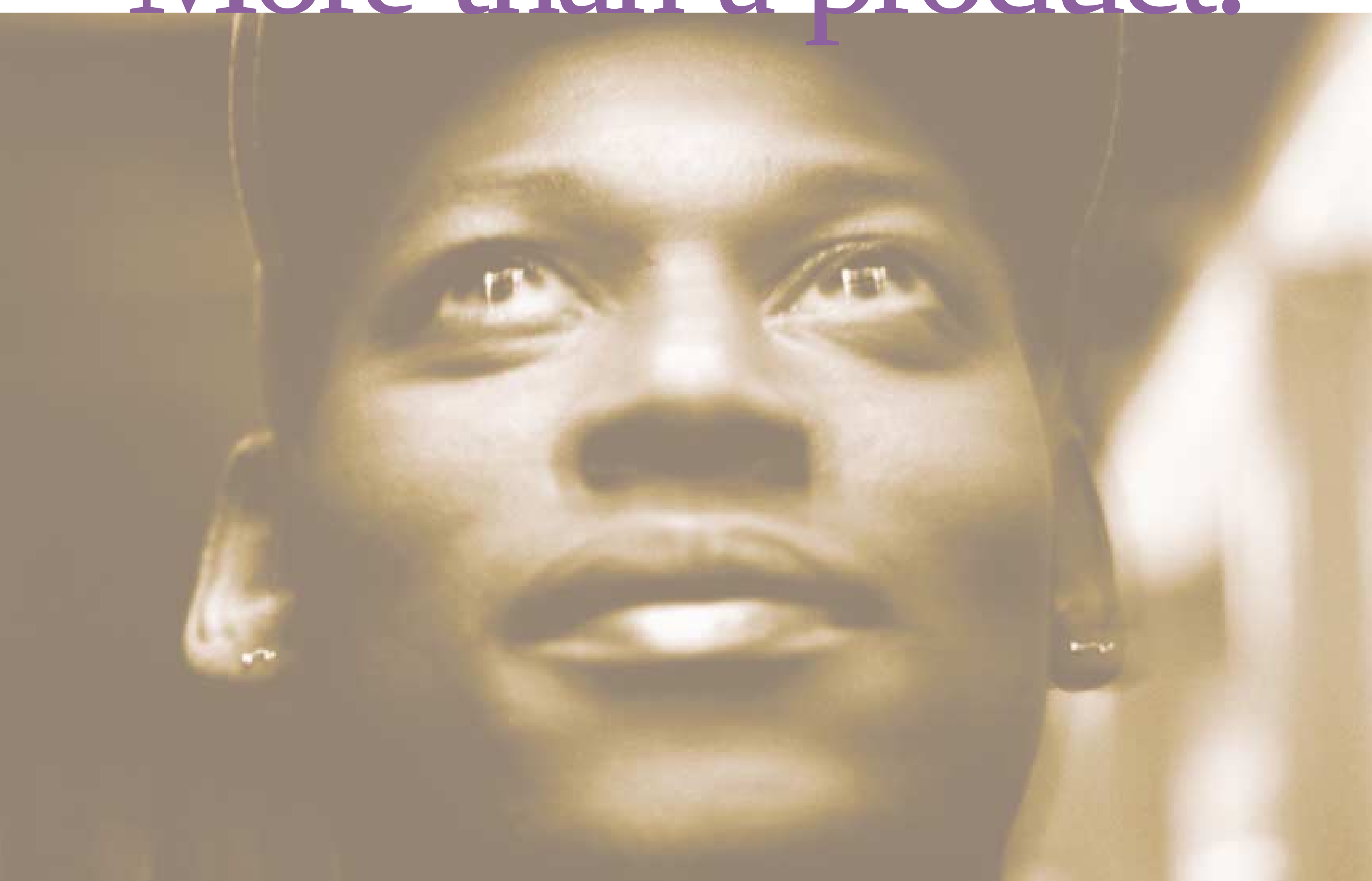
More than a product.



Dear Shareholders,

We believe that the past year brought a turning point for the Female Condom, the progress of its introduction around the world, and the prevention programs that advance it.

Unit sales increased nearly 30% for the year and 45% for the fourth quarter, largely due to recognition by city, state and national health agencies in the United States and multiple countries abroad, and commitments by donor organizations (such as the World Bank and the United Kingdom's Department for International Development), to support and expand STD/HIV/AIDS prevention programs worldwide. This recognition and these commitments are coming because these agencies and organizations now understand that the Female Health Company is not simply selling a product—we are providing an integrated STD/HIV/AIDS prevention program.

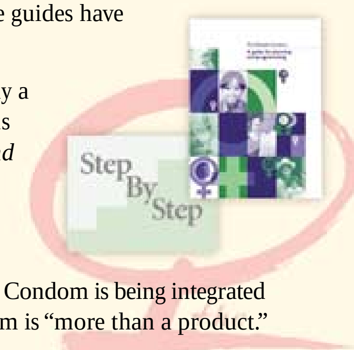
Finding the right approach. Within months of launching the Female Condom, we realized that what we had to do was much more than—and very different from—the traditional approach to introducing a consumer product.

We saw, after studying the demographics and cultures of countries around the world, that there were consistent issues that had to be addressed. If these aspects weren't considered, our educational message would not translate into the actual practice of safer sex, and Female Condom prevention programs would fail.

We learned that a company, regardless of its financial resources, could not do it alone. Communities, through non-government organizations (NGOs) and community-based organizations (CBOs), had to be involved if programs were to succeed. And over the years it became apparent, as we worked to achieve female condom integration, that the communities had to set their own agendas based on their specific cultural and social norms.

Indeed, with time we realized that political leaders from local representatives to national figures, including Presidents and Ministers of Health, needed to express commitment, or failure was likely. And to this commitment must be added training, education, promotion, outreach, marketing support and a mechanism for continuous feedback to allow for adjustment and modification.

Based on these experiences, we developed, pilot-tested and refined two Program Guides. Both guides address the complexities of strategizing and implementing programs to fight STD/HIV/AIDS and unintended pregnancy. While the guides have components that are similar, each addresses specific needs.



The first—*StepByStep*—was prepared for city and state prevention programs in the United States. Already a number of cities, including New York City, Detroit and Miami have implemented successful programs that incorporate the StepByStep program. The second—*The Female Condom: A Guide for Planning and Programming*—was prepared in concert with the Joint United Nations Programme on HIV/AIDS (UNAIDS) and the World Health Organization (WHO), and is now the basis for introducing the Female Condom and building prevention programs in the developing world.

Emphasizing programs, not just product. In this annual report, we show you how the Female Condom is being integrated into prevention programs around the world, and tell you what we mean when we say the Female Condom is "more than a product."

We look at programs in Ghana, South Africa, Namibia and Brazil to give you a sense of the complicated dynamics of program introductions in the developing world. We focus on the State of Florida's multifaceted HIV/AIDS efforts to show you how the Female Condom is integrated in U.S. programs. In all the stories, we highlight the role that FHC and the program guides are playing.

Our work continues. The World Bank recently announced that it was going to make $242.5 million in low-interest loans available to six nations to fight HIV/AIDS and other diseases. The loans are part of the $500 million commitment the World Bank approved in September 2000. Organizations in three of the six nations contacted FHC within days of the announcement regarding the availability of the guide. They wanted the Female Condom, and they wanted to know how to implement a successful Female Condom program.

In addition, the United Kingdom and The Netherlands announced in December that they were making a total of $76 million available for the purchase of reproductive health products, including Female Condoms, to be used in prevention programs in the developing world.

Making an investment in humanity. The coming year offers great opportunity for The Female Health Company, as the Female Condom is widely included in the HIV/AIDS outreach programs expected to start up all around the world.

We thank you for your continued backing and encouragement. Most of all, we thank you for your understanding that, in addition to achieving financial goals, FHC is a company with a long-term commitment to support and invest in global public health. Balancing this humanitarian purpose and capitalism, we are a company actively involved in the fight against HIV/AIDS, the worst plague in the history of humankind.

O.B. Parrish
Chairman and Chief Executive Officer

Mary Ann Leeper, Ph.D.
President and Chief Operating Officer

Ghana

High demand follows cooperative introduction.

With the second-highest HIV rate in western Africa, Ghana is struggling to slow the inexorable spread of AIDS through its population. Like most nations in the sub-Saharan region, Ghana's financial resources are limited.

Now, Ghana has a powerful weapon in its anti-AIDS arsenal. Working with FHC, UNAIDS, the United Nations Population Fund, the Ghana Social Marketing Foundation, and the Society for Women and AIDS in Africa (SWAA), the Ghana Ministry of Health introduced the Female Condom in May 2000. The introduction is part of the International Partnership against AIDS in Africa, and is based on our *Guide for Planning and Programming*.

The product and program were greeted with enthusiasm. "The Female Condom is a long-awaited dream come true for Ghanaians this day!" said the First Lady of Ghana, Nana Konadu Agyeman Rawlings, at the official launch.

Demand for the Female Condom is extremely strong, said Alice Sena Lamptey, the Ghana national coordinator for SWAA: "Younger women, especially, are hearing the prevention message we are delivering through the Female Condom program. They understand they are at risk, and are taking action to protect themselves."

Population (1999)	19.7 million
Adult HIV rate	3.6%
People living with HIV/AIDS	340,000
AIDS deaths in 1999	33,000

Source: UNAIDS/WHO, December 2000

Photo courtesy MSI–Uganda

South Africa

Pilot program develops into nationwide availability.

Home to the largest number of HIV-positive people in the world, South Africa also is home to one of the world's most expansive Female Condom programs.

South Africa was one of the first countries to explore the potential role of the Female Condom in HIV/AIDS prevention. Based on the findings of FHC-sponsored acceptability research, each of the country's nine provinces selected a small number of demonstration sites for Female Condom distribution.

This limited, 18-site introduction proved the product's value in prevention programs, and is providing valuable information about the components, considerations and approaches necessary for a successful nationwide launch.

