PRAXAIR INC
Form 10-Q
October 26, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017
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.)
10 Riverview Drive, DANBURY, CT	06810-6268
(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)

Securities registered pursuant to Section 12(b) of the Act:
Title of each class: Registered on:
Common Stock ($0.01 par value) New York Stock Exchange
1.50% Euro notes due 2020 New York Stock Exchange
1.20% Euro notes due 2024 New York Stock Exchange
1.625% Euro notes due 2025 New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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 ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý Accelerated filer ¨

Non-accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

At September 30, 2017, 286,305,341 shares of common stock ($0.01 par value) of the Registrant were outstanding.

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

	Quarter Ended September 30,	
	2017	2016
SALES	$ 2,922	$ 2,716
Cost of sales, exclusive of depreciation and amortization	1,652	1,533
Selling, general and administrative	304	291
Depreciation and amortization	298	284
Research and development	23	22
Transaction costs and other charges	16	100
Other income (expense) - net	(3)	11
OPERATING PROFIT	626	497
Interest expense - net	41	43
INCOME BEFORE INCOME TAXES AND EQUITY INVESTMENTS	585	454
Income taxes	162	120
INCOME BEFORE EQUITY INVESTMENTS	423	334
Income from equity investments	12	10
NET INCOME (INCLUDING NONCONTROLLING INTERESTS)	435	344
Less: noncontrolling interests	(16)	(5)
NET INCOME - PRAXAIR, INC.	$ 419	$ 339
PER SHARE DATA - PRAXAIR, INC. SHAREHOLDERS		
Basic earnings per share	$ 1.46	$ 1.19
Diluted earnings per share	$ 1.45	$ 1.18
Cash dividends per share	$ 0.7875	$ 0.75
WEIGHTED AVERAGE SHARES OUTSTANDING (000’s):		
Basic shares outstanding	286,467	285,858
Diluted shares outstanding	289,216	288,195

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,	
	2017	2016
SALES	$8,484	$7,890
Cost of sales, exclusive of depreciation and amortization	4,795	4,382
Selling, general and administrative	891	873
Depreciation and amortization	877	837
Research and development	69	69
Transaction costs and other charges	37	100
Other income (expense) - net	(3)	10
OPERATING PROFIT	1,812	1,639
Interest expense - net	120	152
INCOME BEFORE INCOME TAXES AND EQUITY INVESTMENTS	1,692	1,487
Income taxes	468	399
INCOME BEFORE EQUITY INVESTMENTS	1,224	1,088
Income from equity investments	35	31
NET INCOME (INCLUDING NONCONTROLLING INTERESTS)	1,259	1,119
Less: noncontrolling interests	(45)	(25)
NET INCOME - PRAXAIR, INC.	$1,214	$1,094
PER SHARE DATA - PRAXAIR, INC. SHAREHOLDERS		
Basic earnings per share	$4.24	$3.83
Diluted earnings per share	$4.21	$3.80
Cash dividends per share	$2.36	$2.25
WEIGHTED AVERAGE SHARES OUTSTANDING (000's):		
Basic shares outstanding	286,022	285,663
Diluted shares outstanding	288,524	287,727

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

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PRAXAIR, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Millions of dollars)
(UNAUDITED)

	Quarter Ended September 30,	
	2017	2016
NET INCOME (INCLUDING NONCONTROLLING INTERESTS)	$ 435	$ 344
OTHER COMPREHENSIVE INCOME (LOSS)		
Translation adjustments:		
Foreign currency translation adjustments	204	(47)
Income taxes	19	8
Translation adjustments	223	(39)
Funded status - retirement obligations (Note 11):		
Retirement program remeasurements	(9)	(11)
Reclassifications to net income	19	18
Income taxes	(4)	(2)
Funded status - retirement obligations	6	5
Derivative instruments (Note 6):		
Current quarter unrealized gain (loss)	—	—
Reclassifications to net income	—	—
Income taxes	—	—
Derivative instruments	—	—
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)	229	(34)
COMPREHENSIVE INCOME (LOSS) (INCLUDING NONCONTROLLING INTERESTS)	664	310
Less: noncontrolling interests	(26)	(8)
COMPREHENSIVE INCOME (LOSS) - PRAXAIR, INC.	$ 638	$ 302

