The Bear Facts

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WCI Communities Inc.
WCI - $27.50 – NYSE
New Recommendation

Recommendation: Sell Short

Reasons For Short Sale Recommendation

- Homebuilder facing slowdowns in several of its markets.
- Percentage of completion accounting overstates revenue.
- Overall gross margin declined from 23.2% to 21.2% in 2005 third quarter.
- Gross margin decreasing, 25.1% vs 31.3% YR/YR in 2005 third quarter in towers.
- Net new orders (units) declined 20.9% YR/YR in 2005 third quarter in towers.
- Contract values of new tower orders declining.
- Backlog in tower dollars up 34.2% but only up 7.1% in units.
- Revenue in 2005 boosted by one-time items, hurricanes, land sales.
- Overall slowdown or bust in US housing market.

Financials

52 – Week Low 10-12-2005	$23.73	Book Value (mrq)	$22.64
52 – Week high 2-5-2005	$36.30	Diluted Earnings/Shr (ttm)	$4.07
Daily Volume Avg.	618,146	Diluted Earnings/Shr (mrq)	$0.85
52 – Week Change	-12.6%	Sales/Shr (ttm)	$55.60
Market Capitalization	**$1.22B**	Cash/Shr (mrq)	$1.63
Shares Outstanding	44.36M	Price/Book (mrq)	1.21
Float	NA	Price/Earnings (ttm)	6.74
Profit Margin (ttm)	7.64%	Price/Sales (ttm)	0.49
Operating Margin (ttm)	13.77%	Revenue (ttm)	$2.49B
Return on Assets (ttm)	6.95%	EBITDA (ttm)	$360.35M
Return on Equity (ttm)	20.71%	Income to common (ttm)	$190.46M
Current Ratio (mrq)	6.731	Shares Short 1-10-06	5.52M
Debt/Equity (mrq)	1.475	% of Float Short	14.3%
Total Cash (mrq)	$72.26M	Short Ratio	11.0

(ttm) = Trailing 12 months, (mrq) = Most recent quarter, M = Millions, B = Billions, k = Thousands

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Business Description (10K)

WCI Communities, Inc. (the Company or WCI), a Delaware corporation, is a fully integrated homebuilding and real estate services company with over 50 years of experience in the design, construction and operation of leisure-oriented, amenity-rich master-planned communities. We began our operations in Florida through companies that principally focused on developing amenitized communities in the state. In the late 1990's, we changed our business model to capture greater revenues and gross margins by becoming the principal homebuilder in most of our communities. In May 2004, we initiated homebuilding operations outside of Florida with the acquisition of Spectrum Communities, a developer and homebuilder that currently operates in New York, New Jersey and Connecticut. This acquisition established our position in the Northeast U.S. luxury residential market and broadens our capabilities to take advantage of future opportunities in the mid- and high-rise urban residential market. When this report uses the words "we," "us," and "our," these words refer to WCI Communities, Inc. and its subsidiaries, unless the context otherwise requires.

We offer a full complement of products and services to enhance our customers' lifestyles and meet their expectations. We design, sell and build single- and multi-family homes serving move-up, pre-retirement and retirement homebuyers. We design, sell and build luxury residential towers targeting affluent, leisure-oriented home purchasers. We acquire and develop the land in our communities, construct the residences, design, build and operate the amenities in many of our communities and otherwise control most aspects of the planning, design, development, construction and operation of our communities. In certain situations, we elect to sell parcels and lots to others, including other builders and developers or end users.

We conduct development and homebuilding operations in the following markets:

Florida

- East Coast: **Miami, Fort Lauderdale**, **West Palm Beach/Boca Raton**, Daytona Beach and Jacksonville.
- West Coast: Marco Island, Naples, Fort Myers/Cape Coral, Punta Gorda, Sarasota/Bradenton, Tampa/St. Petersburg/Clearwater and Pensacola.

New York: Dix Hills, Croton-on-Hudson, Sleepy Hollow, West Nyack, Eastport, East Fishkill, Lake Grove, Tarrytown and Hopewell Crossing.

New Jersey: Monroe and North Bergen.

Connecticut: Southbury and Danbury.
Maryland.
Virginia and Washington D.C.

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As of December 31, 2004, we have 50 locations where we are building single- and multi-family homes or mid- and high-rise residential units or operating amenity facilities. In total, we control over 17,000 acres of land, where we plan to develop approximately 17,000-20,000 future residences.

Traditional homes

We design, sell and build traditional homes serving primary, second and retirement homebuyers. Our homes range from approximately 1,080 square feet to 8,000 square feet in living space and are priced from over $100,000 to over $5.0 million, with an average selling price per new order for the year ended December 31, 2004 of $432,000. We build most of these homes within our master-planned communities, which often feature attractive amenities, including hotels, such as Ritz-Carlton, Hyatt, Regent International, and Starwood's luxury collection. Many of our communities also include golf courses designed by Raymond Floyd, Peter Jacobson and Greg Norman. We believe that this approach increases the value of our homes and communities and helps us attract affluent purchasers. Additionally, we sometimes sell selected lots directly to buyers for the design and construction of large custom homes.

