arkansas, California, Georgia, Illinois, Kentucky, Louisiana, Mississippi, Missouri, Ohio, Tennessee, Texas, Utah and West Virginia. 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.





## 11. Segments

Sales and operating profit by segment for the quarters and six-month periods ended June 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, refer to Note 4 to the consolidated financial statements included on page 49 of Praxair's 2005 Annual Report):

| <i>(Dollar amounts in millions)</i> | Quarter Ended June 30, |          | Six Months Ended June 30, |           |
|-------------------------------------|------------------------|----------|---------------------------|-----------|
|                                     | 2006                   | 2005     | 2006                      | 2005      |
| <b>SALES<sup>(a)</sup></b>          |                        |          |                           |           |
| North America                       | \$ 1,158               | \$ 1,097 | \$ 2,327                  | \$ 2,157  |
| Europe                              | 296                    | 287      | 564                       | 572       |
| South America                       | 340                    | 274      | 657                       | 518       |
| Asia                                | 155                    | 137      | 302                       | 259       |
| Surface Technologies <sup>(b)</sup> | 127                    | 124      | 252                       | 240       |
|                                     | \$ 2,076               | \$ 1,919 | \$ 4,102                  | \$ 3,746. |
| <b>OPERATING PROFIT</b>             |                        |          |                           |           |
| North America                       | \$ 215                 | \$ 161   | \$ 415                    | \$ 327    |
| Europe                              | 65                     | 72       | 124                       | 139       |
| South America                       | 58                     | 51       | 115                       | 94        |
| Asia                                | 28                     | 24       | 51                        | 46        |
| Surface Technologies <sup>(b)</sup> | 16                     | 14       | 29                        | 25        |
|                                     | \$ 382                 | \$ 322   | \$ 734                    | \$ 631    |

(a) Represents external sales. Intersegment sales, primarily from North America, totaled \$15 million and \$32 million for the quarter and six months ended June 30, 2006, respectively, versus \$14 million and \$27 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. Subsequent Events

On July 3, 2006, Praxair completed the previously announced sale of its aviation services business and on July 10, 2006 the Turkish competition authorities approved the sale of Karbogaz, a Praxair, Inc. joint venture accounted for under the equity method of accounting. Both transactions will be recorded in the third quarter.

**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 six-month periods ended June 30, 2006 and 2005:

| <i>(Dollar amounts in millions)</i> | Quarter Ended June 30, |          |          | Six Months Ended June 30, |          |          |
|-------------------------------------|------------------------|----------|----------|---------------------------|----------|----------|
|                                     | 2006                   | 2005     | Variance | 2006                      | 2005     | Variance |
| Sales                               | \$ 2,076               | \$ 1,919 | +8%      | \$ 4,102                  | \$ 3,746 | +10%     |
| Gross margin <sup>(a)</sup>         | \$ 838                 | \$ 752   | +11%     | \$ 1,657                  | \$ 1,470 | +13%     |
| As a percent of sales               | 40.4%                  | 39.2%    |          | 40.4%                     | 39.2%    |          |
| Selling, general and administrative | \$ 271                 | \$ 247   | +10%     | \$ 544                    | \$ 492   | +11%     |
| As a percent of sales               | 13.1%                  | 12.9%    |          | 13.3%                     | 13.1%    |          |
| Depreciation and amortization       | \$ 174                 | \$ 163   | +7%      | \$ 345                    | \$ 325   | +6%      |
| Other income (expenses) - net       | \$ 11                  | \$ (1)   |          | \$ 9                      | \$ 17    |          |
| Operating profit                    | \$ 382                 | \$ 322   | +19%     | \$ 734                    | \$ 631   | +16%     |
| Interest expense - net              | \$ 41                  | \$ 41    | -%       | \$ 79                     | \$ 83    | -5%      |
| Effective tax rate                  | 26.4%                  | 22.8%    |          | 26.4%                     | 24.3%    |          |
| Net income                          | \$ 247                 | \$ 209   | +18%     | \$ 472                    | \$ 404   | +17%     |

(a) Gross margin excludes depreciation and amortization expense.