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PRAXAIR, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Millions of dollars)
(UNAUDITED)

	Nine Months Ended September 30,	
	2017	2016
NET INCOME (INCLUDING NONCONTROLLING INTERESTS)	$1,259	$1,119
OTHER COMPREHENSIVE INCOME (LOSS)		
Translation adjustments:		
Foreign currency translation adjustments	520	392
Income taxes	77	(3)
Translation adjustments	597	389
Funded status - retirement obligations (Note 11):		
Retirement program remeasurements	(29)	(35)
Reclassifications to net income	39	47
Income taxes	(4)	(5)
Funded status - retirement obligations	6	7
Derivative instruments (Note 6):		
Current period unrealized gain (loss)	—	—
Reclassifications to net income	—	1
Income taxes	—	(1)
Derivative instruments	—	—
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)	603	396
COMPREHENSIVE INCOME (INCLUDING NONCONTROLLING INTERESTS)	1,862	1,515
Less: noncontrolling interests	(73)	(36)
COMPREHENSIVE INCOME - PRAXAIR, INC.	$1,789	$1,479

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

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

	September 30, 2017	December 31, 2016
ASSETS		
Cash and cash equivalents	$ 607	$ 524
Accounts receivable - net	1,809	1,641
Inventories	587	550
Prepaid and other current assets	240	165
TOTAL CURRENT ASSETS	3,243	2,880
Property, plant and equipment (less accumulated depreciation of $13,642 in 2017 and $12,444 in 2016)	11,992	11,477
Goodwill	3,234	3,117
Other intangible assets - net	563	583
Other long-term assets	1,343	1,275
TOTAL ASSETS	$ 20,375	$ 19,332
LIABILITIES AND EQUITY		
Accounts payable	$ 947	$ 906
Short-term debt	84	434
Current portion of long-term debt	910	164
Other current liabilities	981	974
TOTAL CURRENT LIABILITIES	2,922	2,478
Long-term debt	8,243	8,917
Other long-term liabilities	2,468	2,485
TOTAL LIABILITIES	13,633	13,880
Commitments and contingencies (Note 12)		
Redeemable noncontrolling interests (Note 14)	11	11
Praxair, Inc. Shareholders' Equity:		
Common stock $0.01 par value, authorized - 800,000,000 shares, issued 2017 and 2016 - 383,230,625 shares	4	4
Additional paid-in capital	4,091	4,074
Retained earnings	13,417	12,879
Accumulated other comprehensive income (loss) (Note 14)	(4,025)	(4,600)
Less: Treasury stock, at cost (2017 - 96,925,284 shares and 2016 - 98,329,849 shares)	(7,231)	(7,336)
Total Praxair, Inc. Shareholders' Equity	6,256	5,021
Noncontrolling interests	475	420
TOTAL EQUITY	6,731	5,441
TOTAL LIABILITIES AND EQUITY	$ 20,375	$ 19,332

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,	
	2017	2016
OPERATIONS		
Net income - Praxair, Inc.	$1,214	$1,094
Noncontrolling interests	45	25
Net income (including noncontrolling interests)	1,259	1,119
Adjustments to reconcile net income to net cash provided by operating activities:		
Transaction costs and other charges, net of payments	27	93
Depreciation and amortization	877	837
Deferred income taxes	22	(30)
Share-based compensation	44	36
Working capital:		
Accounts receivable	(83)	(44)
Inventory	(11)	11
Prepaid and other current assets	(64)	(32)
Payables and accruals	11	6
Pension contributions	(14)	(8)
Long-term assets, liabilities and other	137	59
Net cash provided by operating activities	2,205	2,047
INVESTING		
Capital expenditures	(972)	(1,056)
Acquisitions, net of cash acquired	(18)	(345)
Divestitures and asset sales	22	41
Net cash used for investing activities	(968)	(1,360)
FINANCING		
Short-term debt borrowings (repayments) - net	(353)	359
Long-term debt borrowings	11	925
Long-term debt repayments	(160)	(728)
Issuances of common stock	90	109
Purchases of common stock	(11)	(133)
Cash dividends - Praxair, Inc. shareholders	(675)	(642)
Noncontrolling interest transactions and other	(85)	(122)
Net cash provided by (used for) financing activities	(1,183)	(232)
Effect of exchange rate changes on cash and cash equivalents	29	25
Change in cash and cash equivalents	83	480
Cash and cash equivalents, beginning-of-period	524	147
Cash and cash equivalents, end-of-period	$607	$627