Sales. We maintain sales centers with community scale models and lifestyle and home demonstration displays. We also maintain professionally decorated model homes, which demonstrate the benefits and features of our products and the community lifestyles. We maintain and manage an inventory of homes that are available immediately or within a few months.

We employ a wide range of sales incentives to market our homes to prospective buyers. These incentives generally fall into one of three categories: (1) cash discounts against the purchase price or credits towards options and upgrades from the standard home features; (2) golf or sports club memberships, automobiles and/or other tangible merchandise; and (3) payment of the buyer's loan closing costs, travel related expenses, and/or certain future expenses for a limited time period such as ad valorem taxes or property owner's association assessments.

Construction. **We typically act as the general contractor in the construction of our residences**. Our employees provide purchasing and quality assurance for, and construction management of, the homes we build, while the material and labor components of our houses are provided by subcontractors. Depending upon the size and complexity of a home's design, the availability of labor, materials and supplies, our construction time ranges from about 100 to 365 calendar days for our single and multi-family homes.

Tower residences

We design, sell and build luxury residential towers and condominium hotels targeted to affluent, leisure-oriented home purchasers. Residences available for sale in our towers range in size from approximately 1,100 square feet to 11,700 square feet in living space and are priced from over $360,000 to over $12.0 million. The average selling price per new order for a tower unit in 2004 was approximately $1.0 million. Our towers range in size from 5 to 30 stories and include 15 to 309 residences.

In 2004, we entered into the design, marketing and development of two condominium hotels located in the Miami and Singer Island, Florida markets, respectively. The Miami development will consist of up to a

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124-unit resort-hotel managed by Regent International Hotels and a 185-unit residential tower. The Singer Island development will consist of up to a 239-unit resort-hotel managed by Starwood Hotels & Resorts Worldwide, Inc. and a 66-unit residential tower. Each condominium hotel plans to offer an array of amenities such as, but not limited to: a gourmet signature restaurant; elite in-residence spa, swimming pool and cabanas; 24-hour concierge, butler, room and valet services.

Design. We commence the design and planning of towers by conducting extensive research relating to the market, customer base, product requirements, pricing and absorption. We also contract for the services of an experienced third party general contractor during the early stages to assist in design, engineering and the estimation of construction costs.

Sales. Once the design for a tower has been completed and its construction costs have been estimated, marketing of the residences commences. We sometimes use various sales incentives in order to attract homebuyers. The use of incentives such as cash discounts against the purchase price or credits toward options and upgrades, depends largely on local economic and competitive market conditions.

Construction. **We hire experienced and bonded third party general contractors specializing in the construction of towers to construct these buildings.** By hiring experienced general contractors to construct our towers, we mitigate many of the risks associated with construction. As the developer of the towers that we build, we manage the entire process from planning to closing of completed residences and turnover of the condominium association to residents.

Generally, construction is not commenced until a substantial number of units are under non-cancelable contracts. We will generally collect from each purchaser a deposit ranging from 10% to 30% of a residence purchase price to cover a portion of estimated construction costs. Once construction is completed, closings of sold residences usually occur within one month, at which time we are paid the balance of the purchase price for the residences sold. Over our 16 year history of building towers, approximately 1% to 2% of the contracts for which nonrefundable contract deposits were collected by us defaulted on the obligation to close the purchase of the tower unit; however, there can be no assurance that our cancellations or defaults will not increase in the future.

Realty brokerage

In 2004, we extended our franchise agreement with Prudential Real Estates Affiliates, Inc. This agreement, allows us to provide exclusive residential brokerage services as Prudential Florida WCI Realty in seven geographic areas across nine counties in Florida and commercial brokerage services in Naples.

Title insurance

We provide title insurance and closing services through a subsidiary, which underwrites its policies on behalf of large national title insurers and derives its revenues from commissions on title insurance premiums and closing services provided to our customers, third party residential closings and commercial closings.

