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Merck in the Muck

Posted by David Gaffen

Shares of [Merck](#) & Co. have not had a day as bad as Monday in a long time — three-plus years, in fact. The stock dove 15% today after cardiologists recommended doctors [reduce issuing prescriptions](#) of the company's cholesterol drugs, Vytorin and Zetia, which it jointly markets with [Schering-Plough](#) Corp.

Sunday, cardiologists at an American College of Cardiology panel in Chicago **presented data from a trial showing that the Vytorin drug** — a combination of Zetia and a previous Merck blockbuster, Zocor — is no better than Zocor, which is **now available in generic form**.

Options activity Monday reflected a **growing number of bearish hedges** on Merck, as more than 10,000 April put options (the option to sell a stock at a later date at a given price) at a \$37.50 strike price were traded. Shares were lately traded at \$37.85. Prior to today, only 2,000 contracts had been opened at that price. **In addition, the cost of those puts increased during trading as investors rushed to hedge against further downside in the stock.**

Merck shares have not declined as much in one day since Sept. 30, 2004, **when the stock fell 27%** after the company pulled arthritis drug Vioxx from the market due to heart problems suffered by some patients who took the medication.

This weekend's report, **and subsequent selloff in Merck shares**, served as the last insults to persevering holders of the stock who suffered through a tough quarter. Prior to Monday, the last day of trading for the first quarter, shares had declined by 23% for 2008.



While analysts were, for the most part, bullish, **as 13 of 21 analysts held the equivalent of buy ratings, according to Thomson Financial**, the bearish bets by investors were increasing as analysts once again question the ability of Merck — and other pharmaceutical companies — to introduce new drugs that will replace the revenue power of previous blockbuster drugs now offered in generic form.

“I think it’s an understandable reaction that valuations are coming down to take away a premium for growth, because their growth is more questionable for the future,” says Damon Ficklin, research analyst at Polen Capital Management in Boca Raton, Fla. His firm does not own shares of Merck or Schering-Plough, which fell 27% on the day.

Despite the increase in bearish bets, April options open interest (the number of outstanding contracts) still reflects a bullish leaning, with more than 119,000 call contracts outstanding to 87,000 put contracts.