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

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Notes to Condensed Consolidated Financial Statements - Praxair, Inc. and Subsidiaries (Unaudited)

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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 2016 Annual Report on Form 10-K. There have been no material changes to the company's significant accounting policies during 2017.

Accounting Standards Implemented in 2017

Simplifying the Measurement of Inventory – In July 2015, the FASB issued updated guidance on the measurement of inventory. The new guidance requires that inventory be measured at the lower of cost or net realizable value, previously inventory was measured at the lower of cost or market. The adoption of this guidance resulted in no material impact.

Accounting Standards to be Implemented

- Revenue Recognition – In May 2014, the FASB issued updated guidance on the reporting and disclosure of revenue. The new guidance requires the evaluation of contracts with customers to determine the recognition of revenue when or as the entity satisfies a performance obligation, and requires expanded disclosures. Subsequently, the FASB has issued amendments to certain aspects of the guidance including the effective date. This guidance is required to be effective beginning in the first quarter 2018 and includes several transition options.

The Company is currently in the process of evaluating and implementing this new guidance, as required, and will be prepared to adopt the new standard on January 1, 2018 using the modified retrospective transition option. Praxair will provide additional disclosures in its 2017 Annual Report on Form 10-K.

- Leases – In February 2016, the FASB issued updated guidance on the accounting and financial statement presentation of leases. The new guidance requires lessees to recognize a right-of-use asset and lease liability for all leases, except those that meet certain scope exceptions, and would require expanded quantitative and qualitative disclosures. This guidance will be effective for Praxair beginning in the first quarter 2019 and requires companies to transition using a modified retrospective approach. Praxair is in the early stages of implementing the new guidance and will provide updates on the expected impact to Praxair in future filings, as appropriate.
- Credit Losses on Financial Instruments – In June 2016, the FASB issued an update on the measurement of credit losses. The guidance introduces a new accounting model for expected credit losses on financial instruments, including trade receivables, based on estimates of current expected credit losses. This guidance will be effective for Praxair beginning in the first quarter 2020, with early adoption permitted beginning in the first quarter 2019 and requires companies to apply the change in accounting on a prospective basis. We are currently evaluating the impact this update will have on our consolidated financial statements.
- Classification of Certain Cash Receipts and Cash Payments – In August 2016, the FASB issued updated guidance on the classification of certain cash receipts and cash payments within the statement of cash flows. The update provides accounting guidance for specific cash flow issues with the objective of reducing diversity in practice. This new guidance will be effective for Praxair beginning in the first quarter 2018 on a retrospective basis, with early adoption optional. Praxair does not expect this requirement to have a material impact.
- Intra-Entity Asset Transfers – In October 2016, the FASB issued updated guidance for income tax accounting of intra-entity transfers of assets other than inventory. The update requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory in the period when the transfer occurs. This new guidance will be effective for Praxair beginning in the first quarter 2018, with early adoption permitted, and should be applied on a modified retrospective basis. We are currently evaluating the impact this update will have on our consolidated financial statements.
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Simplifying the Test for Goodwill Impairment – In January 2017, the FASB issued updated guidance on the measurement of goodwill. The new guidance eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. The guidance will be effective for Praxair beginning in the first quarter 2020. Praxair does not expect this guidance to have a material impact.