Sales increased \$157 million, or 8%, for the second quarter and \$356 million, or 10%, for the six months ended June 30, 2006 versus the respective 2005 periods. Price increases of 3% and 4% for the quarter and year-to-date periods, respectively, were predominantly realized in North and South America due to pricing actions, the pass-through of higher power costs and surcharges. Volume growth of 3% for the quarter and year-to-date periods reflects continued strong volumes to the manufacturing, electronics, and metals end-markets, the impact of which was partially offset by lower on-site volumes to energy end-markets due to refinery outages on the U.S. Gulf Coast. 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 had an immaterial impact for the quarter and year-to-date periods with minimal impact on operating profit.

Gross margin in 2006 improved \$86 million, or 11%, for the second quarter and \$187 million, or 13%, for the six months ended June 30, 2006 versus the respective 2005 periods. The 120 basis point increase in the second quarter and year-to-date gross margin percentage, to 40.4%, was due primarily to realized price increases and cost reduction programs, which combined, continued to outpace underlying inflationary cost pressures.

Selling, general and administrative expenses for the second quarter were \$271 million, or 13.1% of sales, versus \$247 million, or 12.9% of sales, for the respective 2005 period. SG&A expenses for the six-month period were \$544 million, or 13.3% of sales, versus \$492 million, or 13.1% of sales, for the respective 2005 period. Stock option

expense increased selling, general and administrative expenses by \$10 million and \$20 million for the quarter and six months ended June 30, 2006, respectively. The remaining increase was due to currency, acquisitions, and inflationary pressures partially offset by productivity initiatives.

Depreciation and amortization expense increased \$11 million, or 7%, for the second quarter and \$20 million, or 6%, for the six months ended June 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 and six months ended June 30, 2006 included a \$15 million gain resulting from insurance recoveries. Included in 2005 year-to-date other income is a benefit of \$11 million recorded in the first quarter of 2005 associated with a \$20 million favorable settlement of a customer obligation net of a \$9 million charge for various legal matters and insurance accruals, and an \$8 million charge in the second quarter associated with a fire at the St. Louis distribution facility.

Operating profit increased \$60 million or 19% for the second quarter and \$103 million or 16% for the six months ended June 30, 2006 versus the respective 2005 periods. Stock option expense reduced operating profit by \$11 million and \$22 million for the quarter and six months ended June 30, 2006, respectively. Including pro forma stock option expense of \$11 million and \$20 million in the quarter and six months ended June 30, 2005, respectively, underlying operating profit increased \$71 million, or 23%, for the quarter and \$123 million, or 20% for the six-month period. This increase was principally driven by strong realized price increases, the continued impact of focused productivity initiatives and insurance recoveries.

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Interest expense - net was flat for the second quarter and decreased \$4 million, or 5%, for the six-month period ended June 30, 2006 versus 2005 as a result of lower debt balances in the first quarter of 2006.

The effective tax rate was 26.4% for the second quarter and six-month period versus 22.8% and 24.3%, respectively, for the same periods in 2005. The 2005 quarter and year-to-date periods included a net \$9 million income tax benefit in Europe principally related to a tax legislation change. Excluding this benefit, the 2005 quarter and year-to-date underlying tax rate was 26%.

Net income increased \$38 million, or 18%, for the second quarter and \$68 million, or 17%, for the six months ended June 30, 2006 versus the respective 2005 periods. Stock option expense reduced net income by \$7 million and \$14 million for the quarter and six months ended June 30, 2006, respectively. Operating profit growth was the primary driver of the net income improvement and was marginally reduced by a slightly higher effective tax rate for the period.

The number of employees at June 30, 2006 was 27,532, reflecting an increase of 226 employees from December 31, 2005.