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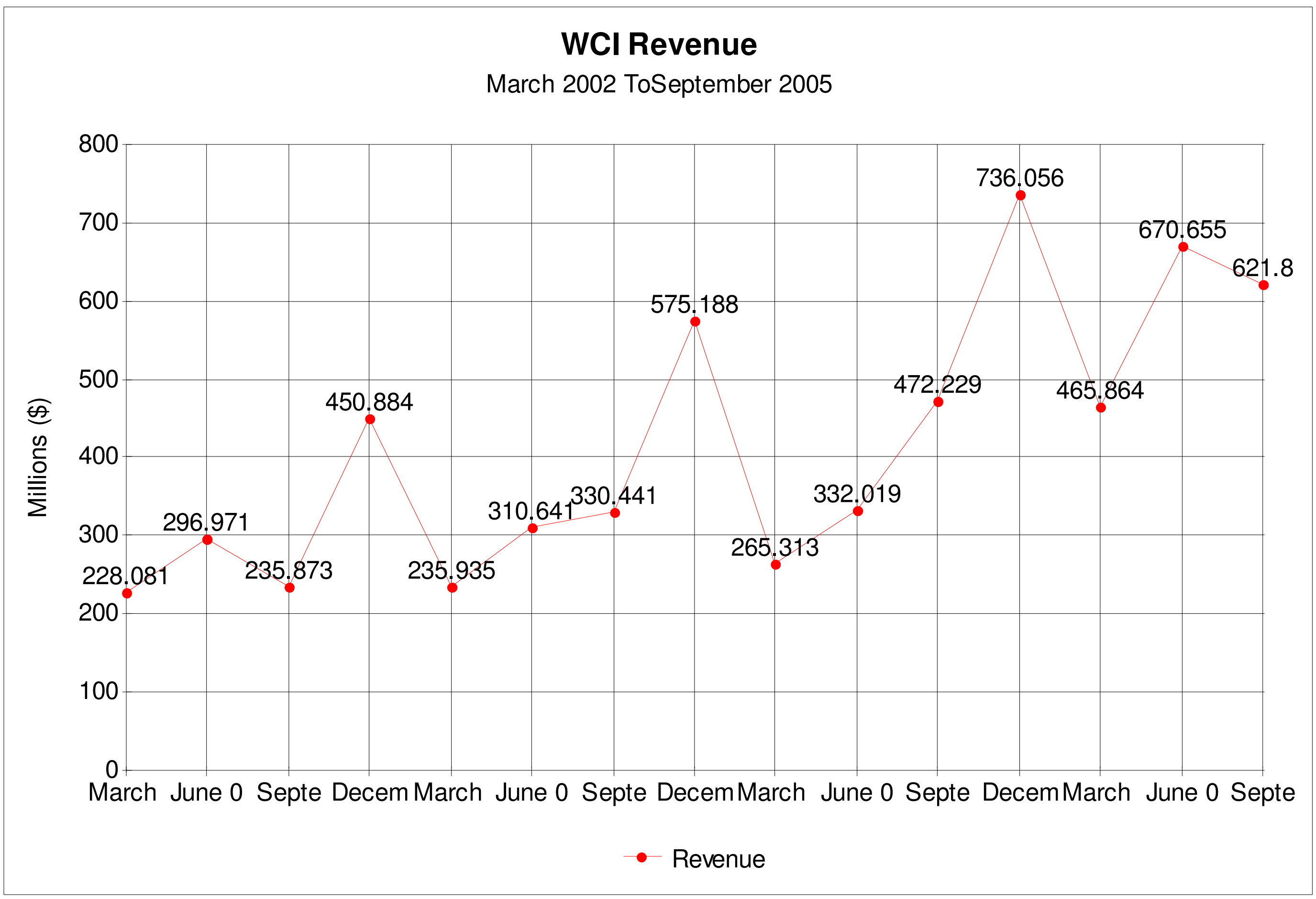
Mortgage banking

We provide residential mortgage banking services to our buyers, as well as third party purchasers through our subsidiary, Financial Resources Group, Inc. (FRG) which also does business as WCI Mortgage. FRG originates home mortgages, which are subsequently sold to mortgage investors.

Slowdown in Several Hot Markets

WCI operates in several housing bubble markets, including Miami, Ft. Lauderdale, and Washington D.C. There was a noticeable slowdown in WCI's 2005 third quarter results. Revenue for the quarter ended September 2005 was $629.1 million, up 31.7 percent, from $472.2 million a year earlier. However, sequentially, revenue declined $48.8 million or 7.3 percent from the 2005 second quarter.