With FHC's help, the South Africa National Department of Health is now preparing to expand the distribution of the Female Condom throughout the country.

Population (1999)	39.9 million
Adult HIV rate	19.9%
People living with HIV/AIDS	4.2 million
AIDS deaths in 1999	250,000

Source: UNAIDS/WHO, December 2000

Namibia

Community advocacy leads to expanded distribution.

Remote and arid, Namibia nevertheless has the third-highest incidence of HIV/AIDS in the world. Clearly, prevention programs are desperately needed. Fortunately, the nation's government and economy make them possible—and likely to succeed.

Led by the Ministry of Health, aggressive HIV/AIDS prevention efforts are beginning to have a positive effect, with the Female Condom playing an important role.

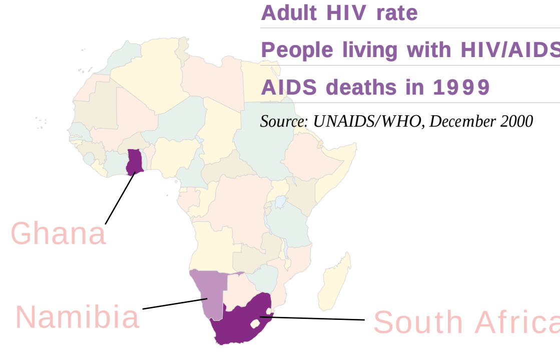
After intense lobbying by women's groups and community organizations interested in making the Female Condom available, a pilot program offered it in a limited area. This small program resulted in a large number of requests for more samples, generated positive word-of-mouth, and discovered that Namibian men were willing to use, and were enthusiastic about, the Female Condom.

Now a multi-sector group led by the new Ministry of Women Affairs and Child Welfare is driving expanded distribution. And on World AIDS Day—December 1, 2000—the Female Condom was launched nationally, using the theme, "Men Make a Difference," as a way to emphasize men's role in safe sex.

Population (1999)	1.7 million
Adult HIV rate	19.5%
People living with HIV/AIDS	160,000
AIDS deaths in 1999	18,000

Source: UNAIDS/WHO, December 2000

Photo courtesy MSI–Uganda



Brazil

Efficacy and acceptance spur additional sales.

Like developing countries around the world, Brazil suffers from a number of social ills, many of which are key contributing factors to HIV/AIDS infection. But so far, South America's most populous country has avoided the worst of the epidemic—mostly because it maintains a proactive approach. Effective prevention programs are in place, and the Female Condom is now playing a major role.

Photo courtesy Marie Stopes International/Julie Etchart

With the Female Condom well integrated into safe-sex efforts, Brazil's Ministry of Health is able to gather important data on its use and acceptance—and on the effectiveness of the programs that promote it.

For example, a year-long study in six cities tracked the Female Condom usage of 2,400 women with varying cultural backgrounds. The study found very high levels of Female Condom use, continuity of use and acceptability, and that the availability of the Female Condom increased the practice of safer sex. In addition, the study confirmed that the Female Condom is an effective alternative method of preventing STDs and HIV/AIDS.

Experience also shows that acceptability of the Female Condom is highest among women and men who are reached through community-based educational programs. Such programs are the core of FHC's international promotion and prevention efforts.

With this information in-hand, the Ministry of Health is purchasing two million additional Female Condoms, and is developing a national program to promote its adoption in local prevention programs.

Population (1999)	167.9 million
Adult HIV rate	0.6%
People living with HIV/AIDS	540,000
AIDS deaths in 1999	18,000

Source: UNAIDS/WHO, December 2000

Florida

Aggressive prevention programs generate results.

With the third-highest HIV/AIDS infection rate in the United States, Florida is focusing its attention—and its considerable financial resources—on prevention. Literally hundreds of outreach programs are fighting the battle against AIDS. And many of them are working closely—and effectively—with FHC to promote the use of the Female Condom, including:

TOPWA (Targeted Outreach for Pregnant Women), which serves high-risk pregnant women, primarily substance abusers

Gettin' Busy, which targets high-risk youth

IDU (Injecting Drug Users Project), which targets substance abusers

SHIP (Senior HIV Intervention Project), which focuses its efforts on senior citizens, and offers counseling and education

- Peer education programs in State correctional facilities
- Adolescent HIV/AIDS seminars delivered via the Internet

Using the FHC-developed StepByStep implementation plan as their guide, these critical programs have helped to get the "safer sex" message heard, and generated an 88% increase in the use of the Female Condom by the people they serve.

Population (1999)	16.0 million
Adult HIV rate	.03%
People living with HIV/AIDS	55,060
AIDS deaths in 1999	1,630

Source: U.S. Census Bureau, State of Florida

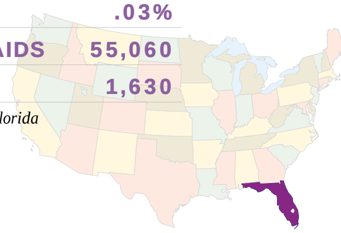


Photo courtesy MSI–Uganda

World

Global epidemic continues to ravage developing nations.

The challenges raised by HIV/AIDS vary significantly from country to country: Sexual practices, cultural mores, gender dynamics, partner communications, STD rates, intravenous drug use, rate of male condom use, rapid urbanization, poverty, inadequate social and medical services, and other factors combine to create complex situations that require unique prevention programs.

People newly infected with HIV in 2000	5.3 million
People currently living with HIV/AIDS	36.1 million
AIDS deaths in 2000	3 million
AIDS deaths since beginning of epidemic	21.8 million

Source: UNAIDS/WHO, December 2000

Photo courtesy State of Florida, Dept. of Health

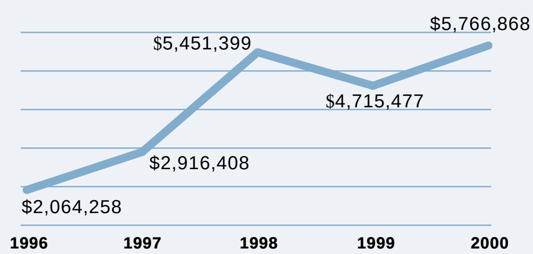
Financial Highlights

The selected financial data from continuing operations for the three years ending September 30, 2000, are derived from the audited Consolidated Financial Statements. The information here should be read in conjunction with "Management's Discussion and Analysis," the Consolidated Financial Statements and related notes, all of which are included in the financial report to follow.

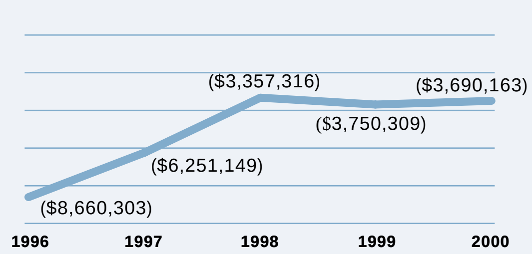
	2000	1999	1998
Net Revenues	**$ 5,766**	$ 4,715	$ 5,451
Net Income (Loss)	**(3,690)**	(3,750)	(3,357)
Net Income (Loss) per Common Share	**(0.30)**	(0.36)	(0.43)
Operating Expenses	**2,975**	2,969	3,329
Common Shares Outstanding	**13,804**	11,930	10,416
Preferred Shares Outstanding	**660**	660	680

Years ended September 30 *In thousands, except per-share data*

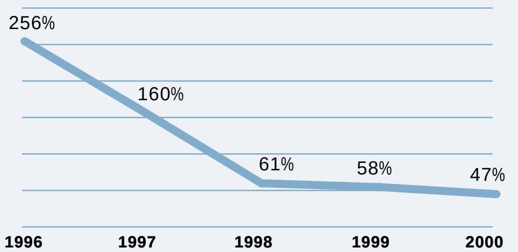
Net Revenues



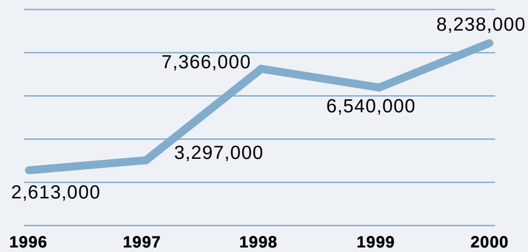
Net Income (Loss)



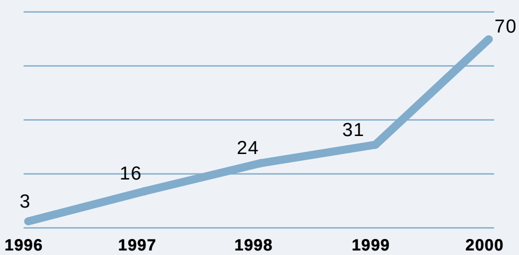
Operating Expenses as a Percent of Sales



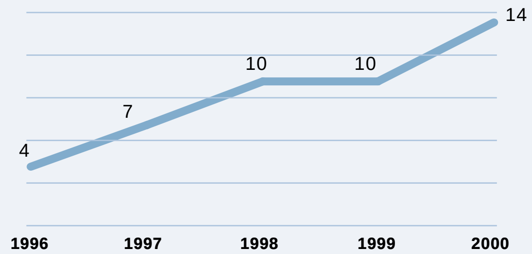
Unit Sales



Public Sector Markets



Commercial Markets



Overview

Over the past few years, the Company completed significant aspects of the development and commercialization of the Female Condom. These initiatives have resulted in the attainment of proprietary manufacturing technology and product design patents, necessary regulatory approvals, endorsements from various organizations within the world medical community, and the development of significant manufacturing capacity. These steps, taken as part of the Company's plan to develop and sell a product with global commercial and humanitarian value, have required the expenditure of significant amounts of capital and resulted in significant operating losses including the period 1996 through the present.