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- Pension Costs - In March 2017, the FASB issued updated guidance on the presentation of net periodic pension cost and net periodic postretirement benefit cost. The new guidance requires the service cost component be reported in the same line item or items as other compensation costs arising from services rendered by employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and not included within operating profit. This guidance will be effective for Praxair beginning in the first quarter 2018, with early adoption optional, and requires companies to transition using a retrospective approach for the presentation of the service cost component and the other cost components and prospectively for the capitalization of the service cost component. Praxair is currently evaluating the impact this update will have on our consolidated financial statements.
- Derivatives and Hedging - In August 2017, the FASB issued updated guidance on accounting for hedging activities. The new guidance changes both the designation and measurement for qualifying hedging relationships and the presentation of hedge results. This guidance will be effective for Praxair beginning in the first quarter 2019, with early adoption optional. Praxair is currently evaluating the impact this update will have on our consolidated financial statements.

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

2. Transaction Costs and Other Charges

2017 Transaction Costs and Other Charges

On June 1, 2017 Praxair and Linde AG ("Linde") entered into a business combination agreement, pursuant to which they agreed to combine their respective businesses subject to shareholder and regulatory approvals (see Note 15). In connection with the intended business combination, Praxair incurred transaction costs which totaled $14 million and $35 million for the quarter and nine months ended September 30, 2017 ($13 million and $34 million after-tax, or $0.05 and $0.12 per diluted share), respectively.

In addition, in the third quarter of 2017, a series of lump sum benefit payments for employees under an international pension plan triggered a settlement of the related pension obligation. Accordingly, Praxair recorded a pension settlement charge of $2 million ($1 million after-tax or less than $0.01 per diluted share).

Classification in the condensed consolidated financial statements

The costs are shown within operating profit in a separate line item on the consolidated statements of income. On the condensed consolidated statement of cash flows, the impact of these costs, net of cash payments, is shown as an adjustment to reconcile net income to net cash provided by operating activities. In Note 13 - Segments, Praxair excluded these costs from its management definition of segment operating profit; a reconciliation of segments operating profit to consolidated operating profit is shown within the segment operating profit table.

Cost Reduction Programs and Other Charges

In the third quarter of 2016, Praxair recorded pre-tax charges totaling $96 million ($63 million after-tax and noncontrolling interests or $0.22 per diluted share). During 2015, Praxair recorded pre-tax charges totaling $165 million ($125 million after-tax and noncontrolling interests, or $0.43 per diluted share).

Reconciliation

The following table summarizes the activities related to the company's cost reduction programs for the nine months ended September 30, 2017:

(millions of dollars)	Severance costs	Other Charges	Total
Balance, January 1, 2017	$ 38	$ 27	$65
Less: Cash payments	(23)	(4)	(27)
Foreign currency translation and other	8	(8)	—
Balance, September 30, 2017	$ 23	$ 15	$38

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2016 Pension Settlement Charge

In 2015 a number of senior managers retired. These retirees are covered by the U.S. supplemental pension plan which provides for a lump sum benefit payment option. Under certain circumstances, such lump sum payments must be accounted for as a settlement of the related pension obligation, but only when paid. Accordingly, in the third quarter 2016, Praxair recorded a pension settlement charge related to net unrecognized actuarial losses of $4 million ($3 million after-tax or $0.01 per diluted share).

2016 Bond Redemption Charge

In February 2016, Praxair redeemed $325 million of 5.20% notes due March 2017 resulting in a $16 million interest charge ($10 million after-tax, or $0.04 per diluted share).

For further details regarding the cost reduction program and other charges, refer to Note 2 to the consolidated financial statements of Praxair's 2016 Annual Report on Form 10-K.

3. Acquisitions

2017 Acquisitions

During the nine months ended September 30, 2017, Praxair had acquisitions totaling $18 million, primarily acquisitions of packaged gas businesses in North America. These transactions resulted in goodwill and other intangible assets of $13 million and $3 million, respectively (see Note 9).