### 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 June 30, |          |          | Six Months Ended June 30, |           |          |
|-------------------------------------|------------------------|----------|----------|---------------------------|-----------|----------|
|                                     | 2006                   | 2005     | Variance | 2006                      | 2005      | Variance |
| <b>SALES<sup>(a)</sup></b>          |                        |          |          |                           |           |          |
| North America                       | \$ 1,158               | \$ 1,097 | +6%      | \$ 2,327                  | \$ 2,157  | +8%      |
| Europe                              | 296                    | 287      | +3%      | 564                       | 572       | -1%      |
| South America                       | 340                    | 274      | +24%     | 657                       | 518       | +27%     |
| Asia                                | 155                    | 137      | +13%     | 302                       | 259       | +17%     |
| Surface Technologies                | 127                    | 124      | +2%      | 252                       | 240       | +5%      |
|                                     | \$ 2,076               | \$ 1,919 | +8%      | \$ 4,102                  | \$ 3,746. | +10%     |
| <b>OPERATING PROFIT</b>             |                        |          |          |                           |           |          |
| North America                       | \$ 215                 | \$ 161   | +34%     | \$ 415                    | \$ 327    | +27%     |
| Europe                              | 65                     | 72       | -10%     | 124                       | 139       | -11%     |
| South America                       | 58                     | 51       | +14%     | 115                       | 94        | +22%     |
| Asia                                | 28                     | 24       | +17%     | 51                        | 46        | +11%     |
| Surface Technologies                | 16                     | 14       | +14%     | 29                        | 25        | +16%     |
|                                     | \$ 382                 | \$ 322   | +19%     | \$ 734                    | \$ 631    | +16%     |

(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 \$61 million, or 6%, for the second quarter and \$170 million, or 8%, for the six months ended June 30, 2006 versus the respective 2005 periods. 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 was unchanged for the quarter and year-to-date periods reflecting higher volumes of gaseous oxygen and nitrogen, merchant liquid and packaged gases to the metals, manufacturing and electronics end-markets which was offset by lower hydrogen on-site volumes due to refinery outages on the U.S. Gulf Coast. Currency contributed 1% and 2% to sales growth for the quarter and year-to-date periods. The pass-through of natural gas costs to on-site hydrogen customers had an immaterial impact for the quarter and year-to-date periods with minimal impact on operating profit.

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Operating profit increased \$54 million, or 34%, for the second quarter and \$88 million, or 27%, for the six months ended June 30, 2006 versus the respective 2005 periods. The quarter and six months ended June 30, 2006 included a \$15 million benefit from insurance recoveries and \$6 million and \$12 million of stock option expense, respectively. Excluding the benefit from insurance recoveries in the 2006 periods and including pro forma stock option expense of \$6 million and \$11 million in the quarter and six months ended June 30, 2005, respectively, underlying operating profit increased \$45 million, or 29%, for the quarter and \$84 million, or 27%, for the six-month period. Realized price increases and the benefit of productivity initiatives were the primary drivers to the strong underlying operating profit growth in the quarter and year-to-date periods. Favorable currency had a small impact on operating profit growth during the quarter.

### Europe

Sales increased \$9 million, or 3%, for the second quarter and decreased \$8 million, or 1%, for the six months ended June 30, 2006 versus the respective 2005 periods. Excluding the unfavorable impact of currency, sales increased \$17 million, or 6%, for the quarter and \$27 million, or 5%, for the year-to-date period, principally due to higher merchant liquid and packaged gas volumes in Spain and Italy and healthcare volumes, partially offset by lower on-site volumes.

Operating profit decreased \$7 million, or 10%, for the second quarter and \$15 million, or 11%, for the six months ended June 30, 2006 versus the respective 2005 periods. The quarter and six months ended June 30, 2006 included \$1 million and \$2 million of stock option expense, respectively. Excluding the unfavorable impact of currency in 2006 and including pro forma stock option expense of \$1 million and \$2 million in the quarter and six months ended June 30, 2005, respectively, underlying operating profit decreased \$3 million, or 4%, for the quarter and \$3 million, or 2%, for the six-month period. Increased price competition in the merchant liquid market limited the pass through of higher power costs.