The Company is developing the commercial and public sector markets for the Female Condom around the world. As part of this plan, the Company has completed a number of distribution agreements and is pursing other arrangements for the marketing and sale of the Female Condom. In the past year, more than 30 countries were added to the list of markets where the Female Condom is available. Management believes that as the number of markets in which the Female Condom is sold increases, sales will grow and at certain unit levels the Company will become profitable. However, there can be no assurance that such level of sales will be achieved in the near term or at all.

Results of Operations

Fiscal Year Ended September 30, 2000 ("2000") Compared to Fiscal Year Ended September 30, 1999 ("1999")

The Company had net revenues of $5.8 million and a net loss attributable to common stockholders of $(3.8) million, or $(0.30) per share in 2000 compared to net revenues of $4.7 million and a net loss attributable to common stockholders of $(3.9) million, or $(0.36) per share in 1999.

The Company's operating loss for the twelve months ended September 30, 2000 was $2,392,631 compared to $2,851,873 for the same period last year for a decrease of 16%. As discussed in more detail in the following paragraphs, the decrease in the Company's net operating loss was a result of gross profit improvements while operating expenses between years had a negligible change. The decline in net loss was smaller (2%), however, due to increases in non-operating interest expenses and amortization of debt issuance costs.

Net revenues increased $1.1 million, or 22%, in 2000 over the prior year. The higher net revenues primarily resulted from increased unit sales shipped to international customers.

Cost of goods sold increased $585,988, or 13%, to $5,184,735 for 2000 from $4,598,747 for 1999. The increase was not in proportion with the sales increase as a result of a larger portion of the Company's total sales being comprised of international and global public sector business (74%) than during the same period in the prior year (56%). The costs of goods sold per unit for such customers' business is less expensive because of the efficiencies related to the production of the bulk sized product sold. The Company's UK-based manufacturing facility utilized approximately 13% of its capacity in 2000 compared with approximately 11% of its capacity in 1999.

Advertising and promotion expenditures did not change materially between years, decreasing 2% to $0.2 million in 2000 compared to $0.3 million in 1999. Advertising and promotion relates exclusively to the U.S. market and includes the costs of print advertising, trade and consumer promotions, product samples and other marketing costs incurred to increase consumer awareness and purchases of the Female Condom. The Company entered an agreement with Mayer Laboratories, Inc. to distribute the Female Condom to the wholesale retail trade in the United States effective October 1, 2000. The Company will continue to distribute directly to U.S. Public sector customers. Mayer currently distributes birth control and STD prevention products and its objective is to increase unit sales of the Female Condom in the wholesale retail trade arena. This agreement complements the Company's strategy to serve as a manufacturer supplying public sector customers and commercial partners worldwide. Additionally, due to the consolidation of administrative functions the Company estimates this agreement will permit it to save $0.3 million in expenses annually.

Selling, general and administrative expenses were $2.7 million in 2000 and 1999. As a percentage of net revenues, the selling, general and administrative expenses were 47% in 2000 compared with 58% in 1999. The decrease as a percentage of net revenues exists, because although the change in general and administrative expenses was flat, net revenues increased 22% between the current and prior fiscal year periods. Selling, general and administrative expenses did not proportionately increase however, because increases in investor relations and selling expenses were offset by reductions in legal and research and development costs.

The Company's strategy is to act as a manufacturer supplying the public sector and commercial partners throughout the world. The Company's partners pay for all marketing and shipping costs. Consequently, as the Company's sales volume increases the Company's operating expenses will not increase significantly.

Non-cash amortization of debt issuance costs increased $71,552 to $245,676 for 2000 from $174,124 for 1999. The increase is due to the amortization period of debt issuance costs relating to the issuance of convertible debentures in May and June 1999. See Note 4 of the Notes to Consolidated Financial Statements for further detail regarding the convertible debentures.

Net interest and non-operating expenses increased $327,544, or 45%, to $1,051,856 for 2000 compared to $724,312 for 1999. The increase exists because the Company had a higher level of debt outstanding during 2000 than 1999 as a result of the issuance of convertible debentures. The result is a larger amount of non-cash expenses incurred from the amortization of discounts on notes payable and convertible debentures for 2000 than for 1999.

The Company was able to cover fixed manufacturing overhead costs and exceeded break-even at the gross profit level. However, the Company must achieve cumulative annual unit sales of approximately 19 million Female Condoms based upon the current average selling price per unit in order to cover operating and non-operating expenses or approximately 32% of manufacturing capacity.

Factors That May Affect Operating Results and Financial Condition

The Company's future operating results and financial condition are dependent on the Company's ability to increase demand for and to cost-effectively manufacture sufficient quantities of the Female Condom. Inherent in this process are a number of factors that the Company must successfully manage in order to achieve favorable future results and improve its financial condition.

Reliance on a Single Product

The Company expects to derive the vast majority, if not all, of its future revenues from the Female Condom, its sole current product. While management believes the global potential for the Female Condom is significant, the product is in the early stages of commercialization and, as a result, the ultimate level of consumer demand around the world is not yet known. To date, sales of the Female Condom have not been sufficient to cover the Company's operating costs.

Distribution Network

The Company's strategy is to act as a manufacturer and to develop a global distribution network for the product by completing partnership arrangements with companies with the necessary marketing and financial resources and local market expertise. To date, this strategy has resulted in numerous in-country distributions in the public sector, particularly in Africa and Latin America. Several partnership agreements have been completed for the commercialization of the Female Condom in private sector markets around the world. However, the Company is dependent on country governments as well as city and state public health departments within the United States to continue their commitment to prevention of STDs, including AIDS, by including Female Condoms in their programs. The Company is also dependent on finding appropriate partners for the private sector markets around the world. Once an agreement is completed, the Company is reliant on the effectiveness of its partners to market and distribute the product. Failure by the Company's partners to successfully market and distribute the Female Condom or failure of country governments to implement prevention programs which include distribution of barrier methods against the AIDS crisis, or an inability of the Company to secure additional agreements for AIDS crisis, or an inability of the Company to secure additional agreements for new markets either in the public or private sectors could adversely affect the Company's financial condition and results of operations.

Inventory and Supply

All of the key components for the manufacture of the Female Condom are essentially available from either multiple sources or multiple locations within a source.

Global Market and Foreign Currency Risks

The Company manufactures the Female Condom in a leased facility located in London, England. Further, a material portion of the Company's future sales are likely to be in foreign markets. Manufacturing costs and sales to foreign markets are subject to normal currency risks associated with changes in the exchange rate of foreign currencies relative to the United States dollar. To date, the Company's management has not deemed it necessary to utilize currency hedging strategies to manage its currency risks. On an ongoing basis, management continues to evaluate its commercial transactions and is prepared to employ currency hedging strategies when it believes such strategies are appropriate. In addition, some of the Company's future international sales may be in developing nations where dramatic political or economic changes are possible. Such factors may adversely affect the Company's results of operations and financial condition.

Government Regulation

The Female Condom is subject to regulation by the FDA, pursuant to the federal Food, Drug and Cosmetic Act ("the FDA Act"), and by other state and foreign regulatory agencies. Under the FDC Act, medical devices must receive FDA clearance before they can be sold. FDA regulations also require the Company to adhere to certain "Good Manufacturing Practices," which include testing, quality control and documentation procedures. The Company's compliance with applicable regulatory requirements is monitored through periodic inspections by the FDA. The failure to comply with applicable regulations may result in fines, delays or suspensions of clearances, seizures or recalls of products, operating restrictions, withdrawal of FDA approval and criminal prosecutions. The Company's operating results and financial condition could be materially adversely affected in the event of a withdrawal of approval from the FDA.

Liquidity and Sources of Capital

Historically, the Company has incurred significant operating losses. Cash used in continuing operations was $1.0 million for 2000 and $2.8 million in 1999. Historically, the Company has funded operating losses and capital requirements, in large part, through the sale of common stock or debt securities convertible into common stock.

During 2000, the Company received approximately $1.3 million in proceeds from newly-issued notes payable and $0.9 million from the issuance of common stock. FHC used these amounts to fund current operations of the Company and to repay existing liabilities.

In the near term, FHC management expects operating losses and capital requirements to continue to exceed funds generated from operations due principally to the Company's fixed manufacturing costs relative to current production volumes and the ongoing need to commercialize the Female Condom around the world.

On September 29, 1997, the Company entered into an agreement with Vector Securities International, Inc. (Vector), an investment banking firm specializing in providing advice to healthcare and life-science companies. Pursuant to this agreement, for a one-year period, Vector will act as the Company's exclusive financial advisor for the purposes of identifying and evaluating opportunities available to the Company for increasing shareholder value. These opportunities may include selling all or a portion of the business, assets or stock of the Company or entering into one or more distribution arrangements relating to the Company's product. Extension of the agreement is currently under consideration. There can be no assurance that any such opportunities will be available to the Company or, if so available, that the Company will ultimately elect or be able to consummate any such transaction.

On November 19, 1998, the Company executed an agreement with a private investor (the "Equity Line Agreement"). This agreement provides for the Company, at its sole discretion, subject to certain restrictions, to sell ("put") to the investor up to $6.0 million of the Company's Common Stock. The Equity Line Agreement expires on February 12, 2001 and, among other things, provides for minimum and maximum puts ranging from $100,000 to $1,000,000 depending on the Company's stock price and trading volume. Puts cannot occur more frequently than every 20 trading days. Upon a proper put under this agreement, the investor purchases Common Stock at a discount of (a) 12% from the then current average market price of the Company's Common Stock, as determined under the Equity Line Agreement, if such average market price is at least $2 or (b) 18% from the then current average market price if such average market price is less than $2. In addition, the Company is required to pay its placement agent sales commissions in Common Stock or cash, at the placement agent's discretion, equal to 7% of the funds raised under the Equity Line Agreement and issue warrants to the placement agent to purchase shares of Common Stock, at an exercise price of $2.17 per share, equal to 10% of the shares of Common Stock sold by the Company under the Equity Line Agreement. Pursuant to the Equity Line Agreement, the Company issued the investor a Warrant to purchase 200,000 shares of Common Stock at $2.17 per share.

