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Why Are Investors Optimistic on Downtrending CVS Caremark Corporation?

Examining technical and sentiment indicators for CVS Caremark Corporation (CVS)

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Keywords: CVS WAG LDG stocks options

CVS Caremark Corporation (CVS: sentiment, chart, options) has been no stranger to the news this past week. If you haven't been paying attention CVS has been working on a deal to acquire Longs Drug Stores Corp. (LDG), in a move to bolster CVS's presence in the West and in Hawaii.

A Little Background

CVS is a pharmacy chain that following its acquisitions of the Eckerd chain and stores from Albertsons, CVS now fills more prescriptions at more drugstores than any other drugstore operator. CVS operates about 6,250 stores, in 38 states. Additionally, since purchasing Caremark Corporation in 2007 the company has operated in 2 segments CVS/pharmacy and Caremark Pharmacy Services. The pharmacy fills more than 1 of every 7 retail prescriptions within the United States, and the latter is 1 of the nation's leading pharmacy-benefit management companies, providing comprehensive prescription benefit management services to more than 2,000 health plans.

Merger and Acquisition News

In August, CVS inked a deal to acquire rival store Longs Drug Store for about $2.57 billion, or $71.50 per share. Longs has 521 stores in Arizona, California, Hawaii, and Nevada and also owns Rx America, a prescription-benefits manager with more than 8 million members.

However, the deal has seen its share of issues, mostly from a rival chain store. Walgreen Company (WAG) has offered to purchase Longs for $75 per share, or $2.8 billion. In a statement, Longs said the CVS bid is more likely to be completed, explaining that Walgreen has not explained how it would fund the buyout. Furthermore, *Reuters* reported this morning LDG is no longer holding merger talks with WAG, paving the way for CVS to takeover the chain.

Taking a Look at Technicals

After hitting an all-time high in June of this year, CVS has dropped more than 23%. Currently, the equity is seeing resistance from its 10-week moving average. This descending trendline could push the shares lower. On the flip side, the equity *was* benefiting from some support in the 35 region. However, it had been testing this level, and today dropped below this support. Not only did the shares fall under this significant level of support, but they also tagged a new

52-week low.

**Weekly Chart of CVS since October 2007
with 10-Week Moving Average**

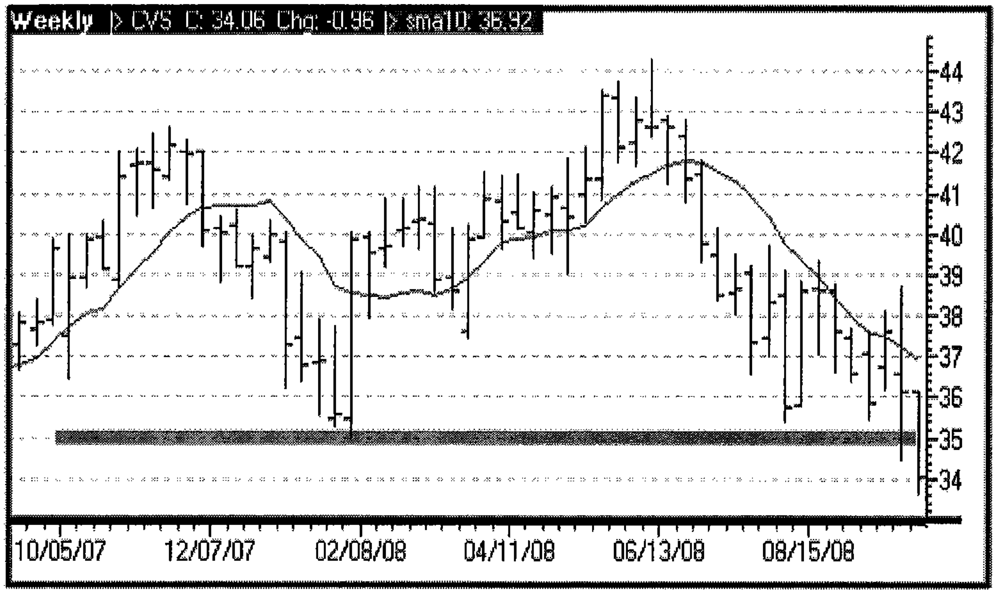

Chart Courtesy Thomson One

Looking at a monthly chart, we see that the security is being pressured lower by its 10-month moving average. Additionally, the shares were poised to take support from their 32-month moving average, but today's plunge put them below this trendline. This moving average could now act as additional resistance in the future.