### South America

Sales increased \$66 million, or 24%, for the second quarter and \$139 million, or 27%, for the six months ended June 30, 2006 versus the respective 2005 periods. Excluding the impact of currency, sales increased 13% for the quarter and year-to-date period primarily due to higher pricing to merchant liquid and packaged gas customers partially offset by lower on-site volumes caused by a customer outage. Additionally, an equipment sale to a Venezuela customer contributed to 8% sales growth in the second quarter and 4% on a year-to-date basis.

Operating profit increased \$7 million or 14% for the second quarter and \$21 million, or 22%, for the six months ended June 30, 2006 versus the respective 2005 periods. The quarter and six months ended June 30, 2006 included \$2 million and \$4 million of stock option expense, respectively. Including pro forma stock option expense of \$2 million and \$3 million in the quarter and six months ended June 30, 2005, respectively, underlying operating profit increased \$9 million, or 18%, for the quarter and \$24 million, or 26%, for the six-month period. Favorable currency contributed 13% growth for the quarter and 16% for the year-to-date period. Sales volumes contributed to approximately half of the operating profit growth. Higher pricing and cost-reduction programs continued to outpace inflationary pressures, favorably contributing to operating profit growth.

### Asia

Sales increased \$18 million, or 13%, for the second quarter and \$43 million, or 17%, for the six months ended June 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.

Operating profit increased \$4 million or 17%, for the second quarter and \$5 million, or 11%, for the six months ended June 30, 2006 versus the respective 2005 periods. The quarter and six months ended June 30, 2006 included \$1 million and \$2 million of stock option expense, respectively. Including pro forma stock option expense of \$1 million and \$2 million in the quarter and six months ended June 30, 2005, respectively, underlying operating profit increased \$5 million, or 22%, for the quarter and \$7 million, or 16%, for the six-month period. Increased sales volumes were the primary driver in operating profit growth. Pricing and productivity initiatives largely offset inflationary pressures on Asia's cost structure.

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Surface Technologies

Sales increased \$3 million, or 2%, for the second quarter and \$12 million, or 5%, for the six months ended June 30, 2006 versus the respective 2005 periods. Excluding the impact of currency, sales increased 4% for the quarter and 8% for the year-to-date period. Volume growth was flat for the quarter and 4% for the year-to-date period driven by higher volumes of OEM aircraft engine parts, oil field service components, and industrial coatings for power turbines. Realized price increases were 4% for the quarter and year-to-date periods.

Operating profit increased \$2 million, or 14%, for the second quarter and \$4 million, or 16%, for the six months ended June 30, 2006 versus the respective 2005 periods. The quarter and six months ended June 30, 2006 included \$1 million and \$2 million of stock option expense, respectively. Including pro forma stock option expense of \$1 million and \$2 million in the quarter and six months ended June 30, 2005, respectively, underlying operating profit increased \$3 million, or 23%, for the quarter and \$6 million, or 26%, for the six-month period. The increase was principally driven by higher sales volumes and the favorable benefits of ongoing cost reduction actions and pricing actions to offset increasing raw material costs.

On July 3, 2006, Praxair completed the previously announced 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). See Note 12 to the condensed consolidated financial statements.

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<br>YTD<br>2006            |                      | Income Statement |                     | Balance Sheet           |  |
|------------------|--------------------------------------|----------------------|------------------|---------------------|-------------------------|--|
|                  | Consolidated<br>Sales <sup>(a)</sup> | Year-To-Date<br>2006 | Average<br>2005  | June<br>30,<br>2006 | December<br>31,<br>2005 |  |
| European euro    | 15%                                  | 0.82                 | 0.77             | 0.80                | 0.85                    |  |
| Brazilian real   | 14%                                  | 2.19                 | 2.57             | 2.16                | 2.34                    |  |
| Canadian dollar  | 9%                                   | 1.15                 | 1.23             | 1.13                | 1.17                    |  |
| Mexican peso     | 5%                                   | 10.83                | 11.13            | 11.40               | 10.68                   |  |
| Chinese RMB      | 2%                                   | 8.04                 | 8.28             | 8.00                | 8.07                    |  |
| Indian rupee     | 2%                                   | 44.89                | 43.70            | 46.40               | 45.20                   |  |
| Korean won       | 2%                                   | 970                  | 1,019            | 960                 | 1,013                   |  |
| Argentinean peso | 1%                                   | 3.07                 | 2.91             | 3.09                | 3.03                    |  |