The Company is required to draw down a minimum of $1 million during the two-year period. If the Company does not draw down the minimum, the Company is required to pay the investor a 12% fee on that portion of the $1 million minimum not drawn down at the end of the two-year period. As of September 30, 2000, the Company has placed four puts for the combined cash proceeds of $582,000 providing the investor with a total of 680,057 shares of the Company's Common Stock. Each put was executed while the Company's stock price was below $2.00 per share. The fourth put, which was executed in the third quarter of the 2000 fiscal year, took place at a price below $1.00 per share. The timing and amount of the stock sales under the agreement are totally at the Company's discretion, subject to the Company's compliance with each of the following conditions at the time the Company requests a stock sale under the agreement:

- the registration statement the Company filed with the SEC for resales of Common Stock by the investor must remain in effect;
- all of the Company's representations and warranties in the agreement must be accurate and the Company must have complied with all of the Company's obligations in the agreement;
- there may not be any injunction, legal proceeding or law prohibiting the company's sale of the stock to the investor;
- the sale must not cause investor's ownership of the Company's common stock to exceed 9.9% of the outstanding shares of the Company's common stock;
- the trading price of the Company's common stock over a five trading day preceding the date of the sale must equal or exceed $1.00 per share; and
- the average daily trading volume of the Company's common stock for a 20 trading day period preceding the date of the sale must equal or exceed 17,000 shares.

While the Company believes that its existing capital resources (including expected proceeds from sales of Common Stock pursuant to the Equity Line Agreement) will be adequate to fund its currently anticipated capital needs, if they are not the Company may need to raise additional capital until its sales increase sufficiently to cover operating expenses. In addition, there can be no assurance that the Company will satisfy the conditions required for it to exercise puts under the Equity Line Agreement. For example, the trading price of the Company's Common Stock has not closed above $1.00 per share since May 2000. Accordingly, the Company may not be able to realize all or any of the funds available to it under the Equity Line Agreement.

The Company has a $1 million note due March 25, 2001 and a $250,000 note payable due February 12, 2001 to Mr. Stephen Dearholt, a Director of the Company. The Company also secured a $50,000 note payable due February 18, 2001 to Mr. O.B. Parrish, the Chairman of the Board and Chief Executive Officer of the Company.

Until internally generated funds are sufficient to meet cash requirements, FHC will remain dependent upon its ability to generate sufficient capital from outside sources. While management believes that revenue from sales of the Female Condom will eventually exceed operating costs and that ultimately operations will generate sufficient funds to meet capital requirements, there can be no assurance that such level of operations will ultimately be achieved, or be achieved in the near term. Likewise, there can be no assurance that the Company will be able to source all or any portion of its required capital through the sale of debt or equity or, if raised, the amount will be sufficient to operate the Company until sales of the Female Condom generate sufficient revenues to fund operations. In addition, any funds raised may be costly to the Company and/or dilutive to stockholders. If the Company is not able to source the required funds or any future capital which becomes required, the Company may be forced to sell certain of its assets or rights or cease operations.

As of December 15, 2000, the Company had approximately $0.3 million in cash, net trade accounts receivable of $0.7 million and current trade accounts payable of $0.6 million. It is estimated that the Company's cash burn rate, with revenues, is less than $0.1 million per month.

Impact of Inflation and Changing Prices

Although the Company cannot accurately determine the precise effect of inflation, the Company has experienced increased costs of product, supplies, salaries and benefits, and increased general and administrative expenses. Historically, the Company has absorbed increased costs and expenses without increasing selling prices.

New Accounting Pronouncements

Please see new "Current Accounting Pronouncements" in Note 1 in financial statements.

To the Board of Directors and Stockholders of The Female Health Company, Chicago, Illinois:

We have audited the accompanying consolidated balance sheet of The Female Health Company and subsidiaries, as of September 30, 2000, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for the years ended September 30, 2000 and 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Female Health Company and subsidiaries as of September 30, 2000, and the results of their operations and their cash flows for the years ended September 30, 2000 and 1999, in conformity with generally accepted accounting principles.

The accompanying consolidated financial statements have been presented assuming that The Female Health Company will continue as a going concern. As more fully described in Note 13, the Company has experienced slower than expected growth in revenues from its sole product, which has adversely affected the Company's current results of operations and liquidity. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 13. The consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts of classification of liabilities that may result from the outcome of this uncertainty.

/s/McGladrey & Pullen LLP
Schaumburg, Illinois
November 17, 2000

Consolidated Balance Sheet

Year Ended September 30	*2000*
ASSETS	
CURRENT ASSETS	
Cash	$ 457,122
Accounts receivable, net of allowances for doubtful accounts of $86,200 and allowance for product returns of $31,800	847,979
Inventories	490,815
Prepaid expenses and other current assets	192,460
Total Current Assets	**1,988,376**
OTHER ASSETS	
Intellectual property, net of accumulated amortization of $513,600	594,421
Other assets	144,652
Total Other Assets	**739,073**
PROPERTY, PLANT AND EQUIPMENT	
Equipment, furniture and fixtures	3,674,398
Less accumulated depreciation	2,281,065
Net Property, Plant and Equipment	**1,393,333**
TOTAL ASSETS	**$ 4,120,782**
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	
CURRENT LIABILITIES	
Notes payable, related party, net of unamortized discount of $88,155	$ 1,211,845
Convertible debentures, net of unamortized discount of $101,664	1,398,336
Accounts payable	427,556
Accrued expenses and other current liabilities	244,155
Preferred dividends payable	132,000
Total Current Liabilities	**3,413,892**
LONG-TERM LIABILITIES	
Deferred gain on sale of facility	1,373,212
Other long term liabilities	26,745
Total Long-Term Liabilities	**1,399,957**
STOCKHOLDERS' EQUITY (DEFICIT)	
Convertible preferred stock, Series I, par value $0.01 per share. Authorized 5,000,000 shares; issued and outstanding 660,000 shares	6,600
Common Stock, par value $0.01 per share. Authorized 22,000,000 shares; issued and outstanding 13,803,699 shares.	138,037
Additional paid-in capital	48,231,986
Unearned consulting fees	(90,815)
Accumulated other comprehensive income	55,661
Accumulated deficit	(49,002,460)
Total Stockholders' Equity	**(660,991)**
Treasury Stock, at cost, 20,000 shares of common stock	(32,076)
Total Stockholders' Equity and Treasury Stock	**(693,067)**
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 4,120,782**

See Notes to Consolidated Financial Statements.

Consolidated Statements of Operations

Year Ended September 30	*2000*	*1999*
NET REVENUES	$ 5,766,868	$ 4,715,477
COST OF PRODUCTS SOLD	5,184,735	4,598,747
GROSS PROFIT	**582,133**	**116,730**
OPERATING EXPENSES		
Advertising and promotion	247,222	251,867
Selling, general and administrative	2,727,542	2,716,736
Total Operating Expenses	**2,974,764**	**2,968,603**
OPERATING (LOSS)	**(2,392,631)**	**(2,851,873)**
NON-OPERATING INCOME (EXPENSE)		
Amortization of debt issuance costs	(245,676)	(174,124)
Interest expense	(1,231,832)	(860,523)
Interest income	34,772	36,030
Non-operating income	145,204	100,181
Total Non-operating Income (Expense)	**(1,297,532)**	**(898,436)**
NET (LOSS)	**(3,690,163)**	**(3,750,309)**
Preferred dividends, Series 1	132,195	133,919
NET (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS	**$ (3,822,358)**	**$ (3,884,228)**
NET (LOSS) PER COMMON SHARE OUTSTANDING	**$ (0.30)**	**$ (0.36)**
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	**12,764,498**	**10,890,173**

See Notes to Consolidated Financial Statements.

Statements of Stockholders' Equity (Deficit)

	Preferred Stock	*Common Stock*	*Additional Paid-In Capital*	*Unearned Consulting Fees*	*Accumulated Other Comprehensive Income*	*Accumulated Deficit*	*Cost of Treasury Stock*	*Total*
BALANCE AT SEPTEMBER 30, 1998	**$ 6,800**	**$ 104,157**	**$ 43,833,843**	**—**	**$ 304,980**	**$ (41,295,874)**	**$ (19,330)**	**$ 2,934,577**
Issuance of 482,964 shares of Common Stock under the equity line of credit	—	4,685	480,315	—	—	—	—	485,000
Issuance of 20,718 shares of Common Stock upon conversion of Preferred Stock	(200)	200	—	—	—	—	—	—
Issuance of 120,000 shares of Common Stock upon exercise of warrants	—	1,200	128,760	—	—	—	—	129,960
Issuance of 175,000 shares of Common Stock for consulting services	—	1,750	184,188	(185,938)	—	—	—	—
Issuance of warrants with convertible debentures	—	—	1,276,300	—	—	—	—	1,276,300
Issuance of 15,000 shares of Common Stock under stock bonus plan	—	150	23,288	—	—	—	—	23,438
Issuance of 18,000 shares of Common Stock upon exercise of stock options	—	180	16,695	—	—	—	—	16,875
Issuance of warrants with short-term notes payable	—	—	253,515	—	—	—	—	253,515
Issuance of 30,691 shares of Common Stock as payment of preferred stock dividends	—	307	31,058	—	—	—	—	31,365
Issuance of warrants for consulting services	—	—	99,483	(99,483)	—	—	—	—
Preferred Stock dividends	—	—	—	—	—	(133,919)	—	(133,919)
Purchase of 10,000 Shares of Common Stock held in Treasury	—	—	—	—	—	—	(12,746)	(12,746)
Issuance of 666,671 shares of Common Stock	—	6,667	493,333	—	—	—	—	500,000
Amortization of unearned consulting fees	—	—	—	84,047	—	—	—	84,047
Comprehensive income (loss):								
Net (loss)	—	—	—	—	—	(3,750,309)	—	(3,750,309)
Foreign currency translation adjustment	—	—	—	—	(115,133)	—	—	(115,133)
Comprehensive income (loss)								(3,865,442)
BALANCE AT SEPTEMBER 30, 1999	**$ 6,600**	**$ 119,296**	**$ 46,820,778**	**$ (201,374)**	**$ 189,847**	**$ (45,180,102)**	**$ (32,076)**	**$ 1,722,970**

See Notes to Consolidated Financial Statements.

