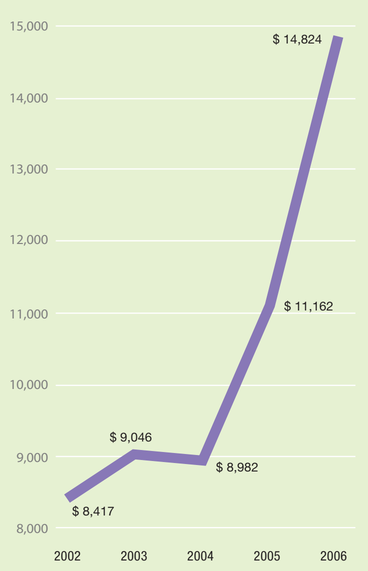
The Female Health Company Annual Report 2006

# the distance travelled

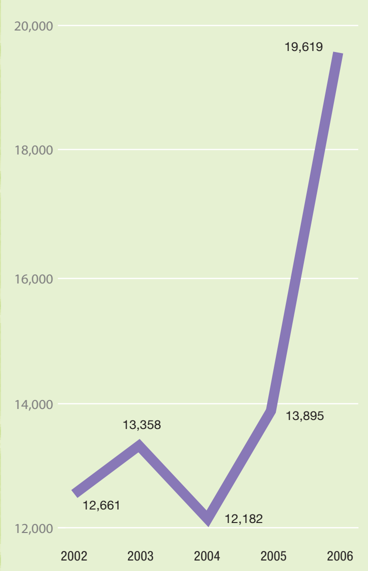
fhc

[ Worldwide sales rising.
More women protected. ]

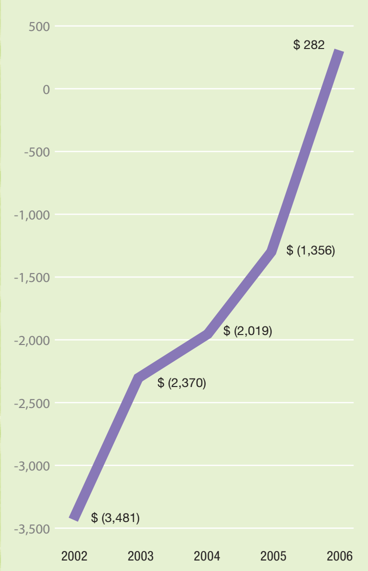
# Financial Highlights




**Net Revenues**
*In thousands*
+33%




**Unit Sales**
*In thousands*
+41%




**Net Income (Loss)**
*In thousands*
+$1.6 M

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| Net Revenues | **$ 14,824** | $ 11,162 | $ 8,982 |
| Net Income (Loss) | **282** | (1,356) | (2,019) |
| Net Income (Loss) per Common Share | **0.01** | (0.07) | (0.11) |
| Selling, General and Administrative Expenses | **4,820** | 4,958 | 3,579 |
| Weighted Average Common Shares Outstanding | **23,801** | 23,095 | 19,926 |
| Preferred Shares Outstanding | **529** | 529 | 529 |

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

# Dear Shareholders:

What a distance we have traveled in our first 10 years operating as a worldwide company. Fiscal year 2006 set records on multiple fronts:

- **Revenues rose 33 percent and unit sales were 41 percent above the levels reached in the prior fiscal year, providing protection against HIV/AIDS for a record number of women.**
- **Female Health Company ended fiscal 2006 with no debt and positive cash flow, and with approximately $2 million in cash and equivalents.**
- **Development, production, and distribution advances, along with growing demand for the FC Female Condom, resulted in our company's first annual profit.**

These achievements are attributable to the hard work, consistency, and ongoing determination of FHC management and employees in the United States and United Kingdom, our unique public sector team, and scores of public and private sector partners.

Our fiscal 2006 results are a triumph for our visionary shareholders and for millions of women worldwide. As the HIV/AIDS pandemic continues, we share an important mission by putting protection into the hands of women who desperately need their own method.

Distribution of our second-generation product, FC2, is expected to make a significant contribution, not only in increased FC accessibility but also in the value and growth of FHC. FC2 is significantly less expensive to manufacture than our first-generation product, FC. Due to providing purchasers with more affordable pricing, we believe FC2 can penetrate markets more rapidly, which is critically important in the battle against HIV/AIDS.

Our second-generation product is the result of a four-year development program. After rigorous scientific review, the World Health Organization (WHO) advised FHC that FC2 was acceptable for purchase by United Nations agencies. In addition, the European Union and the Indian Government have approved FC2.

Our company continues to reach out across the world, and we achieved much in Asia in fiscal 2006. FHC successfully established an FC2 manufacturing facility in Malaysia, and signed a memorandum of understanding to manufacture FC2 jointly in India with our partner, Hindustan Latex Limited (HLL). Our products will be distributed in India as part of government-sponsored HIV/AIDS prevention programs and marketed to consumers by HLL.