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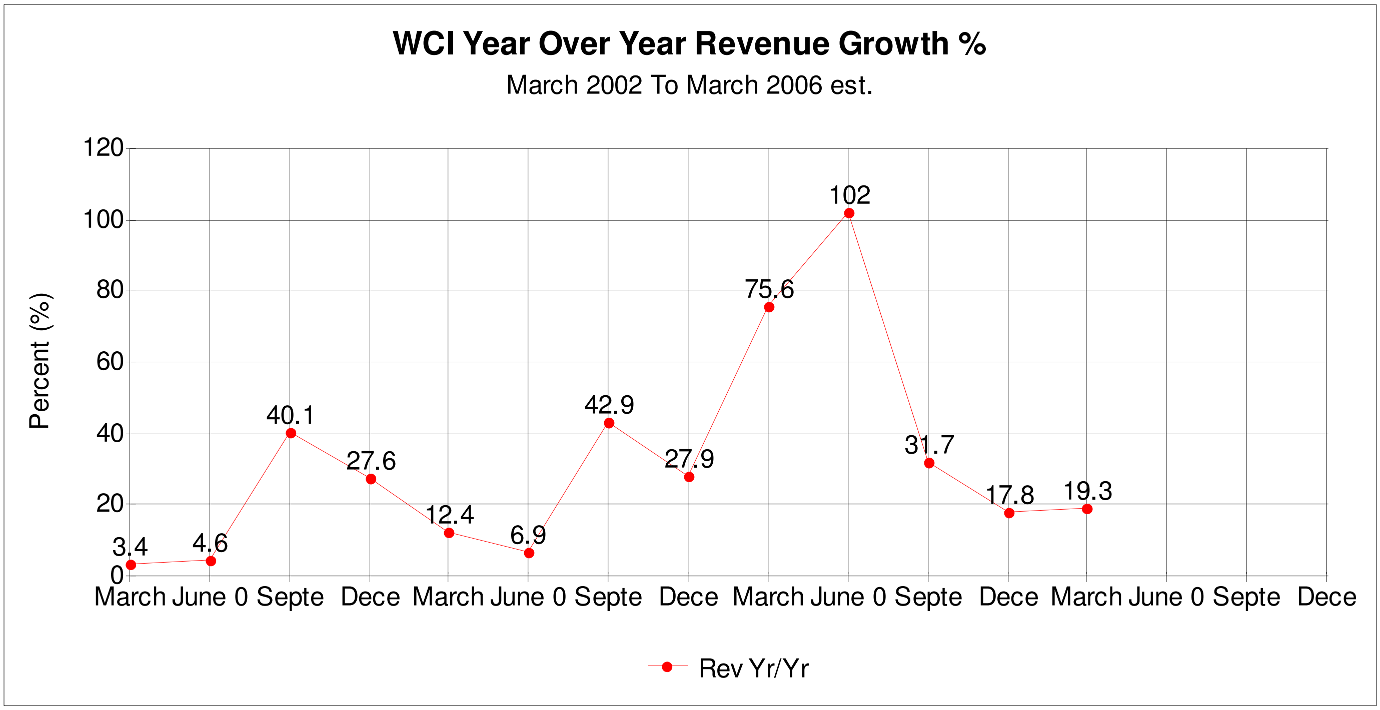

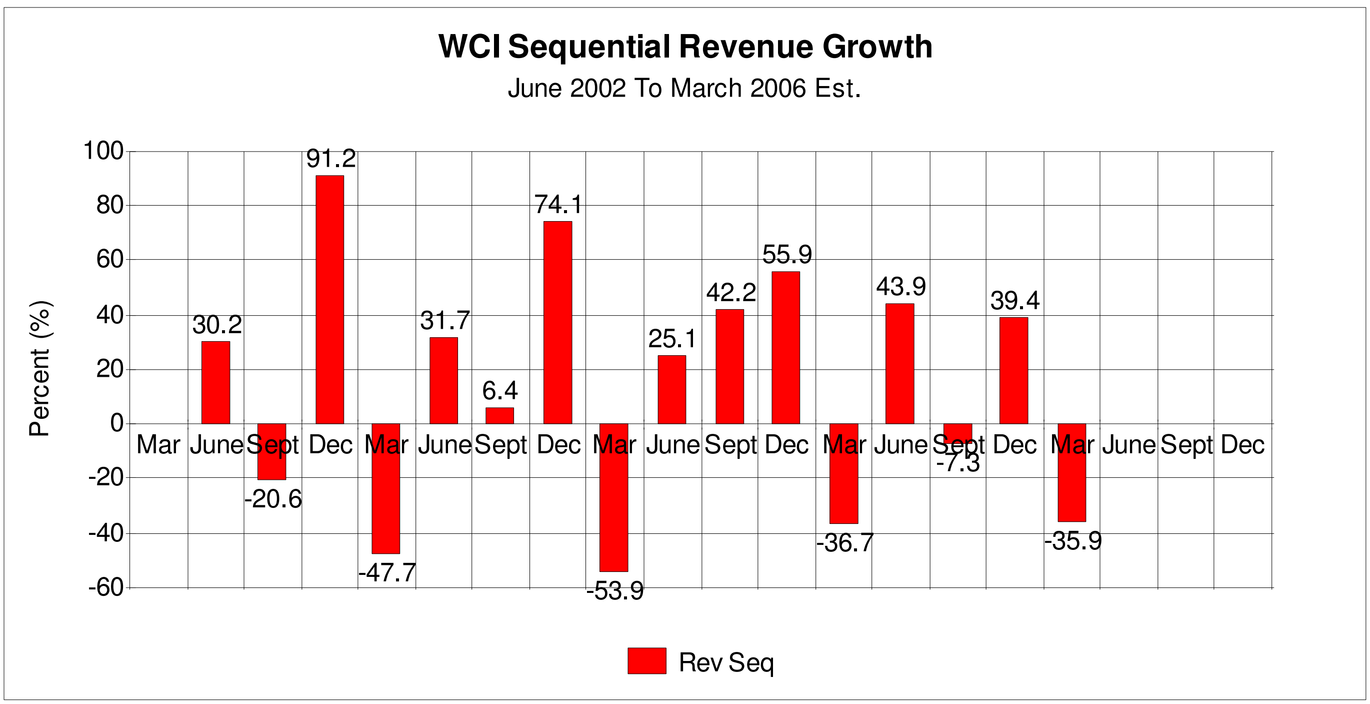

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Notice from the previous sequential revenue chart that revenue growth in the quarters ending in December shows how growth is slowing. Revenue growth went from 91.2% in 2002 to 74.4% in 2003 to 55.9% in 2004 to an estimated 39.4% in 2005.