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|                    |     |       |       |       |       |
|--------------------|-----|-------|-------|-------|-------|
| Venezuelan bolivar | <1% | 2,150 | 2,065 | 2,150 | 2,150 |
|--------------------|-----|-------|-------|-------|-------|

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

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**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>                 | Six Months Ended<br>June 30, |          |
|--|------------------------------|----------|
|  | 2006                         | 2005     |
| <b>NET CASH PROVIDED BY (USED FOR):</b>      |                              |          |
| <b>OPERATING ACTIVITIES</b>                  |                              |          |
| Net income                                   | \$ 472                       | \$ 404   |
| Depreciation and amortization                | 345                          | 325      |
| Accounts receivable                          | (76)                         | (59)     |
| Inventory                                    | (20)                         | (23)     |
| Payables and accruals                        | (15)                         | 74       |
| Pension contributions                        | (118)                        | (72)     |
| Other - net                                  | 47                           | 30       |
| Net cash provided by operating activities    | \$ 635                       | \$ 679   |
| <b>INVESTING ACTIVITIES</b>                  |                              |          |
| Capital expenditures                         | \$ (526)                     | \$ (363) |
| Acquisitions                                 | (6)                          | (5)      |
| Divestitures and asset sales                 | 13                           | 13       |
| Net cash used for investing activities       | \$ (519)                     | \$ (355) |
| <b>FINANCING ACTIVITIES</b>                  |                              |          |
| Debt reductions - net                        | \$ (54)                      | \$ (131) |
| Excess tax benefit on stock option exercises | 12                           | -        |
| Issuances of common stock                    | 156                          | 126      |
| Purchases of common stock                    | (217)                        | (192)    |
| Cash dividends                               | (161)                        | (116)    |
| Minority transactions and other              | (5)                          | (7)      |
| Net cash used for financing activities       | \$ (269)                     | \$ (320) |

**Cash Flow from Operations**

Cash provided by operations of \$635 million for the six months ended June 30, 2006 decreased \$44 million versus 2005. The decline was due to an increase in U.S. pension contributions, U.S. income tax payments and reduced accounts payable accrual levels.

**Investing**

Net cash used for investing of \$519 million for the six months ended June 30, 2006 increased \$164 million, or 46%, versus 2005 primarily due to an increase in capital expenditures in North America and Asia versus the year ago periods.

**Financing**

Cash used for financing activities of \$269 million for the six months ended June 30, 2006 decreased \$51 million versus the respective 2005 period. For the six months ended June 30, 2006, cash dividends were \$0.50 per share compared to \$0.36 per share for 2005, resulting in a \$45 million, or 39%, increase in cash dividends paid. More than offsetting this increase was a decrease of \$77 million versus 2005 in debt reductions - net due to increased capital expenditure levels. At June 30, 2006, Praxair's total debt outstanding of \$3,454 million was relatively flat with total debt outstanding of \$3,447 million at December 31, 2005.

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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).