We have many more miles to travel, but the success we achieved in 2006 is extremely encouraging. It is a distinct privilege to be on this journey with a growing network of people working diligently to improve the lives of millions of women worldwide.

O.B. Parrish
Chairman and Chief Executive Officer

**Contents**

# FC2 improves access


**More women in the world will have access to affordable female condoms.**

The World Health Organization (WHO) reviewed FC2 near the close of our fiscal year and advised FHC that it was acceptable for bulk procurement by United Nations agencies. WHO deemed FC2 to be manufactured at least to the same standard as FC.

Both FC products look similar, but production costs of the second-generation model are less than those of the original. Made of polyurethane, the manufactured sheath of FC is formed through a welding process. FC2 is made of a nitrile polymer and is manufactured by a process that leaves no seam. The process costs less, particularly for high-volume FC2 production runs. Lower costs and prices to purchasers are expected to result in increased volume purchases and greater availability to women across the world.

"With these developments, we expect FC2 demand to accelerate," said O.B. Parrish, FHC chairman and chief executive officer. "The orders are rising largely because the global community recognizes that women need protection from HIV and AIDS. There is increasing agreement among nations that prevention is cost-effective."

Early in calendar 2007 FHC plans to submit a supplement for FC2 to its original Premarket Approval (PMA) to the U.S. Food and Drug Administration (FDA).

See page 34 for FHC availability around the world.

Below: FC2 coming off the dipping line in the Malaysian facility.

Left: Water leak testing in the quality assurance laboratory in the Indian facility.

# Expanding FHC production capacity

**FHC revenue growth of 33 percent in fiscal 2006 outpaced the previous fiscal year's level by 9 percentage points, demonstrating that FC is increasing in demand and is being made available to more women.**

To meet the rising demand, FHC has taken steps to increase production capacity. A modular manufacturing design allows FHC to respond promptly to increasing orders.

The original FHC manufacturing plant in the United Kingdom continues to make FC and has production capacity of 60 million units. The second-generation model is manufactured on one line in Malaysia. An additional FC2 line in Malaysia will be operational in the first quarter of calendar 2007. When a third FC2 production line comes on line in India, also expected in the first quarter of calendar 2007, FHC will have the capacity to produce more than 22 million FC2 units annually.

These Asian manufacturing facilities are strategic in that they are located near large populations affected by HIV and can produce volumes at reduced cost. More affordable production means more women served.

During fiscal 2006 FHC received orders for more than 8.5 million FC units from the United States Agency for International Development (USAID). USAID has an expanded-response plan that includes a commodity fund to finance male and female condoms for HIV/AIDS programs and to ensure expedited delivery to countries.

Continuity is critically important. If supply is interrupted or blocked, customers can become frustrated and the world loses valuable time in the battle against HIV/AIDS. Streamlining distribution is important so that users have an ongoing supply.

As FHC monitors incoming orders, discussions occur about capacity needs. "Managing growth is a remarkable opportunity and a key challenge," according to O.B. Parrish. "Our modular manufacturing plan responds to increased demand. A new FC2 production line can be installed in about six months."

FHC maintains a lead over competitors due to the extensive scientific and regulatory reviews required for the introduction of healthcare products, along with issued and applied-for patents.

Above top: The packing line, UK facility.

Above bottom: Manufacturing line in the UK facility.

Below: The modular manufacturing line in the Malaysian facility.

# Empowering women to protect themselves

The WHO advice that FC2 is acceptable for purchase by UN agencies coincided with the 16th International AIDS Conference in Toronto, the main theme of which was the feminization of AIDS. Attendees focused on ways to strengthen women's rights, curb gender discrimination and violence against women, and empower women to use prevention methods.

**"As the only woman-initiated form of prevention against HIV, the female condom can provide millions of women with an essential tool to negotiate safer sex," says Mary Ann Leeper, FHC director, strategic advisor and spokesperson.**

UNAIDS reports that 17.7 million females worldwide, age 15 years and older, are living with HIV. The Global Coalition on Women and AIDS, a UNAIDS Initiative, is calling for more money for AIDS programs that work for women, along with closing the funding gap for the female condom and for microbicides development.

In sub-Saharan Africa, the impact of the global HIV/AIDS pandemic on women is more intense than in any other region of the world. Fifty-nine percent of HIV/AIDS cases in this area are females 15 years or older, according to the December 2006 *AIDS Epidemic Update*, released by UNAIDS and WHO.

The number of women with HIV is growing in part because women are twice as likely as men to contract HIV from an infected partner during unprotected heterosexual intercourse. Women's biological susceptibility to HIV is compounded by gender inequality in many cultures, thereby reducing the power of women to negotiate safer sex.

The epidemic has multiple effects on women, who are expected to care for sick family members. In addition, infection with HIV can result in loss of income and property when women become widowed. If HIV or AIDS status is discovered, violence against women can occur.

See page 32 for more on FHC's Global Public Sector team.