Percentage of Completion Accounting

Revenue recognition — Traditional Homebuilding. We recognize homebuilding revenues when homes close and title to and possession of the property is formally transferred to the buyer. The majority of our homebuilding revenues are received in cash within one or two days subsequent to closing. We include amounts in transit from title companies at the end of each reporting period in cash and cash equivalents.

Revenue recognition — Tower Homebuilding. **Revenue for tower residences under construction is recognized on the percentage-of-completion method**. Revenue is recorded as a portion of the value of non-cancelable tower unit contracts when (1) construction is beyond a preliminary stage, (2) the buyer is committed to the extent of being unable to require a full refund except for non-delivery of the residence, (3) a substantial percentage of residences are under non-cancelable contracts, (4) collectibility of sales prices are reasonably assured and (5) costs can be reasonably estimated. Revenue recognized is calculated based upon the percentage of total costs incurred in relation to estimated total costs. The percentage-of-completion method is applied since we meet applicable requirements under SFAS 66, Accounting for Sales of Real Estate. Actual revenues and costs to complete building construction in the future could differ from our current estimates. If our estimates of tower revenues and development costs are significantly different from actual amounts, then our revenues, related cumulative profits and costs of sales may be revised in the period that estimates change.

Tower revenues increased 5.4% and 32.7% for the three and nine months ended, respectively. The increase for the respective periods was primarily due to the increase in the number of towers recognizing percentage-of-completion revenues, offset by a decrease in revenue from the sale of completed tower units. The three months ended September 30, 2004 benefited from the initial revenue recognition of one tower, which contributed approximately $104.2 million compared to $37.6 million for same period in 2005. We believe that this percentage of completion accounting overstates actual revenue.

Gross Margin

Overall gross margin declined from 23.2% in the 2004 third quarter to 21.3% in the 2005 third quarter. This was despite overall revenue increasing 31.7%. In tower residences, the gross margin situation is much worse.

Tower revenue increased only 5.4% from $241.1 million to $254.0 million in the 2005 third quarter. Tower gross margin plunged from 31.3% to 25.1%. **The decrease in gross margin percentage for the three and nine months was primarily due to**: **(1) a shift in the mix of towers under percentage-of-completion toward a greater proportion of moderately-priced, lower margin towers, (2) the reduced**

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margin from the closings of completed tower units which averaged approximately 25.1% and 29.8% margin in 2005 compared to 32.9% and 35.3% for the respective periods in 2004, (3) revisions to interest capitalization calculations for tower inventories and (4) a $2.0 million net charge to cost of sales in the three months ended **due to reductions in estimated gross margin associated with towers under construction and/or closed out during the quarter.** This is why we believe that revenue is overstated with percentage of completion accounting.

New Orders

Net new orders of towers declined from 421 units to 333 units, a decline of 20.9% in the 2005 third quarter compared to the year earlier. The contract values of new orders decreased 9.5% from $428.5 million to $387.6 million. The **decrease in contract values of new orders for the three months was primarily due to the decrease in finished inventory available for sale and a decline in the number of towers converting to contract**. During the three months ended September 30, 2005, WCI converted two towers containing 212 units compared to five towers containing 626 units in the comparable prior year period.

Obtaining permits in certain locations continues to take longer than it has historically. New WCI communities in Florida and the Northeast, originally scheduled to open in the latter half of 2005, are now expected to commence selling in the first half of 2006. This timing change, along with the continued limiting of releases in certain existing communities are **expected to cause orders in the fourth and first quarters of 2006 to potentially fall below year-ago levels.**

“Limiting of releases in certain existing communities” is code for we can’t sell everything we would like to because of the slowdown in housing. In many of their markets, speculators account for 20 to 25 percent of all purchasers. These speculators were only buying because prices were rising fast. They will disappear when prices start to drop.

2006

On October 31, 2005 when WCI released its third quarter financial results, WCI lowered EPS guidance by $0.10 to $0.40 a share. On December 8, 2005, WCI raised EPS guidance for 2006 to $5.25 to $5.50 a share up from the previous estimate of at least $5.00. However, analysts have been lowering WCI’s EPS estimates. For the 4th quarter of 2005, estimates have been lowered from $1.56 to $1.25, a drop of almost 20%. For the 2005 fiscal year EPS estimates have been lowered from $4.33 to $4.04. For the first quarter of 2006, EPS estimates have been lowered from $0.59 to $0.53. For the 2006 fiscal year EPS estimates have been raised from $4.85 to $5.09. This is less than the company’s guidance. We believe that EPS estimates will be lowered for 2006.