	Preferred Stock	*Common Stock*	*Additional Paid-In Capital*	*Unearned Consulting Fees*	*Accumulated Other Comprehensive Income*	*Accumulated Deficit*	*Cost of Treasury Stock*	*Total*
BALANCE AT SEPTEMBER 30, 1999	**$ 6,600**	**$ 119,296**	**$ 46,820,778**	**$ (201,374)**	**$ 189,847**	**$ (45,180,102)**	**$ (32,076)**	**$ 1,722,970**
Issuance of 197,093 shares of Common Stock under the equity line of credit	—	1,971	95,029	—	—	—	—	97,000
Issuance of 200,000 shares of Common Stock for consulting services		2,000	112,055	(114,055)	—	—	—	—
Issuance of warrants with convertible debentures	—	—	157,700	—	—	—	—	157,700
Forfeiture of 6,000 shares of Common Stock under stock bonus plan	—	(60)	(17,190)	—	—	—	—	(17,250)
Issuance of warrants with short-term notes payable	—	—	193,289	—	—	—	—	193,289
Issuance of 20,005 shares of Common Stock as payment of interest on debentures	—	200	16,356	—	—	—	—	16,556
Issuance of 41,352 shares of Common Stock as payment of preferred stock dividends	—	413	33,185	—	—	—	—	33,598
Preferred Stock dividends	—	—	—	—	—	(132,195)	—	(132,195)
Issuance of 1,421,669 shares of Common Stock	—	14,217	820,783	—	—	—	—	835,000
Amortization of unearned consulting fees	—	—	—	224,614	—	—	—	224,614
Comprehensive income (loss):								
Net (loss)	—	—	—	—	—	(3,690,163)	—	(3,690,163)
Foreign currency translation adjustment	—	—	—	—	(134,186)	—	—	(134,186)
Comprehensive income (loss)								(3,824,349)
BALANCE AT SEPTEMBER 30, 2000	**$ 6,600**	**$ 138,037**	**$ 48,231,985**	**$ (90,815)**	**$ 55,661**	**$ (49,002,460)**	**$ (32,076)**	**$ (693,067)**

See Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

Year Ended September 30	*2000*	*1999*
OPERATING ACTIVITIES		
Net (Loss)	$ (3,690,163)	$ (3,750,309)
ADJUSTMENTS TO RECONCILE NET (LOSS) TO NET CASH (USED IN) OPERATING ACTIVITIES:		
Depreciation	425,899	468,758
Amortization of intellectual property rights	110,025	119,501
Provision for (recovery of) inventory obsolescence	40,286	(6,394)
Provision for doubtful accounts, returns and discounts	(224,846)	22,460
Issuance of Common Stock for bonuses and consulting services	—	23,438
Amortization of unearned consulting fees	224,614	84,047
Amortization of discounts on notes payable and convertible debentures	957,192	671,854
Amortization of deferred income realized on U.K. grant	(53,490)	(142,723)
Amortization of deferred gain on sale and leaseback of building	(84,495)	(91,772)
Amortization of debt issuance costs	245,676	174,124
CHANGES IN OPERATING ASSETS AND LIABILITIES		
Accounts receivable	869,242	(507,929)
Inventories	438,442	(105,433)
Prepaid expenses and other current assets	30,676	149,617
Accounts payable	(222,543)	128,165
Accrued expenses and other current liabilities	(98,352)	(78,733)
NET CASH (USED IN) OPERATING ACTIVITIES	**$ (1,031,837)**	**$ (2,841,329)**
INVESTING ACTIVITIES		
Capital expenditures	$ (11,284)	$ (22,637)
NET CASH (USED IN) INVESTING ACTIVITIES	**$ (11,284)**	**$ (22,637)**
FINANCING ACTIVITIES		
Proceeds from issuance of common stock	835,000	500,000
Proceeds from issuance of common stock under the equity line of credit	97,000	485,000
Proceeds from issuance of common stock upon exercise of puts	—	146,835
Proceeds from related party notes issued	—	300,000
Proceeds from convertible debentures issued	—	1,305,000
Purchase of common stock held in treasury	—	(12,746)
Dividend paid on preferred stock	(40,150)	(161,670)
Payments on long-term debt and capital lease obligations	—	(638,620)
NET CASH PROVIDED BY FINANCING ACTIVITIES	**$ 891,850**	**$ 1,923,799**
Effect of exchange rate changes on cash	37,684	30,589
Net (decrease) in cash	**(113,587)**	**(909,578)**
Cash at beginning of year	570,709	1,480,287
CASH AT END OF YEAR	**$ 457,122**	**$ 570,709**
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Interest paid	191,634	190,444
SUPPLEMENTAL SCHEDULE OF NONCASH FINANCING ACTIVITIES		
Issuance of warrants on convertible debentures and notes payable	350,989	1,529,815
Common stock issued for payment of preferred stock dividends and convertible debenture interest	50,154	31,365
Preferred dividends declared, Series 1	132,195	133,919
Renewal of notes payable with related parties	1,300,000	1,000,000

See Notes to Consolidated Financial Statements.

Note 1. NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation and nature of operations:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, The Female Health Company - UK and The Female Health Company - UK, plc. All significant intercompany transactions and accounts have been eliminated in consolidation. The Female Health Company ("FHC" or the "Company") is currently engaged in the marketing, manufacture and distribution of a consumer health care product known as the Reality female condom, "Reality," in the U.S. and "femidom" or "femy" outside the U.S. The Female Health Company - UK, is the holding company of The Female Health Company - UK, plc, which operates a 40,000 sq. ft. leased manufacturing facility located in London, England.

The product is currently sold or available in either or both commercial (private sector) and public sector markets in 30 countries. It is commercially marketed directly by the Company in the United States and the United Kingdom and through marketing partners globally.

Significant accounting policies:

Use of estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and use assumptions that affect certain reported amounts and disclosures. Actual results may differ from those estimates.

Significant accounting estimates include the following:

Trade receivables include a provision for sales returns and trade allowances, which is based on management's estimate of future product returns from customers in connection with unsold product which has expired or is expected to expire before it is sold. The estimated cost for product returns, price discounts and trade allowances are accrued when the initial sale is recorded.

The market value of inventory is based on management's best estimate of future sales and the time remaining before the existing inventories reach their expiration dates.

The Company evaluates intellectual property rights for impairment by comparing the net present value of the asset's estimated future income stream to the asset's carrying value.

Although management uses the best information available, it is reasonably possible that the estimates used by the Company will be materially different from the actual results. These differences could have a material effect on the Company's future results of operations and financial condition.

Cash: Substantially all of the Company's cash was on deposit with one financial institution.

Inventories: Inventories are valued at the lower of cost or market. The cost is determined using the first-in, first-out (FIFO) method. Inventories are also written down for management's estimates of product which will not sell prior to its expiration date. Write downs of inventories establish a new cost basis which is not increased for future increases in the market value of inventories or changes in estimated obsolescence.

Foreign currency translation: In accordance with Financial Accounting Standards No. 52, "Foreign Currency Translation", the financial statements of the Company's international subsidiaries are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities, the historical exchange rate for stockholders' equity and a weighted average exchange rate for each period for revenues, expenses, and gains and losses. Translation adjustments are recorded as a separate component of stockholders' equity as the local currency is the functional currency.

Equipment and furniture and fixtures: Depreciation and amortization is computed by the estimated useful lives of the respective assets which range as follows:

Equipment	5 - 10 years
Furniture and fixtures	3 years

Intellectual property rights: The Company holds patents on the female condom in the United States, the European Union, Japan, Canada, Australia and The People's Republic of China and holds patents on the manufacturing technology in various countries. The Company also licenses the trademark "Reality" in the United States and has trademarks on the names "femidom" and "femy" in certain foreign countries. Intellectual property rights are amortized on a straight-line basis over their estimated useful life of twelve years.

Financial instruments: The Company has no financial instruments for which the carrying value materially differs from fair value.

Revenue Recognition: Revenues from product sales are recognized as the products are shipped to the customers.

Research and Development Costs: Research and development costs are expensed as incurred. The amount of costs expensed for the years ended September 2000 and 1999 was $67,099 and $122,196, respectively.

Stock-Based Compensation: The value of stock options awarded to employees is measured using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees." The Company has provided pro forma disclosures in Note 7 of net income as if the fair value-based method prescribed by Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation," ("FAS 123") was used in measuring compensation expense.

Advertising: The Company's policy is to expense production costs in the period in which the advertisement is initially presented to consumers.

Income taxes: The Company files separate income tax returns for its foreign subsidiaries. Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (FAS 109) requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are also provided for carryforwards for income tax purposes. In addition, the amount of any future tax benefits is reduced by a valuation allowance to the extent such benefits are not expected to be realized.

Earnings per share (EPS): Basic EPS is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS is computed giving effect to all dilutive potential common shares that were outstanding during the period. Dilutive potential common shares consist of the incremental common shares issuable upon conversion of convertible preferred shares or convertible debt and the exercise of stock options and warrants for all periods. Fully diluted (loss) per share is not presented since the effect would be anti-dilutive.

Other comprehensive income: Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as foreign currency translation adjustments, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

New accounting pronouncements: In June 1998, the FASB adopted SFAS 133, Accounting for Derivative Instruments and Hedging Activities. SFAS 133 establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting. In June 1999, the FASB adopted SFAS 137, Accounting for Derivative Instruments and Hedging Activities Deferral of the Effective Date of FASB Statement No. 133. SFAS 133, as amended by SFAS 137, is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. Management believes that the adoption of FAS No. 133 will have no material impact on the Company.