# FHC's passage to India

**Our biggest global outreach effort this year occurred in India, now having surpassed South Africa as the nation with the largest number of HIV/AIDS cases.**

In terms of percentages, however, India's rate of incidence is less than 1 percent. But countries such as India and China, due to their billion-plus populations, would be devastated if the incidence were to increase to the 20-percent-plus levels in some nations in sub-Saharan Africa. Prevention is the only way to prevent this from occurring.

UNAIDS reports that India has approximately 5.7 million people living with HIV. According to the National AIDS Control Organization, "The bulk of HIV infections in India are occurring during unprotected heterosexual intercourse. Consequently, women account for a growing proportion of people living with HIV (some 38 percent in 2005), especially in rural areas." A large proportion of women with HIV appear to have acquired the virus from their regular partners who were infected during paid sex. In some regions of India, half of sex workers have been found to be HIV-infected.

In partnership with Hindustan Latex Limited (HLL), FHC products are being distributed in two ways: as part of government-sponsored HIV/AIDS prevention programs and marketed directly to consumers under the brand name Confidom.

The FHC partnership with HLL to manufacture and distribute FC2 will be an important new strategy to control HIV infections. O.B. Parrish and Mike Pope, vice president and general manager of FHC UK, journeyed to India to help launch FC in India. Meetings were held with India's health minister, retail distributors, and hundreds of others engaging in frank discussions on ways to fight the pandemic.

Above: FHC's O.B. Parrish with Mr. M. Ayyappan, chairman of Hindustan Latex, making an inspection on the manufacturing line at the Hindustan Latex facility.

Middle: The Hindustan Latex team.

Bottom: The modular manufacturing line in the Indian facility.

# Inventive marketing strategies

For a view into consumer marketing strategies in India, log on to www.confidom.com, a Web site intended to reach Indians who can afford to purchase the product. Confidom is being promoted as a tool for healthy intimacy and “a great way to protect oneself.”

The day after World AIDS Day 2006, the UK medical journal *The Lancet* published an article exploring how a pleasure-oriented approach to promotion might reduce rates of sexually transmitted diseases. The viewpoint concluded, “Since pursuit of pleasure is one of the main reasons that people have sex, this factor must be addressed when motivating people to use condoms and participate in safer sexual behaviour.”

The opinion piece was hailed by some, but some leaders continue to discourage condom usage. Emphasizing abstinence only, however, has not been proven to result in a decrease in the vast numbers of HIV infections worldwide.

Ideas about sex are polarized in many countries, and FHC takes a culturally sensitive approach. Given the magnitude of the pandemic, FHC remains open to multiple strategies to build awareness and reduce the problem.

In addition to the Confidom brand in India, FC is marketed throughout the world under different names: FC Female Condom®, Reality®, Femidom®, Dominique®, Femy®, Myfemy®, Protectiv®, and Care®.


A view of the Web marketing campaign for Confidom.

# Partnership and collaboration

**Support from governments and organizations from both the public and private sectors is essential to sustain large-scale FC programs.**

- Government Ministries of Health provide access to FC as part of preventative outreach programs for women.
- International donor organizations — the U.N. Population Fund, USAID, the World Bank, the Department of International Development, and others — have supported FC training and education. They have also financed FC supplies and distribution.
- FHC distribution partners include Terpan in France, HLL in India, and Pharmascience in Canada.

Left: EU Parliament member Max van den Berg, of the Netherlands, holding the Female Condom at an EU symposium.

# Financial Review



**Overview**

The Company manufactures, markets and sells the FC Female Condom, the only Food and Drug Administration-approved product under a woman's control which provides dual protection against unintended pregnancy and sexually transmitted diseases, including HIV/AIDS. During 2003, the Company started developing a second generation Female Condom, FC2, which was completed in 2005. The Company believes that FC2 will result in a significant reduction in production costs and accelerate growth.

**Revenues.** The Company's revenues are derived from sales of the Female Condom, its only product, and are recognized upon shipment of the product to its customers. The Company's strategy is to develop a global market and distribution network for its product by completing partnership arrangements with companies with the necessary marketing and financial resources and local market expertise. The Company's customers include the following:

- The Company sells the Female Condom to the global public sector under the umbrella of its agreement with the Joint United Nations Programme on HIV/AIDS (UNAIDS). This agreement facilitates the availability and distribution of the Female Condom at a reduced price based on the Company's cost of production. The current price per unit ranges between £0.38 and £0.445 (British pounds sterling), or approximately $0.74 to $0.87. Currently, the Female Condom is available in approximately 92 countries through public sector distribution.
- The Company sells the Female Condom in the United States to city and state public health clinics as well as not-for-profit organizations such as Planned Parenthood.
- The Company sells the Female Condom in the commercial private sector principally through distribution partners. Currently the Female Condom is available through various channels in 108 countries and is commercially marketed directly to consumers in 10 countries, including the United States, Canada, Mexico, Spain, France and India.
- On September 30, 2003, the Company entered into an agreement with the U.S. Agency for International Development (USAID) to supply up to 25 million units of FC during the term of the contract, which originally expired on December 31, 2006, and was later extended until March 31, 2007. The product would be used primarily in USAID HIV/AIDS prevention programs in developing countries. In 2006, USAID exercised the option to procure six million incremental units within the calendar year. Between the inception of the agreement and December 18, 2006, the Company shipped USAID 8.3 million units and estimates the number of units purchased to be 11.7 million.
- On March 25, 2004, the Company appointed Global Protection Corporation as the exclusive distributor of the Female Condom for public sector sales within a nine-state region in the eastern United States. Global Protection Corporation is required to purchase 2.6 million units within a three-year period to retain exclusive distribution rights. As of December 18, 2006, the Company had sold Global Protection Corporation 1.1 million units of its minimum purchase requirement.
- On December 18, 2001, the Company announced the three year appointment of Total Access Group as the exclusive distributor for public sales within a 15-state region in the western United States. Total Access Group was required to meet minimum unit purchase requirements within the three-year period to retain exclusive distribution rights and achieved the required levels. As a result, effective January 1, 2005, Total Access Group received a two-year extension as the exclusive distributor for public sales within a 20-state region located between the midwestern and western portions of the United States. Total Access Group is now required to purchase 1.4 million units within the two-year period to retain exclusive distribution rights. As of December 18, 2006, Total Access Group had purchased 1.0 million units under the extension.
- On May 9, 2006, the Company announced that it had entered into a Memorandum of Understanding with Hindustan Latex Limited, or HLL, a Government of India Enterprise, to negotiate, in good faith, formal agreements related to the manufacture of FC2 in India. Negotiations are currently underway. In May 2006, HLL introduced the Female Condom to consumers under the name Confidom Passion Rings. HLL markets the product as India's first female condom for safe sex and contraception, targeting high-end upwardly mobile consumers. FC, already available in three major cities, will be introduced eventually into a total of 34 cities within India. HLL is the Company's exclusive distributor in India.

- In May 2006, the Company received an initial order for 500,100 Female Condoms from the National AIDS Control Organization of the Ministry of Health & Family Welfare, Government of India. The order was placed through UNFPA, the United Nations Population Fund. The Female Condoms will be used in the National AIDS Control Organization's Reproductive Health and HIV/AIDS prevention programs, and distribution will initially be focused on commercial sex workers in six high-prevalence states in India. In May 2006, India was reported as having 5.7 million HIV/AIDS cases, less than 1% of its 1 billion plus population, making India the largest HIV population in the world. UNAIDS reported in 2005 that a significant portion of new infections in India are occurring in women who are married and who have been infected by husbands who frequent sex workers. UNAIDS further states that commercial sex serves as a major driver of the epidemic in most parts of India. The Indian Government is implementing prevention programs to preclude what happened in some sub-Saharan African countries where more than 20% of the population is HIV positive.

Significant quarter to quarter variations may result from time to time due to the timing and shipment of large orders and not any fundamental change in the Company's business. Because the Company manufactures FC in a leased facility located in London, England, and FC2 in a leased facility located in Malaysia, a portion of the Company's operating costs occur in foreign markets. While a material portion of the Company's future sales are likely to be in foreign markets, all sales are denominated in British pounds sterling or United States dollars. Manufacturing costs and sales to foreign markets are subject to normal currency risks associated with changes in the exchange rate of British pounds sterling relative to the United States dollar. For 2006, 58% of the Company's net revenues, 88% of the Company's cost of products sold and 28% of the Company's operating expenses were affected by changes in the exchange rate of British pounds sterling relative to the United States dollar. Approximately 18% of net revenues in 2006 were to the Company's customers in Brazil, whose purchases are denominated in U.S. dollars. On an ongoing basis, management continues to evaluate the Company's commercial transactions and is prepared to employ currency hedging strategies when it believes such strategies are appropriate. For 2006, the Company estimated that the net adverse impact of the exchange rate fluctuations was not significant.

**Expenses.** The Company manufactures FC at its facility located in the United Kingdom and FC2 at its facility located in Selangor D.E., Malaysia. The Company's cost of products sold consists primarily of direct material costs, direct labor costs and indirect production and distribution costs. Direct material costs include raw materials used to make the Female Condom, principally polyurethane for FC and a latex hybrid for FC2. Indirect product costs include logistics, quality control, and maintenance expenses, as well as costs for helium, nitrogen, electricity and other utilities. 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.

The Company has experienced increased costs of products, supplies, salaries and benefits, and increased general and administrative expenses. In 2005 and 2006, the Company has, where possible, increased selling prices to offset such increases in costs.

As noted above, the Company's manufacturing costs are subject to currency risks associated with changes in the exchange rate of British pounds sterling 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. A decrease of the value of the U.S. dollar compared to British pounds sterling has the effect of increasing the Company's cost of sales and decreasing its gross profit margin.

**Operating Highlights**. The Company's net revenues have increased in recent periods. The Company had net revenues of $14,824,242 in the fiscal year ended September 30, 2006, as compared to net revenues of $11,161,555 in the fiscal year ended September 30, 2005.