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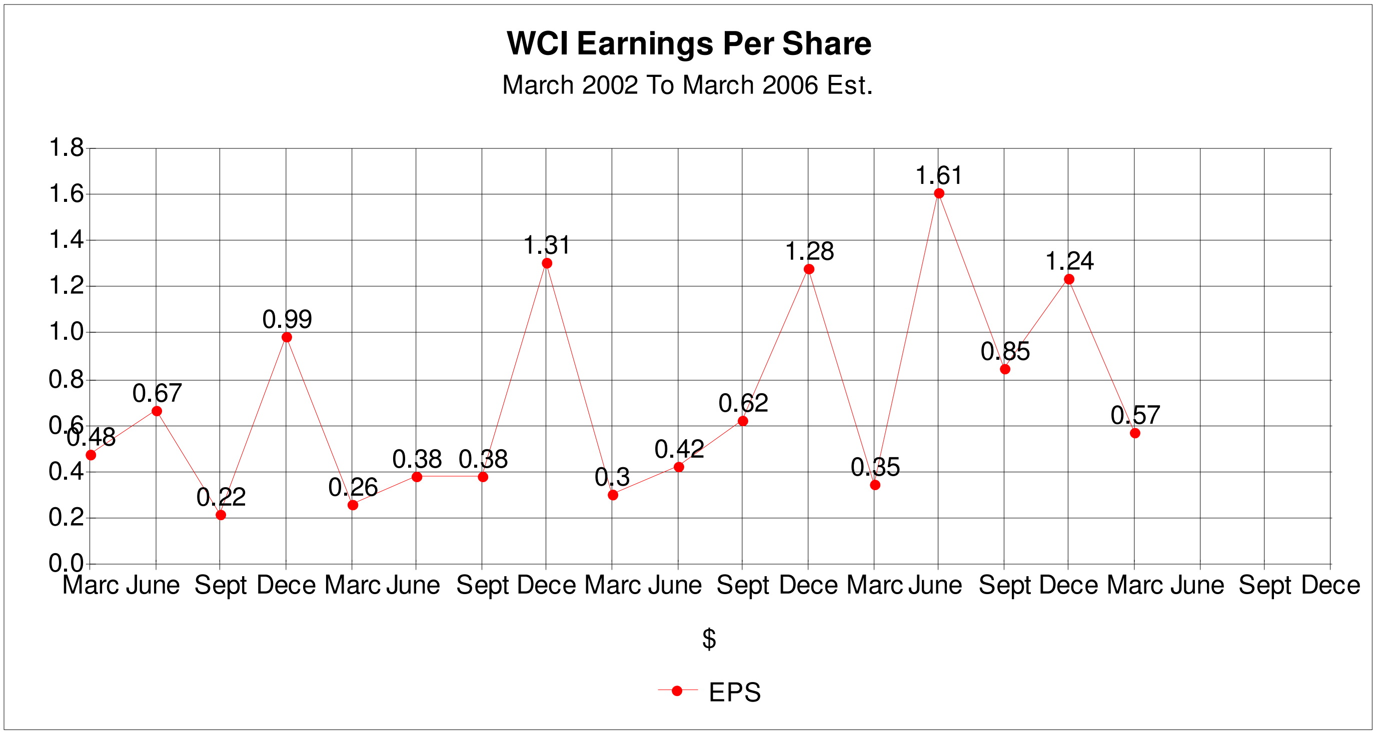