Monthly Chart of CVS since November 2007
with 10-Month and 32-Month Moving Averages

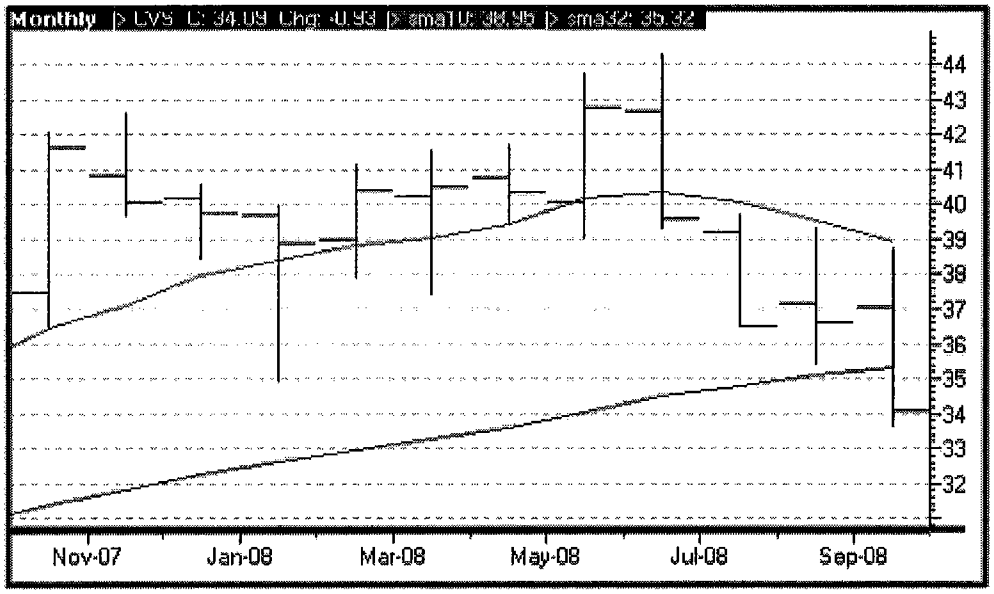

Chart Courtesy Thomson One

What Analysts Are Saying...

For a stock that has lost more than 21% in 3.5 months, analysts seem pretty enthused. According to *Zacks*, no less than 10 brokerages currently rate the shares a "strong buy" and 2 are recommending the stock with a "buy" rating. On the other side, only 4 brokerages rate the equity a "hold." Additionally, according to *Thomson Financial*, the security's current average 12-month price target estimate is docked at $48.14. Not only is this estimate higher than CVS's all-time high, but it also indicates that analysts are expecting the shares to rally more than 37% within the next year. For a dropping stock, the analysts seem overly optimistic, and there is little room for upgrades. Meaning, if the stock is victim to any negative brokerage activity it could pressure the shares even lower.

BUY/SELL/HOLD RATINGS

Strong Buy	10
Buy	2
Hold	4
Sell	0
Strong Sell	0

In the Options Arena

In the October series, the most popular call contract is at the 37.50 strike, which is currently 12% out of the money, with open interest of 3,471 contracts. This out-of-the-money open interest indicates that short-term speculators have high hopes for the shares. Looking ahead at the November series, there are currently only 15,111 contracts open on the 40 call, which is almost 20% out of the money. Any unwinding of this optimism could smack the shares lower.

Furthermore, the put players have little reason to back out of their winning positions. The most popular front-month put contract is at the 35 strike. Today's drop put this contract in the money.

During the past 10 days, CVS has logged an ISE call/put ratio of 17.08. In other words, the stock's call options have been more than 17 times as popular as their put counterparts. What's more, this ratio ranks higher than any other reading taken during the past year, suggesting that option players are extremely optimistic.

The Final Verdict

In conclusion, CVS followers should be careful. The stock slipped below key levels of support today, and there is still plenty of optimism to unwind on the shares. From a contrarian perspective, the combination of dropping prices and bullish sentiment has bearish implications.

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