The Company had positive cash flow from operations of $0.3 million during the fiscal year ended September 30, 2006. In fiscal 2005, the Company had negative cash flows from operations of $0.2 million.

In fiscal 2005, the Company had a net loss attributable to common stockholders of $(1,516,863) or $(0.07) per share for the fiscal year ended September 30, 2005. The Company had net income attributable to common stockholders of $120,778 or $0.01 per share in fiscal 2006. Based on the level of the Company's expenses and the average selling price per unit in fiscal 2006, the Company must achieve cumulative annual unit sales of approximately 19.5 million Female Condoms to cover operating and non-operating expenses. The Company had unit sales of 19.6 million in fiscal 2006.

## Results of Operations

*Fiscal Year Ended September 30, 2006 ("2006") Compared to Fiscal Year Ended September 30, 2005 ("2005")*

The Company had net revenues of $14,824,242 and net income attributable to common stockholders of $120,778 or $0.01 per share in 2006 compared to net revenues of $11,161,555 and a net loss attributable to common stockholders of $(1,516,863) or $(0.07) per share in 2005.

Gross profit increased $1,445,577, or 36%, to $5,489,410 for 2006 from $4,043,833 for 2005. The increase was a result of expanding net revenues more than offsetting the increase in fixed and variable costs incurred to manufacture the Company's product in 2006.

Net revenues increased $3,662,687, or 33%, in 2006 over the prior year. The higher net revenues resulted from increased demand from global public sector customers. The increased global public sector shipments in the countries of Brazil, Zimbabwe and Tanzania were partially offset by slightly reduced purchasing from South Africa, Botswana and France.

Cost of products sold increased $2,217,110, or 31%, to $9,334,832 for 2006 from $7,117,722 for 2005. The increase in cost of products sold is a result of a significant increase in volume and a slight increase in manufacturing costs.

Advertising and promotional expenditures increased $95,397 to $218,500 for 2006 from $123,103 for 2005. The increase relates to the cost of engaging a public relations firm, beginning in the third quarter of 2005 and continuing throughout fiscal 2006, to promote FC2 and communicate the Company's global contribution to women's health.

Selling, general and administrative expenses decreased $138,529, or 3%, from $4,958,208 in 2005 to $4,819,679 in 2006. The decrease resulted from reductions in amortization expense, reduced consulting fees and expense reimbursement from the Business Linkages Challenge Fund grant which were partially offset by higher employee compensation costs. Amortization expense declined as intangible assets became fully amortized during the second quarter of 2006. Consulting fees dropped at the conclusion of Sarbanes-Oxley compliance preparation activities, early in 2006.

Research and development costs decreased $62,900 to $210,876 in 2006 from $273,776 in 2005. The costs in 2005 and, to a lesser extent, the costs in 2006 primarily relate to expenses related to the safety and acceptability studies for the FC2 program and establishing manufacturing capacity in Malaysia and India.

The Company's operating income increased $1,551,609 to $240,355 in 2006 from $(1,311,254) in 2005 due to the improved gross profit coupled with a slight decrease in operating expenses. Total operating expenses decreased $106,032 from $5,355,087 in 2005 to $5,249,055 in 2006 as a result of decreases in selling, general and administrative and research and development expenses which were offset slightly by an increase in advertising and promotional expenses.

In the category of net interest and miscellaneous income/expense, the Company recorded income of $41,671 for 2006 compared to $44,402 of expense for 2005. The improvement was a result of debt elimination during the latter part of the first quarter of 2005 and an increase in interest income as a result of improved cash flow in 2006.

By reaching annual unit sales of 19.6 million Female Condoms in 2006 the Company was able to cover fixed manufacturing overhead costs, exceed break-even at the gross profit level, and cover operating and non-operating expenses.

## 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 the Female Condom 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 ultimate level of consumer demand around the world is not yet known. In 2006, sales of the Female Condom were sufficient to cover the Company's operating costs.

## Distribution Network

The Company's strategy is to develop a global distribution network for the Female Condom by entering into partnership arrangements with financially secure companies with appropriate marketing expertise. This strategy has resulted in numerous in-country distributions in the public sector, particularly in Africa, Latin America and recently India. The Company has also entered into several partnership agreements for the commercialization of the Female Condom in consumer sector markets around the world. However, the Company is dependent on country governments and global donors, as well as U.S. municipal and state public health departments, to continue AIDS/HIV/STD prevention programs that include Female Condoms as a component of such programs. The Company's commercial market penetration is dependent on its ability to identify appropriate business partners who will effectively market and distribute the Female Condom within its contractual territory. Failure by the Company's partners to successfully market and distribute the Female Condom or failure of country governments to establish and sustain HIV/AIDS prevention programs which include distribution of Female Condoms, the Company's inability to secure additional agreements with global AIDS prevention organizations, or the Company's inability to secure agreements in new markets, either in the public or private sectors, could adversely affect the Company's financial condition and results of operations.