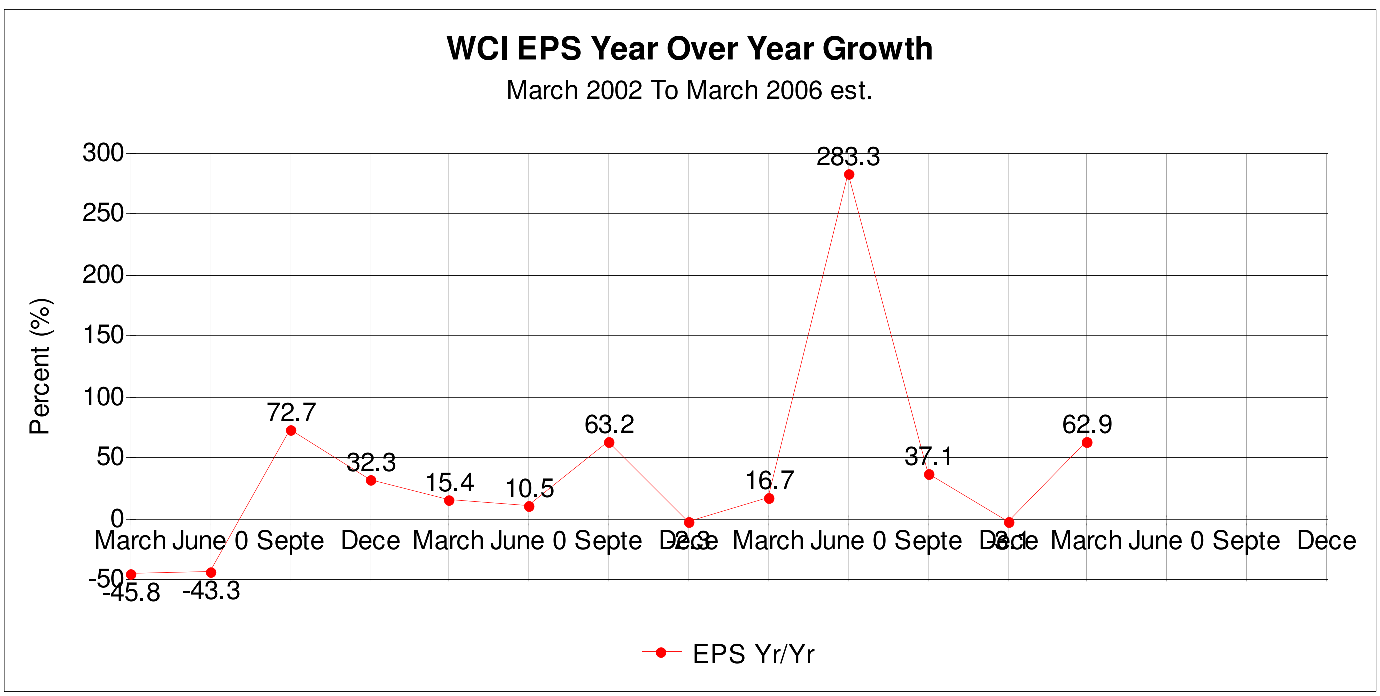

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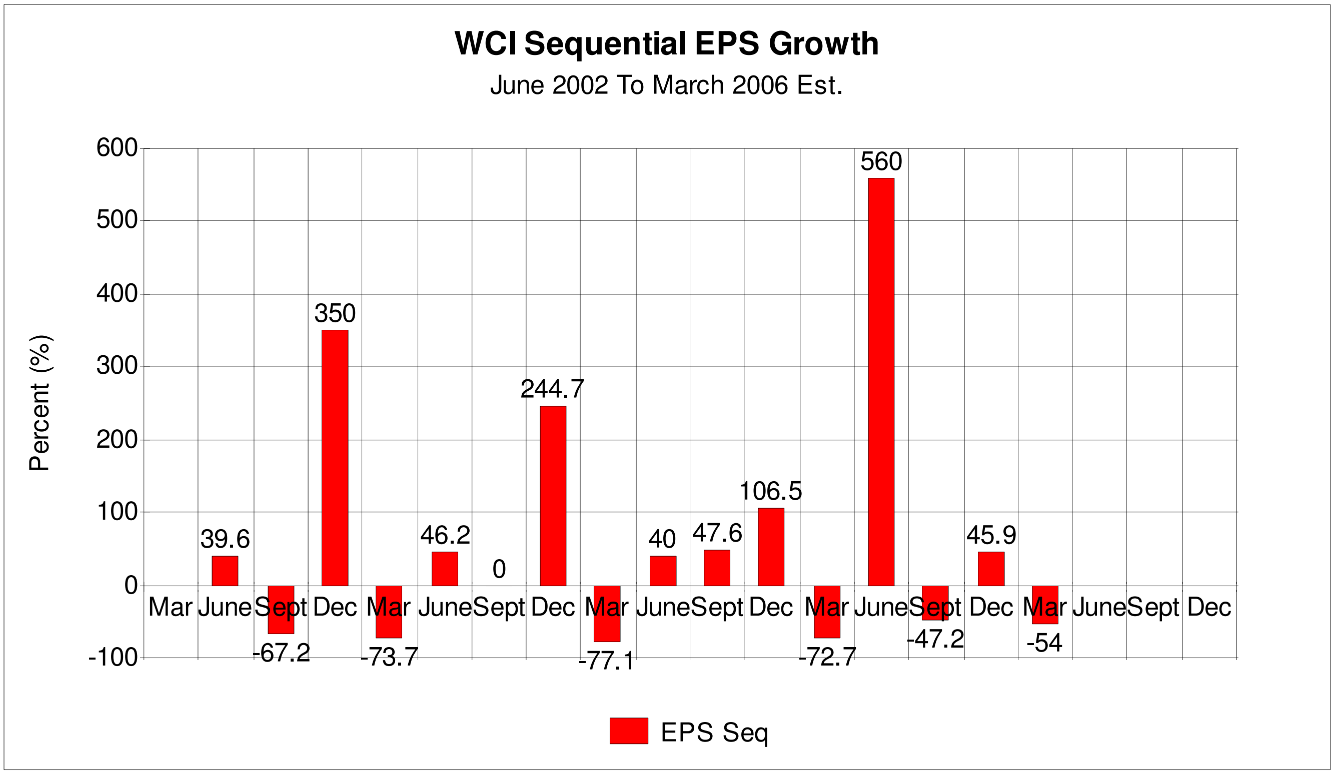