Reclassifications: Certain expenses on the statement of income for the year ended September 30, 1999, have been reclassified to be consistent with the presentation shown for the year ended September 30, 2000.

Note 2. INVENTORIES

The components of inventory consist of the following at September 30, 2000:

Raw materials	$ 210,933
Work in process	193,182
Finished goods	160,700
Less allowance for obsolescence	(74,000)
Net inventory	**$ 490,815**

Note 3. LEASES

The Company entered into a seven-year operating lease with a third party for office space effective September 12, 1994. The Company has also guaranteed an affiliate's lease with an unrelated third party which expires January 31, 2001. On November 1, 1998 the office space was sublet for the remaining term of the lease. Rental expense under the affiliate lease was $15,797 and $14,999 in 2000 and 1999, respectively, which is net of sublease rentals of $39,204 and $35,018 in 2000 and 1999, respectively.

On December 10, 1996, the Company entered into what is in essence a sale and leaseback agreement with respect to its 40,000 square foot manufacturing facility located in London, England. The Company received $3,365,000 (£1,950,000) for leasing the facility to a third party for a nominal annual rental charge and for providing the third party with an option to purchase the facility for one pound during the period December 2006 to December 2027.

As part of the same transaction, the Company entered into an agreement to lease the facility back from the third party for base rents of $304,000 (£195,000) per year payable quarterly until 2016. The lease is renewable through December 2027. The Company was also required to make a security deposit of $304,000 (£195,000) to be reduced in subsequent years. The facility had a net book value of $1,398,819 (£810,845) on the date of the transaction. The $1,966,181 (£1,139,155) gain which resulted from this transaction will be recognized ratably over the initial term of the lease. Unamortized deferred gain as of September 30, 2000 was $1,373,212 (£925,585).

In 1987, a subsidiary entered into a lease for office and factory space expiring January 31, 2001. These offices and factory space were vacated and subsequently this space was subleased to a third party for a period expiring January 31, 2001. At the time the sublease was entered into a liability was established for all future costs to the end of the lease, net of expected sublease receipts.

Details of operating lease expense in total and separately for transactions with related parties is as follows:

Years ended September 30	*2000*	*1999*
Operating lease expense		
Factory and office leases	$ 614,333	$ 691,399
Affiliate lease (net of sublease rentals)	15,797	14,999
Other	19,063	22,231
Total lease expense	**$ 649,193**	**$ 728,629**

Future minimum payments under operating leases, including the affiliate lease guarantee, consisted of the following at September 30, 2000:

	Operating	*Rentals receivable under subleases*
2001	$ 427,324	$ 13,068
2002	315,450	—
2003	315,450	—
2004	313,334	—
2005	303,615	—
Thereafter	3,402,342	—
Total minimum payments	**$5,077,515**	**$ 13,068**

Note 4. NOTES PAYABLE AND LONG-TERM DEBT

During 1999, the Company renewed a $1,000,000 note with Mr. Dearholt, a current director of the Company. The outstanding note payable had an interest rate of 12%. As part of the transaction, the Company issued Mr. Dearholt warrants to purchase 200,000 shares of the Company's common stock at $1.16 per share, which represented 80% of the average trading price for the five trading days prior to the closing date for the transaction and resulted in an initial discount on the note of $194,574. Any stock issued under the warrants carry certain registration rights. The warrants expire in 2008. The discount in combination with the note's 12% coupon resulted in an effective interest rate of 35 percent on the note.

Additionally, during 1999 the Company borrowed $250,000 from Mr. Dearholt and $50,000 from O.B. Parrish, also a current director of the Company. Each note payable bears interest at 12%. As part of the transactions, the Company issued Mr. Dearholt and Mr. Parrish warrants to purchase 50,000 and 10,000 shares of the Company's common stock at $1.35 and $1.25 per share, respectively, which represented 80% of the average trading price for the five trading days prior to the closing date for the transaction and resulted in an initial discount on the notes of $49,219 and $9,722, respectively. Any stock issued under the warrants carry certain registration rights. The warrants expire in 2008 and 2007, respectively. The discount in combination with the notes' 12% coupon resulted in an effective interest rate of 35 percent for each note.

During 2000, the Company renewed the $1,000,000 note with Mr. Dearholt. The outstanding note payable bears interest at 12% and is payable in full in 2001. As part of the transaction, the Company issued Mr. Dearholt warrants to purchase 250,000 shares of the Company's common stock at $.71 per share which represented 80% of the average trading price for the five trading days prior to the closing date for the transaction and resulted in an initial discount on the note of $148,999. Any stock issued under the warrants carry certain registration rights. The warrants expire in 2010. In addition, if the Company defaults on its obligation under the note, the Company is required to issue an additional 250,000 shares of its common stock to Mr. Dearholt in addition to all other remedies to which Mr. Dearholt may be entitled. The note is recorded at September 30, 2000, net of unamortized discount of $71,641. The discount in combination with the note's 12% coupon resulted in an effective interest rate of 27 percent on the note.

Additionally, during 2000 the Company renewed the $250,000 note with Mr. Dearholt and $50,000 note with O.B. Parrish. Each note payable bears interest at 12% and is payable in full in 2001. As part of the transactions, the Company issued Mr. Dearholt and Mr. Parrish warrants to purchase 62,500 and 12,500 shares of the Company's common stock at $.77 and $.72 per share, respectively, which represented 80% of the average trading price for the five trading days prior to the closing date for the transaction and resulted in an initial discount on the notes of $36,853 and $7,437, respectively. Any stock issued under the warrants carry certain registration rights. The warrants expire in 2010, for each note. Also if the Company defaults on its obligation under the note, the Company is required to issue an additional 62,500 and 12,500 shares of its common stock to Mr. Dearholt and Mr. Parrish, respectively, in addition to all other remedies to which each is entitled. The notes are recorded at September 30, 2000, net of unamortized discounts of $13,639 and $2,875, respectively. The discount in combination with the notes' 12% coupon resulted in an effective interest rate of 27 percent for each note.

On May 19 and June 3, 1999, the Company issued an aggregate of $1,500,000 of convertible debentures and warrants to purchase 1,875,000 shares of the Company's common stock to five accredited investors. These warrants expire in 2004. Interest on the convertible debentures is due at a rate of 8% per annum, payable quarterly in either cash or, at the investor's option, common stock of the Company at its then current market value. From December 2, 1999 to February 11, 2000, interest on the convertible debentures was at the rate of 10% annually, and then returned to 8% annually. Repayment of the convertible debentures is secured by a first security interest in all of the Company's assets. In addition, if the Company defaults in payment of the principal or interest due on the convertible debentures in accordance with their terms, the Company must immediately issue 1,500,000 shares of its common stock to the investor at no cost. The issuance of these shares will not affect any of the outstanding warrants then held by the investor, which warrants will continue in effect in accordance with their terms.

Additionally, warrants to purchase 337,500 shares of the Company's common stock were issued to the Company's placement agent in this offering. The warrants have a term of five years and are exercisable at an exercise price equal to the lesser of 70% of the market price of the common stock at the time of the exercise or $1.00. The warrants were valued at $224,800 which was recorded as additional paid-in capital.

The convertible debentures beneficial conversion feature is valued at $336,400 and the warrants to purchase 1,875,000 shares of the Company's common stock are valued at $715,100. In accordance with SEC reporting requirements for such transactions, the Company recorded the value of the beneficial conversion feature and warrants (a total of $1,051,500) as additional paid in capital. The corresponding amount of $1,051,500 was recorded as a discount on convertible debentures and is amortized over 1 year using the interest rate method. The note is recorded net of a discount of $101,664 at September 30, 2000. The discount in combination with the debenture's 8% coupon resulted in an effective interest rate of 159 percent for the debentures.

The original principal balance plus any accrued but unpaid interest of the convertible debentures may be convertible into shares of the Company's common stock at the investor's election, at any time after one year, based on a per share price equal to the lesser of (a) 70% of the market price of the Company's common stock at the time of conversion or $1.00. The convertible debentures were originally payable one year after issuance. However, the Company elected, under the terms of the convertible debentures, to extend the due date to two years after issuance. As a result of the Company making this election, the Company issued to the investors at the time of the extension, 375,000 additional warrants to purchase shares of the Company's common stock on the same terms as the previously issued warrants. These warrants expire in 2005. The warrants were valued at $157,700 and recorded as additional paid-in capital.

On April 6, 1999 the Company restructured its $602,360 (£370,000) Aage V. Jensen Charity Foundation note payable. The terms included immediate payment of $177,000 (£110,000) as of the date of the restructuring agreement and required nine installment payments beginning April 15, 1999 and concluding on December 10, 1999. To avoid incurring additional interest related to the loan, the Company paid off the entire loan on June 10, 1999.

Note 5. INCOME TAXES

A reconciliation of income tax expense and the amount computed by applying the statutory Federal income tax rate to loss before income taxes as of September 30, 2000 and 1999, are as follows:

Years ended September 30	*2000*	*1999*
Tax credit statutory rates	$ (1,254,700)	$ (1,275,100)
Nondeductible expenses	59,100	59,300
State income tax, net of federal benefits	(175,900)	(177,700)
Benefit of net operating loss not recognized, increase in valuation allowance	1,371,500	1,374,500
Other	—	19,000
Total income tax expense	**$ —**	**$ —**

As of September 30, 2000, the Company had federal and state net operating loss carryforwards of approximately $35,428,000 for income tax purposes expiring in years 2005 to 2016. The benefit relating to $1,537,800 of these net operating losses relates to exercise of common stock options and will be credited directly to stockholders' equity when realized. The Company also has investment tax and research and development credit carryforwards for income tax purposes aggregating approximately $127,000 at September 30, 2000, expiring in years 2006 to 2010. The Company's U.K. subsidiary, The Female Health Company - UK, plc subsidiary has U.K. net operating loss carryforwards of approximately $65,770,000 as of September 30, 2000. These U.K. net operating loss carryforwards can be carried forward indefinitely to be used to offset future U.K. taxable income. Significant components of the Company's deferred tax assets and liabilities are as follows at September 30, 2000:

Deferred tax assets	
Federal net operating loss carryforwards	$ 12,046,000
State net operating loss carryforwards	2,335,000
Foreign net operating loss carryforwards	19,732,000
Foreign capital allowances	906,000
Tax credit carryforwards	127,000
Accounts receivable allowances	48,000
Other	17,000
Total gross deferred tax assets	35,211,000
Valuation allowance for deferred tax assets	35,194,000
Deferred tax assets net of valuation allowance	17,000
Deferred tax liabilities:	
Equipment, furniture and fixtures	(17,000)
Net deferred tax assets	**$ —**

The valuation allowance increased (decreased) by $(4,213,500) and $1,711,000 for the years ended September 30, 2000 and 1999, respectively.