2016 Acquisitions

During the nine months ended September 30, 2016, Praxair had acquisitions totaling $345 million, primarily the acquisition of Yara International ASA's European carbon dioxide business ("European CO2 business") and packaged gases businesses in North America and Europe. These transactions resulted in goodwill and other intangible assets of $129 million and $71 million, respectively. In addition, Praxair purchased a remaining 34% share in a Scandinavian joint venture for $104 million.

European CO2 Acquisition

On June 1, 2016 Praxair, Inc. completed an acquisition of a European CO2 business, which is a leading supplier of liquid CO2 and dry ice primarily to the European food and beverage industries. The business operates CO2 liquefaction plants and dry ice production facilities across the UK, Ireland, Norway, Denmark, Germany, Netherlands, Belgium, France and Italy. This acquisition was accounted for as a business combination; accordingly, the results of operations were consolidated from June 1, 2016 in the European business segment.

The purchase price for the acquisition was approximately $230 million (€206 million) and resulted in $121 million of intangible assets. The intangible assets primarily consist of $69 million of goodwill and $51 million of customer relationships that will be amortized over their estimated useful life of 20 years.

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4. Supplemental Information

Inventories

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

(Millions of dollars)	September 30, 2017	December 31, 2016
Inventories		
Raw materials and supplies	$ 214	$ 197
Work in process	55	45
Finished goods	318	308
Total inventories	$ 587	$ 550

Long-term receivables

Long-term receivables are not material and are largely reserved. Such long-term receivables are included within other long-term assets in the condensed consolidated balance sheets and totaled $51 million and $46 million at September 30, 2017 and December 31, 2016, respectively. These amounts are net of reserves of $53 million and $50 million, respectively. The amounts in both periods relate primarily to government receivables in Brazil and other long-term notes receivable from customers. Collectability is reviewed regularly and uncollectible amounts are written off as appropriate.

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5. Debt

The following is a summary of Praxair's outstanding debt at September 30, 2017 and December 31, 2016:

(Millions of dollars)	September 30, 2017	December 31, 2016
SHORT-TERM		
Commercial paper and U.S. bank borrowings	$ 38	$ 333
Other bank borrowings (primarily international)	46	101
Total short-term debt	84	434
LONG-TERM (a)		
U.S. borrowings (U.S. dollar denominated unless otherwise noted)		
Floating Rate Notes due 2017 (b)	—	150
1.05% Notes due 2017	400	400
1.20% Notes due 2018	499	499
1.25% Notes due 2018 (c)	478	478
4.50% Notes due 2019	598	598
1.90% Notes due 2019	499	499
1.50% Euro-denominated notes due 2020	706	627
2.25% Notes due 2020	299	299
4.05% Notes due 2021	497	497
3.00% Notes due 2021	496	496
2.45% Notes due 2022	597	597
2.20% Notes due 2022	498	498
2.70% Notes due 2023	497	497
1.20% Euro-denominated notes due 2024	648	575
2.65% Notes due 2025	397	397
1.625% Euro-denominated notes due 2025	585	519
3.20% Notes due 2026	725	725
3.55% Notes due 2042	662	662
Other	12	12
International bank borrowings	56	49
Obligations under capital leases	4	7
	9,153	9,081
Less: current portion of long-term debt	(910)	(164)
Total long-term debt	8,243	8,917
Total debt	$ 9,237	$ 9,515

(a) Amounts are net of unamortized discounts, premiums and/or debt issuance costs as applicable.
(b) In February 2017, Praxair repaid $150 million of floating rate notes that became due.
(c) September 30, 2017 and December 31, 2016 include a $1 million and $4 million fair value increase, respectively, related to hedge accounting. See Note 6 for additional information.

In June 2017, the company entered into a $500 million 364-day revolving credit facility with a syndicate of banks which expires in June 2018. The credit facility is with major financial institutions and is non-cancelable by the issuing financial institution until maturity. The only financial covenant requires Praxair not to exceed a maximum 70% leverage ratio, which is consistent with the company's $2.5 billion senior unsecured credit facility (see Note 11 to the consolidated financial statements of Praxair's 2016 Annual Report on Form 10-K). No borrowings were outstanding under the credit agreement at September 30, 2017.