On September 30, 2003, the Company entered into an agreement with USAID to supply it with up to 25 million units of FC during the term of the contract. The contract, which originally had a three-year term scheduled to expire on December 31, 2006, has been extended until March 31, 2007. The Female Condom is used primarily in USAID HIV/AIDS prevention programs in developing countries. USAID also had the option to order up to 8 million units of FC for the 2006 calendar year. In 2006, USAID exercised a contract option allowing it to procure six million incremental units within a calendar year. Between the inception of the agreement and December 18, 2006, the Company shipped USAID 8.3 million units. The Company estimates total units purchased under the contract to be 11.7 million.

On March 25, 2004, the Company announced the appointment of Global Protection Corporation ("Global") as the exclusive distributor for public sector sales within a nine-state region in the eastern United States. Global is required to purchase 2.6 million units within a three-year period to retain exclusive distribution rights. As of December 18, 2006, Global had purchased 1.1 million units.

On December 18, 2001, the Company announced the three-year appointment of Total Access Group ("TAG") as the exclusive distributor for public sales within a 15-state region in the western United States. TAG was required to meet minimum unit purchase requirements within the three-year period to retain exclusive distribution rights and achieved the required levels. As a result, effective January 1, 2005, TAG was rewarded a two-year extension as the exclusive distributor for public sales within a 20-state region located between the midwestern and western portions of the United States. TAG was required to purchase 1.4 million units within the two-year period to retain exclusive distribution rights. As of December 18, 2006, TAG had purchased 1.0 million units under the extension. Presently, the Company is in the process of negotiating a new four-year extension with TAG which the Company anticipates will become effective in January 2007.

## 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 FC in a leased facility located in London, England, and FC2 in a leased facility located in Malaysia. 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. For 2006, 58% of the Company's net revenues, 88% of the Company's cost of products sold and 28% of the Company's operating expenses were affected by changes in the exchange rate of foreign currencies relative to the United States dollar. Approximately 18% of net revenues in 2006 were to customers in Brazil, whose purchases are denominated in U.S. dollars.

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. For 2006, the Company estimates that the net impact of the exchange rate fluctuations was not significant.

### Government Regulation

The Female Condom is subject to regulation by the FDA pursuant to the federal Food, Drug and Cosmetic Act (the "FDC 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 cash operating losses relating to expenses to develop, manufacture, and promote the Female Condom. However, in 2006 the Company generated $0.3 million in positive cash flow from operations as a result of increased sales volume and reduced operating and non-operating expenses. In 2005 cash used in operations was $0.2 million.

In prior years, the Company has funded operating losses and capital requirements, in large part, through the sale of preferred stock, common stock or debt securities convertible into common stock.

At September 30, 2006, the Company had working capital of $5.0 million and stockholder's equity of $4.8 million compared to working capital of $3.8 million and stockholder's equity of $3.3 million as of September 30, 2005.

The Company believes its current cash position is adequate to fund operations of the Company in the near future, although no assurances can be made that such cash will be adequate. However, the Company may sell equity securities to raise additional capital and may borrow funds under its Heartland Bank credit facility.

Presently, the Company has two revolving notes with Heartland Bank that allow the Company to borrow up to $1,500,000 and expire on July 1, 2007. These notes were extended under the same terms as the initial notes dated May 19, 2004, with the exception of the interest rate, which has been reduced to prime plus 1% (prime rate was 8.25% at September 30, 2006). No new warrants were issued as part of the extension of these notes. These notes are collateralized by substantially all of the assets of the Company. No amounts were outstanding under the revolving notes at September 30, 2006.

As of December 18, 2006, the Company had approximately $1.5 million in cash, net trade accounts receivable of $3.2 million and current trade accounts payable of $1.6 million. Presently, the Company has no required debt service obligations.

### 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. In 2005 and 2006 the Company has, where possible, increased selling prices to offset such increases in costs.

### New Accounting Pronouncements

Please see "New Accounting Pronouncements" in *Note 1* of the financial statements.

# Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheet of The Female Health Company and Subsidiaries, as of September 30, 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years ended September 30, 2006 and 2005. 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 the standards of the Public Company Accounting Oversight Board (United States). 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, 2006, and the results of their operations and their cash flows for the years ended September 30, 2006 and 2005, in conformity with U.S. generally accepted accounting principles.