Note 6. ROYALTY AGREEMENTS

The Company has royalty agreements for sales of its products which provide for royalty payments based on sales quantities and achievement of specific sales levels. However, no royalty expense was incurred for the years ended September 30, 1999 or 2000.

Note 7. COMMON STOCK

Stock Option Plans

The Company has various stock option plans that authorize the granting of options to officers, key employees and directors to purchase the Company's common stock at prices generally equal to the market value of the stock at the date of grant. Under these plans, the Company has 94,028 shares available for future grants as of September 30, 2000. The Company has also granted options to one of its legal counsel and an affiliate. Certain options are vested and exercisable upon issuance, others over periods up to four years and still others based on the achievement of certain performance criteria by the Company and market prices of its common stock.

Summarized information regarding all of the Company's stock options is as follows:

	Number of Shares	*Weighted Average Exercise Price*
Outstanding at September 30, 1998	**1,174,478**	**$ 2.29**
Granted	1,876,000	0.86
Exercised	(18,000)	0.01
Expired or canceled	(79,178)	6.75
Outstanding at September 30, 1999	**2,953,300**	**$ 1.27**
Granted	50,000	0.50
Exercised	—	—
Expired or canceled	(85,900)	0.93
Outstanding at September 30, 2000	**2,917,400**	**$ 1.26**

Options shares exercisable at September 30, 2000 and 1999 are 438,300 and 425,766, respectively.

Options Outstanding and Exercisable

Options Outstanding				Options Exercisable	
Range of Exercise Prices	*Number Outstanding at 9/30/00*	*Weighted Average Remaining Life*	*Weighted Average Exercise Price*	*Number Exercisable at 9/30/00*	*Weighted Average Exercise Price*
$ 0.50	50,000	10.0	$ 0.50	—	$ —
0.85	1,784,500	7.9	.85	—	—
1.56	16,000	5.3	1.56	16,000	1.56
2.00	1,066,900	3.8	2.00	422,300	2.00
$ .50 to $2.00	**2,917,400**	**6.4**	**$ 1.26**	**438,300**	**$ 1.98**

Stock options have been granted to employees at, or in excess of, fair market value at the date of grant. Accordingly, in accordance with APB 25 and related interpretations, no compensation cost has been recognized related to such stock option grants.

Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant dates for all awards consistent with the method set forth under FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("FAS 123") the Company's net loss and loss per share would have been increased to the pro forma amounts indicated below:

Years ended September 30	*2000*	*Loss per Share*	*1999*	*Loss per Share*
Net loss attributable to common stockholders	$ (3,822,355)	$ (0.30)	$ (3,884,228)	$ (0.36)
Compensation expense related to stock options granted	(413,656)	(0.03)	(371,902)	(0.03)
Total	**$ (4,236,011)**	**$ (0.33)**	**$ (4,256,130)**	**$ (0.39)**

As the provisions of FAS 123 have been applied only to options granted since September 30, 1995, the resulting pro forma compensation cost is not representative of that to be presented in future years, when the pro forma cost would be fully reflected.

The fair value of options was estimated at the date of grant using the Black-Scholes option pricing model assuming expected volatility of 63.4% and risk-free interest rates of 5.38% and 5.00% for 2000 and 1999, respectively; and expected lives of one to three years and 0.0% dividend yield in both periods. The weighted average fair value of options granted was $.35 and $.61 for the years ended September 30, 2000 and 1999, respectively.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. Because the Company's employee stock options have characteristics different from those of traded options, and because changes in the input assumptions can materially affect the fair value estimate, the model may not provide a reliable single measure of the fair value of its employee stock options.

Stock Bonus Plan

During 1997, the Company adopted a stock bonus plan ("1997 Bonus Plan") to provide stock bonuses in lieu of cash bonuses to key employees who are responsible for the Company's future growth and financial success. The 1997 Bonus Plan provides for the award of up to 200,000 shares which are nontransferable and subject to a risk of forfeiture for one year subsequent to grant date. During the year ended September 30, 1999, 15,000 shares of restricted stock were issued to key employees. No shares of restricted stock was issued to key employees during the year ended September 30, 2000. Expense under the plan was $23,438 for the year ended September 30, 1999.

Common Stock Purchase Warrants

The Company enters into consulting agreements with separate third party professionals to provide investor relations services and financial advisory services. In connection with the consulting agreements, the Company granted warrants to purchase common stock. At September 30, 2000, 175,000 warrants were exercisable.

In 1999, the Company issued 100,000 warrants. The value of the warrants of $99,483 was recognized as unearned consulting fees and additional paid-in capital and the expense is being recognized over the term of the agreement. In 2000 the Company did not issue any warrants related to such arrangements.

No warrants were exercised during 2000. At September 30, 2000, the following warrants were outstanding:

	Number Outstanding
Warrants issued in connection with:	
Financial advisory services contract	$ 175,000
Convertible debentures	2,587,500
Convertible preferred stock	176,000
Equity line of credit	200,000
Notes payable	1,225,000
Outstanding at September 30, 2000	**$ 4,363,500**

At September 30, 2000, the Company had reserved a total of 9,101,400 shares of its common stock for the exercise of options and warrants outstanding. This amount includes shares reserved to satisfy obligations due if the Company defaults on the payment of interest or principal on $1.3 million of notes due between February and March 2000, and the convertible debentures due May and June 2000.

Issuance of Stock

The Company has issued common stock to consultants for providing investor relation services. In 1999, the Company issued 175,000 shares of common stock with a market value of $185,938 which was recorded as unearned consulting fees which is being recognized over the term of the agreement. In 2000, the Company issued 200,000 shares of common stock with a market value of $114,055 which was recorded as unearned consulting fees and is being recognized over the term of the agreement.

Note 8. PREFERRED STOCK

The Company has outstanding 660,000 shares of 8% cumulative convertible preferred stock (Series 1). Each share of preferred stock is convertible into one share of the Company's common stock on or after August 1, 1998. Annual preferred stock dividends will be paid if and as declared by the Company's Board of Directors. No dividends or other distributions will be payable on the Company's common stock unless dividends are paid in full on the preferred stock. The preferred stock may be redeemed at the option of FHC, in whole or in part, on or after August 1, 2000, subject to certain conditions, at $2.50 per share plus accrued and unpaid dividends. In the event of a liquidation or dissolution of the Company, the preferred stock would have priority over the Company's common stock. During 1999, 20,718 shares were converted into common stock.

Note 9. EQUITY LINE OF CREDIT

On November 19, 1998, the Company executed an agreement with a private investor, Kingsbridge (the Equity Line Agreement). This agreement provides for the Company, at its sole discretion, subject to certain restrictions, to sell ("put") to the investor up to $6.0 million of the Company's common stock, subject to a minimum put of $1.0 million over the duration of the agreement. The Equity Line Agreement expires 24 months after the effective date of the registration statement which was February 1999 and, among other things, provides for minimum and maximum puts ranging from $100,000 to $1,000,000 depending on the Company's stock price and trading volume. The Company is required to draw down a minimum of $1 million during the two-year period. If the Company does not draw down the minimum, the Company is required to pay the investor a 12% fee on that portion of the $1 million minimum not drawn down at the end of the two-year period. Upon execution of the agreement, the Company issued Kingsbridge 200,000 warrants to purchase common stock at $2.17 per share. As of September 30, 2000, the Company had placed four puts for the combined cash proceeds of $582,000 providing the selling stockholders with a total of 680,057 shares of the Company's common stock.

The timing and amount of the stock sales under the agreement are totally at the Company's discretion, subject to the Company's compliance with each of the following conditions at the time the Company requests a stock sale under the agreement:

- The registration statement the Company filed with the SEC for sales of stock under the agreement must remain in effect.
- All of the Company's representations and warranties in the agreement must be accurate and the Company must have complied with all of the obligations in the agreement.
- There may not be any injunction, legal proceeding or law prohibiting the Company's sale of the stock to Kingsbridge.
- The Company's counsel must issue a legal opinion to Kingsbridge.
- The sale must not cause Kingsbridge's ownership of the Company's common stock to exceed 9.9% of the outstanding shares of the Company's common stock.
- The trading price of the Company's common stock over a five-trading-day period preceding the date of the sale must equal or exceed $1.00 per share.
- The average daily trading volume of the Company's common stock for a twenty- trading-day period preceding the date of the sale must equal or exceed 17,000 shares.

The trading price of the Company's common stock was below $1.00 per share as of September 30, 2000. Although Kingsbridge waived the condition relating to the trading price for the fourth put completed during the third quarter of fiscal year 2000, the Company can make no assurance that Kingsbridge will waive this condition or any other condition under the Equity Line Agreement if the Company cannot satisfy such conditions to use the Equity Line Agreement if needed in the near future.

Note 10. EMPLOYEE RETIREMENT PLAN

Effective October 1, 1997, the Company adopted a Simple Individual Retirement Account (IRA) plan for its employees. Employees are eligible to participate in the plan if their compensation reaches certain minimum levels and are allowed to contribute up to a maximum of $6,000 annual compensation to the plan. The Company has elected to match 100% of employee contributions to the plan up to a maximum of 3% of employee compensation for the year ending September 30, 2000. The Company elected to match 1% of employee compensation during the prior year. Company contributions were $17,539 and $6,541 for 2000 and 1999, respectively.