|   | June 30,<br>2006          |       | December<br>31,<br>2005      |       |    |       |    |       |
|---|---------------------------|-------|------------------------------|-------|----|-------|----|-------|
| <i>(Dollar amounts in millions)</i>                     |                           |       |                              |       |    |       |    |       |
| <u>TOTAL CAPITAL</u>                                    |                           |       |                              |       |    |       |    |       |
| Debt  | \$                        | 3,454 | \$                           | 3,447 |    |       |    |       |
| Minority interests                                      |                           | 203   |                              | 202   |    |       |    |       |
| Shareholders' equity                                    |                           | 4,269 |                              | 3,902 |    |       |    |       |
|   | \$                        | 7,926 | \$                           | 7,551 |    |       |    |       |
| <br>DEBT-TO-CAPITAL RATIO                               |                           | 43.6% |                              | 45.6% |    |       |    |       |
|   | Quarter Ended<br>June 30, |       | Six Months Ended<br>June 30, |       |    |       |    |       |
|   | 2006                      | 2005  | 2006                         | 2005  |    |       |    |       |
| <u>AFTER-TAX RETURN ON<br/>CAPITAL (ROC)</u>            |                           |       |                              |       |    |       |    |       |
| Adjusted operating profit <sup>(a,c)</sup>              | \$                        | 382   | \$                           | 311   | \$ | 734   | \$ | 611   |
| Less: adjusted taxes <sup>(a,c)</sup>                   |                           | (90)  |                              | (60)  |    | (173) |    | (126) |
| Less: tax benefit on interest<br>expense <sup>(b)</sup> |                           | (11)  |                              | (11)  |    | (21)  |    | (22)  |
| Add: equity income                                      |                           | 3.    |                              | 5.    |    | 5     |    | 9     |
| Net operating profit after-tax<br>(NOPAT)               | \$                        | 284   | \$                           | 245   | \$ | 545   | \$ | 472   |
| <br>Beginning capital                                   | \$                        | 7,740 | \$                           | 7,321 | \$ | 7,551 | \$ | 7,358 |
| Ending capital  | \$                        | 7,926 | \$                           | 7,373 | \$ | 7,926 | \$ | 7,373 |
| Average capital   | \$                        | 7,833 | \$                           | 7,347 | \$ | 7,739 | \$ | 7,366 |
| <br>ROC %   |                           | 3.6%  |                              | 3.3%  |    | 7.0%  |    | 6.4%  |
| <br>ROC % (annualized)                                  |                           | 14.5% |                              | 13.4% |    | 14.1% |    | 12.8% |

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(a) The quarter and six months ended June 30, 2005 have been adjusted to include pro forma stock option expense of \$11 million (\$7 million net of tax) and \$20 million (\$13 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 quarter and six months ended June 30, 2006 include a \$15 million benefit, \$10 million after-tax, related to insurance recoveries. This benefit increased annualized ROC by 0.5% for the quarter and 0.3% for the year-to-date period.

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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 third quarter of 2006, diluted earnings per share are expected to be in the range of \$0.70 to \$0.73.

For the full year of 2006, Praxair expects year-over-year sales growth to approximate 10%. Diluted earnings per share are expected to be in the range of \$2.85 to \$2.90, including an estimated stock option expense of \$0.08 per share. Full-year capital expenditures are expected to be in the area of \$1 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](http://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.
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**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 June 30, 2006 is provided below:

| <u>Period</u><br><i>(Thousands)</i> | <b>Total<br/>Number of<br/>Shares<br/>Purchased</b> | <b>Average<br/>Price Paid<br/>Per Share</b> | <b>Total Number<br/>of Shares<br/>Purchased as<br/>Part of<br/>Publicly<br/>Announced<br/>Plans or<br/>Programs<sup>(1)</sup></b><br><i>(Thousands)</i> | <b>Maximum<br/>Number of<br/>Shares that<br/>May Yet be<br/>Purchased<br/>Under the<br/>Program<sup>(2)</sup></b> |
|-------------------------------------|---|---|---|---|
| April 2006                          | 448   | 54.78                                       | 448   | N/A   |
| May 2006                            | 1,813   | 55.74                                       | 1,813   | N/A   |
| June 2006                           | -   | -   | -   | N/A   |
| Second Quarter 2006                 | 2,261   | 55.55                                       | 2,261   | 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.





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

The Annual Meeting of Shareholders of Praxair, Inc. was held on April 25, 2006. The results of the matters submitted to a vote of security holders were disclosed in Item 4 of the Company's Form 10-Q for the quarter ended March 31, 2006 and are incorporated herein by reference.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

(a) Exhibits:

3.01 Restated Certificate of Incorporation of Praxair, Inc. as filed with the Secretary of State of the State of Delaware on May 8, 2006

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)

**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: July 26, 2006

By: /s/ Patrick M. Clark

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

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