McGladrey & Pullen, LLP

Schaumburg, Illinois
December 27, 2006

# Consolidated Balance Sheet

| *Year Ended September 30* | 2006 |
|---|---|
| **ASSETS** | |
| CURRENT ASSETS | |
| Cash | $ 1,827,393 |
| Restricted cash | 237,741 |
| Accounts receivable, net of allowance for doubtful accounts of $45,000 | 3,160,801 |
| Inventories | 1,011,672 |
| Prepaid expenses and other current assets | 413,532 |
| **Total Current Assets** | **6,651,139** |
| OTHER ASSETS | 187,940 |
| **Total Other Assets** | **187,940** |
| EQUIPMENT AND FURNITURE AND FIXTURES | |
| Equipment not yet in service | 205,837 |
| Equipment, furniture and fixtures | 4,920,483 |
| Less accumulated depreciation | 4,519,627 |
| **Net Property, Plant and Equipment** | **606,693** |
| **TOTAL ASSETS** | **$ 7,445,772** |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | |
| CURRENT LIABILITIES | |
| Accounts payable | $ 599,023 |
| Accrued expenses and other current liabilities | 970,439 |
| Preferred dividends payable | 11,210 |
| **Total Current Liabilities** | **1,580,672** |
| LONG-TERM LIABILITIES | |
| Deferred gain on sale of facility | 1,092,775 |
| **Total Long-Term Liabilities** | **1,092,775** |
| STOCKHOLDERS' EQUITY | |
| Convertible preferred stock, Class A Series 1, par value $0.01 per share; Authorized 5,000,000 shares; issued and outstanding 56,000 shares | 560 |
| Convertible preferred stock, Class A Series 3, par value $0.01 per share; Authorized 700,000 shares; issued and outstanding 473,377 shares | 4,734 |
| Convertible preferred stock, Class B, par value $0.50 per share; Authorized 15,000 shares; no shares issued and outstanding | – |
| Common stock, par value $0.01 per share; Authorized 38,500,000 shares; issued and outstanding 24,316,363 shares | 243,164 |
| Additional paid-in capital | 64,291,244 |
| Unearned consulting fees | (61,000) |
| Deferred compensation | (449,325) |
| Accumulated other comprehensive income | 598,474 |
| Accumulated deficit | (59,823,450) |
| | **4,804,401** |
| Treasury stock, at cost, 20,000 shares of common stock | (32,076) |
| **Total Stockholders' Equity** | **4,772,325** |
| **TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY** | **$ 7,445,772** |

*See Notes to Consolidated Financial Statements.*

| *Years Ended September 30* | *2006* | *2005* |
|---|---|---|
| NET REVENUES | **$ 14,824,242** | $ 11,161,555 |
| COST OF PRODUCTS SOLD | **9,334,832** | 7,117,722 |
| **GROSS PROFIT** | **5,489,410** | **4,043,833** |
| OPERATING EXPENSES: | | |
| Advertising and promotion | **218,500** | 123,103 |
| Selling, general and administrative | **4,819,679** | 4,958,208 |
| Research and development costs | **210,876** | 273,776 |
| **Total Operating Expenses** | **5,249,055** | **5,355,087** |
| **OPERATING INCOME (LOSS)** | **240,355** | **(1,311,254)** |
| NONOPERATING INCOME (EXPENSE): | | |
| Interest expense | **(11,250)** | (53,752) |
| Interest income | **65,267** | 23,453 |
| Foreign currency translation loss | **(12,346)** | (14,103) |
| **Total Nonoperating Income (Expense)** | **41,671** | **(44,402)** |
| **NET INCOME (LOSS)** | **282,026** | **(1,355,656)** |
| Preferred dividends, Class A Series 1 | **11,201** | 11,201 |
| Preferred dividends, Class A Series 3 | **150,047** | 150,006 |
| **NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS** | **$ 120,778** | **$ (1,516,863)** |
| **NET INCOME (LOSS) PER BASIC COMMON SHARE OUTSTANDING** | **$ 0.01** | **$ (0.07)** |
| **BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING** | **23,801,167** | **23,094,868** |
| **NET INCOME (LOSS) PER DILUTED COMMON SHARE OUTSTANDING** | **$ 0.01** | **$ (0.07)** |
| **DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING** | **26,494,568** | **25,967,085** |