Note 11. INDUSTRY SEGMENTS AND FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS

The Company currently operates primarily in one industry segment which includes the development, manufacture and marketing of consumer health care products.

The Company operates in foreign and domestic regions. Information about the Company's operations in different geographic areas (determined by the location of the operating unit) is as follows.

Years ended September 30	*2000*	*1999*
Net revenues:	*(Amounts in thousands)*	
United States	$ 2,116	2,350
International	3,651	2,365
Operating profit (loss):		
United States	(917)	(1,221)
International	(1,476)	(1,631)
Identifiable assets:		
United States	661	1,760
International	3,460	4,747

On occasion, the Company's U.S. unit sells product directly to customers located outside the U.S. Were such transaction reported by geographic destination of the sale rather than the geographic location of the unit, U.S. revenues would be decreased and International revenues increased by $37,000 and $177,000 in 2000 and 1999, respectively.

Note 12. CONTINGENT LIABILITIES

The testing, manufacturing and marketing of consumer products by the Company entail an inherent risk that product liability claims will be asserted against the Company. The Company maintains product liability insurance coverage for claims arising from the use of its products. The coverage amount is currently $5,000,000 for FHC's consumer health care product.

Note 13. RELATED PARTIES

It has been and currently is the policy of the Company that transactions between the Company and its officers, directors, principal shareholders or affiliates are to be on terms no less favorable to the Company than could be obtained from unaffiliated parties. The Company intends that any future transactions between the Company and its officers, directors, principal shareholders or affiliates will be approved by a majority of the directors who are not financially interested in the transaction.

Note 14. CONTINUING OPERATIONS

The Company's consolidated financial statements have been prepared on a going concern basis which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. The Company incurred a loss of $3.8 million for the year ended September 30, 2000, and as of September 30, 2000, had an accumulated deficit of $49.0 million. At September 30, 2000, the Company had working capital of ($1.4) million and stockholders' (deficit) of ($.7) million. In the near term, the Company expects operating and capital costs to continue to exceed funds generated from operations, due principally to the Company's fixed manufacturing costs relative to current production volumes and the ongoing need to commercialize the female condom around the world. As a result, operations in the near future are expected to continue to use working capital. Management recognizes that the Company's continued operations depend on its ability to raise additional capital through a combination of equity or debt financing, strategic alliances and increased sales volumes.

At various points during the developmental stage of the product, the Company was able to secure resources, in large part through the sale of equity and debt securities, to satisfy its funding requirements. As a result, the Company was able to obtain FDA approval, worldwide rights, manufacturing facilities and equipment and to commercially launch the female condom.

Management believes that recent developments, including the Company's agreement with the UNAIDS, a joint United Nations program on HIV/AIDS, provide an indication of the Company's early success in broadening awareness and distribution of the female condom and may benefit efforts to raise additional capital and to secure additional agreements to promote and distribute the female condom throughout other parts of the world.

On September 29, 1997, the Company entered into an agreement with Vector Securities International, Inc. (Vector), an investment banking firm specializing in providing advice to healthcare and life-science companies. Pursuant to this agreement, as extended, Vector will act as the Company's exclusive financial advisor for the purposes of identifying and evaluating opportunities available to the Company for increasing shareholder value. These opportunities may include selling all or a portion of the business, assets or stock of the Company or entering into one or more distribution arrangements relating to the Company's product. There can be no assurance that any such opportunities will be available to the Company or, if so available, that the Company will ultimately elect or be able to consummate any such transaction. Management is currently determining whether the Company should seek to extend this arrangement.

The Company has also obtained an equity line of credit. See Note 9 for details.

On May 19, 1999 and June 3, 1999 the Company issued an aggregate $1.5 million of convertible debentures and warrants to purchase 1,875,000 shares of the Company's common stock to five accredited investors. See Note 4 for additional detail.

Between September and November 1999 the Company completed a private placement where 983,333 shares of the Company's common stock were sold for $737,500, of which $500,000 was received through September 30, 1999. The stock sales were directly with accredited investors and included one current director of the Company. The Company provided the shares to these investors at a $.75 share price.

During the year ended September 30, 2000, the Company completed private placements where 1,305,000 shares of the Company's common stock were sold for $697,500 of which $597,500 was received through September 30, 2000. The stock sales were directly with accredited investors and included two current directors of the Company. The Company provided the shares to these investors at prices which ranged from $.50 and $.75.

While the Company believes that its existing capital resources will be adequate to fund its currently anticipated capital needs, if they are not the Company may need to raise additional capital until its sales increase sufficiently to cover operating expenses. In addition, there can be no assurance that the Company will satisfy the conditions required for it to exercise puts under the Equity Line Agreement. Accordingly, the Company may not be able to realize all or any of the funds available to it under the Equity Line Agreement.

Further, there can be no assurance, assuming the Company successfully raises additional funds or enters into business agreements with third parties, that the Company will achieve profitability or positive cash flow. If the Company is unable to obtain adequate financing, management will be required to sharply curtail the Company's efforts to promote the female condom and to curtail certain other of its operations or, ultimately, cease operations.

Corporate Information

Profile

The Female Health Company (FHC) is the maker of the Female Condom, a revolutionary option for contraception and the prevention of sexually transmitted diseases, including HIV/AIDS.

FHC was created as a worldwide company in February 1996 with the purchase of Chartex Resources Ltd., the holder of exclusive worldwide rights to the Female Condom. FHC is the sole manufacturer and marketer of the Female Condom in the world.

The corporation holds exclusive product and technology patents in the United States, Australia, Brazil, Canada, the European Patent Convention, France, Germany, Italy, Spain, the United Kingdom, the People's Republic of China, South Korea, New Zealand, Hong Kong and Japan.

The Female Condom is available through public sector agencies in more than 70 countries around the world and throughout the United States. It also is sold commercially in 14 countries around the world—including the United States, United Kingdom, Australia, Brazil, Canada, China, Denmark, France, Holland, Japan, Spain, Switzerland, Turkey and Venezuela.

Product

The Female Condom is designed for use by women to help prevent HIV/AIDS, other sexually transmitted diseases and unintended pregnancy. Made of polyurethane, the soft, thin sheath lines the vagina and covers the labia during intercourse, held in place with a soft ring at each end.

Clinical studies in the United States and Japan show that the Female Condom is 95% to 98% efficacious in protecting against pregnancy when used correctly and consistently. Studies have shown the Female Condom to be a highly effective barrier to the viruses and bacteria that cause sexually transmitted diseases, including HIV/AIDS.

The Female Health Company and its partners currently market the Female Condom under the Reality® brand name in the United States, and Reality™, Femidom™, Femy™, Care™, MyFemy™, Dominique™, and the "The Female Condom" in the rest of the world.

Officers

O.B. Parrish
Chief Executive Officer

Mary Ann Leeper, Ph.D.
President / Chief Operating Officer

William R. Gargiulo Jr.
Vice President / Secretary (retired)

Michael Pope
Vice President, U.K. Operations

Mitchell Warren
Vice President, International Affairs

Jack Weissman
Vice President, Sales

Board of Directors

O.B. Parrish
Chairman of the Board
Chief Executive Officer
The Female Health Company
Chicago, Illinois

Mary Ann Leeper, Ph.D.
President / Chief Operating Officer
The Female Health Company
Chicago, Illinois

William R. Gargiulo Jr.
Vice President (retired)
The Female Health Company
Chicago, Illinois

David R. Bethune
Chairman and Chief Executive Officer
Atrix Laboratories
Fort Collins, Colorado

Stephen M. Dearholt
Partner
Insurance Processing Center
Milwaukee, Wisconsin

Michael R. Walton
President / Owner
Sheboygan County Broadcasting Co.
Milwaukee, Wisconsin

James R. Kerber
Consultant to the insurance industry
Englewood, Colorado

Corporate Headquarters
875 N. Michigan Avenue
Suite 3660
Chicago, IL 60611
312.280.1119

Manufacturing Headquarters
One Sovereign Park
Park Royal, London, England

World Wide Web Address
www.femalehealth.com
www.femalecondom.org

E-mail Address
info@femalehealth.com
info@femalecondom.org

Transfer Agent and Registrar
Firstar Trust Company
Milwaukee, Wisconsin

Independent Auditors
McGladrey & Pullen, LLP
Schaumburg, Illinois

Legal Counsel
Reinhart, Boerner, Van Deuren,
Norris & Rieselback, S.C.
Milwaukee, Wisconsin

Stock Exchange Listing
The Female Health Company common shares are traded on the OTC Bulletin Board.
Symbol: FHCO

Inquiries
Shareholders, prospective investors, stockbrokers, financial analysts and other parties seeking additional information about The Female Health Company (including Securities and Exchange Commission Form 10-KSB and Quarterly Reports to Shareholders) should contact Investor Relations at 312.280.1119, send an e-mail request to info@femalehealth.com, or write to:

Investor Relations
The Female Health Company
875 N. Michigan Avenue, Suite 3660
Chicago, IL 60611

For more information about The Female Health Company and the Female Condom, visit www.femalehealth.com or www.femalecondom.org. Or dial our fax-on-demand service—800-PROINFO—and enter the company code: FHCO.

CREDITS

Editorial, Management **Boy Genius! Advertising + Marketing Communications** / Skokie, Illinois / 847.933.9680 / eboygenius@home.com

Design **Parish Design** / Harbert, Michigan / 616.469.7593 / cparish@triton.net

Prepress / Printing **Triangle Printers Inc.** / Skokie, Illinois / 847.675.3700 / arickett@triangleprinters.com

The Female Health Company

875 N. Michigan Avenue
Suite 3660
Chicago, IL 60611
312.280.1119
www.femalehealth.com