

Microsoft's Latest Yahoo Snub Leaves Some Traders Uncertain.

There's that old saw about if you look around the table at a poker game and can't recognize the sucker, it's you. Yahoo's Jerry Yang might have some experience in this matter, as he's now broached the possibility of a merger with Microsoft -- something he rejected earlier in the year.

Options traders can be forgiven, then, if they're taking a wait-and-see approach.



Shares of Yahoo fell 13% to \$12.20 Friday, one day after the dissolution of a revenue-sharing deal with its larger competitor Google, and, after Microsoft Chief Executive Steve Ballmer pointedly dismissed the idea of a merger with Yahoo.

The current back-and-forth centers on the idea that Microsoft doesn't plan to buy Yahoo, but that it may put together some sort of search-partnership deal, which Mr. Ballmer endorsed as a possibility. While a number of analysts are convinced this will happen, those in the options market on Friday weren't.

Activity was high in the November \$13 calls, where more than 17,000 contracts changed hands, which suggests that people are saying "the stock is being massively oversold and people are looking for it to rebound in short order," says Jocelynn Drake, analyst at Schaeffer's Investment Research. However, more than 16,000 \$12 put contracts, or options to sell the stock at \$12 at a later date, also changed hands.

However, the action in the December and January options don't suggest an undercurrent of optimism that some sort of deal between Microsoft and Yahoo will happen, even a search-partnership deal. There was more activity in puts than calls in December options, which reflects expectations for weakness in Yahoo's share price. Activity in January options slanted more to the call side, with more than 20,000 out-of-the-money calls changing hands, compared with about 7,000 put contracts.

"There is the hope that eventually they will do something, but the time frame is questionable," says William Lefkowitz, chief options strategist at vFinance Investments. "They could say they're not making a bid and then make a bid."

Indeed, Youssef Squali, analyst at Jefferies & Co., predicted that Microsoft would make an offer by the end of the year. Mr. Squali says a search deal with similar terms as the offer in July would guarantee annual cash flow of \$2.3 billion to Yahoo, and such an offer would result in a net present value of about \$11 billion, or about \$8 a share. (Mr. Squali does not own Yahoo shares and has a \$20 price target on them.) "At the end of the day, a search deal is very much in the cards," he says.

For now, traders don't agree. But things can always change.

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