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6. Financial Instruments

In its normal operations, Praxair is exposed to market risks relating to fluctuations in interest rates, foreign currency exchange rates, energy costs and to a lesser extent precious metal prices. The objective of financial risk management at Praxair is to minimize the negative impact of such fluctuations on the company's earnings and cash flows. To manage these risks, among other strategies, Praxair routinely enters into various derivative financial instruments ("derivatives") including interest-rate swap and treasury rate lock agreements, currency-swap agreements, forward contracts, currency options, and commodity-swap agreements. These instruments are not entered into for trading purposes and Praxair only uses commonly traded and non-leveraged instruments.

There are three types of derivatives that the company enters into: (i) those relating to fair-value exposures, (ii) those relating to cash-flow exposures, and (iii) those relating to foreign currency net investment exposures. Fair-value exposures relate to recognized assets or liabilities, and firm commitments; cash-flow exposures relate to the variability of future cash flows associated with recognized assets or liabilities, or forecasted transactions; and net investment exposures relate to the impact of foreign currency exchange rate changes on the carrying value of net assets denominated in foreign currencies.

When a derivative is executed and hedge accounting is appropriate, it is designated as either a fair-value hedge, cash-flow hedge, or a net investment hedge. Currently, Praxair designates all interest-rate and treasury-rate locks as hedges for accounting purposes; however, currency contracts are generally not designated as hedges for accounting purposes unless they are related to forecasted transactions. Whether designated as hedges for accounting purposes or not, all derivatives are linked to an appropriate underlying exposure. On an ongoing basis, the company assesses the hedge effectiveness of all derivatives designated as hedges for accounting purposes to determine if they continue to be highly effective in offsetting changes in fair values or cash flows of the underlying hedged items. If it is determined that the hedge is not highly effective, then hedge accounting will be discontinued prospectively.

Counterparties to Praxair's derivatives are major banking institutions with credit ratings of investment grade or better and no collateral is required, and there are no significant risk concentrations. Management believes the risk of incurring losses on derivative contracts related to credit risk is remote and any losses would be immaterial.

The following table is a summary of the notional amount and fair value of derivatives outstanding at September 30, 2017 and December 31, 2016 for consolidated subsidiaries:

	Notional Amounts		Fair Value Assets		Liabilities	
(Millions of dollars)	September 30, 2017	December 31, 2016	September 30, 2017	December 31, 2016	September 30, 2017	December 31, 2016
Derivatives Not Designated as Hedging Instruments:						
Currency contracts:						
Balance sheet items (a)	$2,303	$ 2,104	$2	$ 11	$ 18	$ 18
Derivatives Designated as Hedging Instruments:						
Currency contracts:						
Balance sheet items (a)	$38	$ 38	$—	$ 3	$ 1	$ —
Forecasted purchases (a)	4	—	—	—	—	—
Interest rate contracts:						
Interest rate swaps (b)	475	475	1	4	—	—
Total Hedges	$517	$ 513	$1	$ 7	$ 1	$ —
Total Derivatives	$2,820	$ 2,617	$3	$ 18	$ 19	$ 18

(a) Assets are recorded in prepaid and other current assets, and liabilities are recorded in other current liabilities.

(b) Assets are recorded in other long term assets.

Currency Contracts

Balance Sheet Items

Foreign currency contracts related to balance sheet items consist of forward contracts entered into to manage the exposure to fluctuations in foreign-currency exchange rates on recorded balance sheet assets and liabilities denominated in currencies other than the functional currency of the related operating unit. Certain forward currency contracts are entered into to protect underlying monetary assets and liabilities denominated in foreign currencies from foreign exchange risk and are not designated as hedging instruments. The fair value adjustments on these contracts are offset by the fair value adjustments recorded on the underlying monetary assets and liabilities. Praxair also enters into forward currency contracts, which are designated as hedging instruments, to limit the cash flow exposure on certain foreign-currency denominated intercompany loans. The fair value adjustments on these contracts are recorded to AOCI, with the effective portion immediately reclassified to earnings to offset the fair value adjustments on the underlying debt instrument.