The Real Estate Cycle

The Boom: 2003 to 2005

Investors, speculators and flippers had been making amazing profits for several years. These easy profits attracted new speculators into the market, who further push up prices, which keeps the cycle going. After all, you hear "prices can only go up". At this point, 25 percent of all sales are to speculators, even higher for properties believed to be easy to rent out. That would be condos, especially high rise towers. Even better if they are in Las Vegas or Miami. After all, prices only go up. This becomes a speculative frenzy or bubble. At this point you will hear many commentators on TV and in print say that it is not a bubble because of, demographics, interest rates, etc… Many buyers at this point use borrowed money to purchase because they are planning on a quick sale.

Builders prey on the speculators simply by announcing their attention to begin a new development. They can "pre-sell" many new units to these speculators. The more high rises they can announce the more they can "pre-sell". The more pre-sale contracts they have signed the more loans they can obtain from the banks to pay for construction.

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The Top: 2005

Bubbles end when the supply of new speculators runs out. The lack of enough new speculators causes prices to stall, which turns off speculators that bought only because price were rising. The speculators now plan to sell but only at higher prices than they paid. This causes increased supply and decreased demand that everybody knows eventually leads to lower prices that will overwhelm even the stubborn sellers. At this point, you will hear "experts" say that things are returning to a more "normal" market and prices will only increase 5 or 6 percent instead of 15 to 20 percent. They will say how this is healthier for the market. You will notice increases in inventory and the amount of time it takes to sell a house increase dramatically, from days to months. Housing prices don't collapse, they just don't go up. We believe that this is where we are in the cycle right now in the United States.

However, the last speculative buyers, the ones that paid the most with borrowed money are the first to panic. Many of these speculators have multiple units and can't afford to hang on to them. They are forced sellers. They reduce their prices to sell quickly, which cause prices to fall faster, which cause more panic to those at lower entry prices.

Many of the new developments that were announced last year were started in the second half of 2005. So housing start numbers still set records at the same time that real estate inventory for sale also sets records. We saw this last week and all the housing stocks went up on this good housing start news. All the new building causes increases in labor and materials prices. The cost of building new developments overwhelms the cash flow coming from sales of completed developments. Cash flow turns negative, which causes builders to use debt to keep the business going. The debt will be repaid once the units are finished and are sold to the speculators that promised to buy. Housing insiders are selling their stock.

The Bust: 2006 to 2007

Many sellers hope to still sell their properties for more than they paid. Some take them of the market rather than face a loss. However the mortgage payments begin to eat them up and the will be forced to sell or face bankruptcy. Panic sets in and now they will sell for any price, if they can find a buyer. Congress will call for tougher lending standards. Many regular buyers that bought their homes with interest only mortgages will find that their payment is about to rise 40 percent right at the time the value of their property is declining. They were sold these mortgages with the thought that they could always refinance or sell the property for a big profit after three years. Now there will be even more forced sellers, which will lower prices even further. At this point, just finding a buyer will be tough.

Homebuilders will find speculators walking away from pre-sale contracts. This will leave builders in the most speculative markets with heavy debt loads, negative cash flow and no buyers. Unfinished projects will not be finished because of a lack of financing and no buyers. Homebuilder stocks that seemed so cheap at 8 P/E's will now be more expensive because of the decline in earnings and will get even cheaper or go bankrupt. This cycle has happened in the past and it is happening now.

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Conclusion

While on the surface WCI looks cheap, we believe it is a value trap. The housing and high-rise condo markets are beginning to decline. WCI operates in drastically slowing markets like Miami and Washington D.C. The Greater Capital Area Realtors showed that the Washington D.C. housing market slumped in November. **Inventories increased 69 % and contracts declined 19% year over year** during the month. "**Hidden inventory" from speculators may be hitting the market contributing to the sharp increase seen in recent months said a local housing expert.**

Data from the Realtor group showed that **sales contracts in the District of Columbia fell 18.2% year over year in November and dropped 19.2% in Montgomery County, Md**., which is in the northwest suburbs of Washington. **Listings, meanwhile, rose 58.1% in D.C. and 74.6% in Montgomery County during the same timeframe.** Last week**,** Comstock Homebuilding **(CHCI)** a small homebuilder that primarily operates in the D.C. area, cut its fourth-quarter guidance and said it plans to expand outside of its core Washington market. On a November conference call, Toll Brothers **CEO Robert Toll said he was seeing a slowdown in sales in many markets, including Washington D.C., Maryland and Northern Virginia. Those are all markets that WCI is in.**

Three years ago, WCI was a $9 stock. It is very possible that this company could experience hard times in the immediate future. In 2002 EPS was $2.36, in 2003 EPS was $2.33, in 2004 EPS was $2.62. WCI's stock traded at 4 times earnings and that was in a normal housing market. We have a price target of $19 within 12 months. We recommend investors sell this stock.