Forecasted Purchases

Foreign currency contracts related to forecasted purchases consist of forward contracts entered into to manage the exposure to fluctuations in foreign-currency exchange rates on forecasted purchases of capital-related equipment and services denominated in currencies other than the functional currency of the related operating units. These forward contracts were designated and accounted for as cash flow hedges.

Net Investment Hedge

In 2014 Praxair designated the €600 million ($706 million as of September 30, 2017) 1.50% Euro-denominated notes due 2020 and the €500 million ($585 million as of September 30, 2017) 1.625% Euro-denominated notes due 2025, as a hedge of the net investment position in its European operations. In 2016 Praxair designated an incremental €550 million ($648 million as of September 30, 2017) 1.20% Euro-denominated notes due 2024 as an additional hedge of the net investment position in its European operations. These Euro-denominated debt instruments reduce the company's exposure to changes in the currency exchange rate on investments in foreign subsidiaries with Euro functional currencies. Since hedge inception, exchange rate movements have reduced long-term debt by $125 million (long-term debt increased by $214 million during the first nine months of 2017), with the offsetting gain shown within the cumulative translation component of AOCI in the condensed consolidated balance sheets and the consolidated statements of comprehensive income.

Interest Rate Contracts

Outstanding Interest Rate Swaps

At September 30, 2017, Praxair had one outstanding interest rate swap agreement with a $475 million notional amount related to the $475 million 1.25% notes that mature in 2018. The interest rate swap effectively converts fixed-rate interest to variable-rate interest and is designated as a fair value hedge. Fair value adjustments are recognized in earnings along with an equally offsetting charge / benefit to earnings for the changes in the fair value of the underlying debt instrument. At September 30, 2017, $1 million was recognized as an increase in the fair value of these notes ($4 million at December 31, 2016).

Terminated Treasury Rate Locks

The following table summarizes the unrecognized gains (losses) related to terminated treasury rate lock contracts:

(Millions of dollars)	Year Terminated	Original Gain / (Loss)	Unrecognized Gain / (Loss) (a) September 30, 2017	December 31, 2016
Treasury Rate Locks				
Underlying debt instrument:				
$500 million 2.20% fixed-rate notes that mature in 2022 (b)	2012	$ (2)	$ (1)	$ (1)
$500 million 3.00% fixed-rate notes that mature in 2021 (b)	2011	(11)	(4)	(5)
$600 million 4.50% fixed-rate notes that mature in 2019 (b)	2009	16	3	4
Total - pre-tax			$ (2)	$ (2)
Less: income taxes			1	1
After- tax amounts			$ (1)	$ (1)

(a) The unrecognized gains / (losses) for the treasury rate locks are shown in accumulated other comprehensive income ("AOCI") and are being recognized on a straight line basis to interest expense – net over the term of the underlying debt agreements. Refer to the table below summarizing the impact on the company's consolidated statements of income and AOCI for current period gain (loss) recognition.

(b)

The notional amount of the treasury rate lock contracts are equal to the underlying debt instrument with the exception of the treasury rate lock contract entered into to hedge the $600 million 4.50% fixed-rate notes that mature in 2019. The notional amount of this contract was $500 million.

The following table summarizes the impact of the company's derivatives on the consolidated statements of income:

	Amount of Pre-Tax Gain (Loss) Recognized in Earnings *			
	Quarter Ended September 30,		Nine Months Ended September 30,	
(Millions of dollars)	2017	2016	2017	2016
Derivatives Not Designated as Hedging Instruments				
Currency contracts:				
Balance sheet items				
Debt-related	$ 19	$ (10)	$ 128	$ 73
Other balance sheet items	(1)	(1)	1	2
Total	$ 18			