*See Notes to Consolidated Financial Statements.*

# Consolidated Statements of Stockholders' Equity

*Years Ended September 30, 2006 and 2005*

| | *Preferred Stock Class A Series 1* | *Preferred Stock Class A Series 3* | *Preferred Stock Class B* | *Common Stock* | *Additional Paid-In Capital* | *Unearned Consulting Fees* | *Deferred Compensation* | *Accumulated Other Comprehensive Income (Loss)* | *Accumulated Deficit* | *Cost of Treasury Stock* | *Total* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **BALANCE AT SEPTEMBER 30, 2004 (balance forwarded)** | **$ 560** | **$ 4,734** | **$ —** | **$ 207,152** | **$ 59,700,265** | **$ (69,547)** | **$ —** | **$ 441,634** | **$ (58,427,365)** | **$ (32,076)** | **$ 1,825,357** |
| Issuance of 275,000 shares of Common Stock for consulting services | — | — | — | 2,750 | 421,000 | (423,750) | — | — | — | — | — |
| Issuance of 3,000 shares of Common Stock upon exercise of stock options | — | — | — | 30 | 4,170 | — | — | — | — | — | 4,200 |
| Issuance of 113,500 restricted shares of Common Stock | — | — | — | 1,135 | 197,672 | — | (198,807) | — | — | — | — |
| Issuance of 2,200,000 shares of Common Stock upon exercise of stock warrants | — | — | — | 22,000 | 2,023,000 | — | — | — | — | — | 2,045,000 |
| Issuance of 90,647 shares of Common Stock as payment of Preferred Stock dividends | — | — | — | 906 | 149,053 | — | — | — | — | — | 149,959 |
| Issuance of 100,000 shares of Common Stock as incentive for exercise of stock warrants | — | — | — | 1,000 | 171,400 | — | — | — | — | — | 172,400 |
| Issuance of 240,000 Common Stock warrants as incentive for exercise of stock warrants | — | — | — | — | 169,676 | — | — | — | — | — | 169,676 |
| Preferred Stock dividends | — | — | — | — | — | — | — | — | (161,207) | — | (161,207) |
| Amortization of deferred compensation | — | — | — | — | — | — | 198,807 | — | — | — | 198,807 |
| Amortization of unearned consulting fees | — | — | — | — | — | 387,848 | — | — | — | — | 387,848 |
| Comprehensive loss: | | | | | | | | | | | |
| Net loss | — | — | — | — | — | — | — | — | (1,355,656) | — | (1,355,656) |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | (126,559) | — | — | (126,559) |
| COMPREHENSIVE LOSS | | | | | | | | | | | **(1,482,215)** |
| **BALANCE AT SEPTEMBER 30, 2005** | **$ 560** | **$ 4,734** | **$ —** | **$ 234,973** | **$ 62,836,236** | **$ (105,449)** | **$ —** | **$ 315,075** | **$ (59,944,228)** | **$ (32,076)** | **$ 3,309,825** |

*See Notes to Consolidated Financial Statements.*

*Years Ended September 30, 2006 and 2005*

| | *Preferred Stock Class A Series 1* | *Preferred Stock Class A Series 3* | *Preferred Stock Class B* | *Common Stock* | *Additional Paid-In Capital* | *Unearned Consulting Fees* | *Deferred Compensation* | *Accumulated Other Comprehensive Income* | *Accumulated Deficit* | *Cost of Treasury Stock* | *Total* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **BALANCE AT SEPTEMBER 30, 2005 (balance forwarded)** | **$ 560** | **$ 4,734** | **$ —** | **$ 234,973** | **$ 62,836,236** | **$ (105,449)** | **$ —** | **$ 315,075** | **$ (59,944,228)** | **$ (32,076)** | **$ 3,309,825** |
| Issuance of 170,000 shares of Common Stock for consulting services | — | — | — | 1,700 | 283,300 | (285,000) | — | — | — | — | — |
| Issuance of 1,000 shares of Common Stock upon exercise of stock options | — | — | — | 10 | 1,390 | — | — | — | — | — | 1,400 |
| Issuance of 462,875 restricted shares of Common Stock | — | — | — | 4,629 | 704,259 | — | (839,800) | — | — | — | (130,912) |
| Issuance of 75,000 shares of Common Stock as bonus | — | — | — | 750 | 123,100 | — | — | — | — | — | 123,850 |
| Issuance of 110,154 shares of Common Stock as payment of Preferred Stock dividends | — | — | — | 1,102 | 148,924 | — | — | — | — | — | 150,026 |
| Issuance of 200,000 Common Stock warrants for consulting services | — | — | — | — | 194,035 | — | — | — | — | — | 194,035 |
| Preferred Stock dividends | — | — | — | — | — | — | — | — | (161,248) | — | (161,248) |
| Amortization of deferred compensation | — | — | — | — | — | — | 390,475 | — | — | — | 390,475 |
| Amortization of unearned consulting fees | — | — | — | — | — | 329,449 | — | — | — | — | 329,449 |
| Comprehensive income: | | | | | | | | | | | |
| Net income | — | — | — | — | — | — | — | — | 282,026 | — | 282,026 |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | 283,399 | — | — | 283,399 |
| COMPREHENSIVE INCOME | | | | | | | | | | | **565,425** |
| **BALANCE AT SEPTEMBER 30, 2006** | **$ 560** | **$ 4,734** | **$ —** | **$ 243,164** | **$ 64,291,244** | **$ (61,000)** | **$ (449,325)** | **$ 598,474** | **$ (59,823,450)** | **$ (32,076)** | **$ 4,772,325** |

*See Notes to Consolidated Financial Statements.*

# Consolidated Statements of Cash Flows

| *Years Ended September 30* | *2006* | *2005* |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Net Income (Loss) | **$ 282,026** | $ (1,355,656) |
| ADJUSTMENTS TO RECONCILE NET INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES: | | |
| Depreciation | **63,004** | 56,950 |
| Amortization of patents | **43,809** | 136,818 |
| Increase in (recovery of) inventory obsolescence | **26,245** | (3,356) |
| (Recovery of) increase in allowance for doubtful accounts, returns and discounts | **(15,568)** | 47,561 |
| Interest added to certificate of deposit | **(2,347)** | (2,802) |
| Amortization of unearned consulting fees | **329,449** | 387,848 |
| Amortization of discounts on notes payable | **—** | 46,252 |
| Common stock warrants issued for investor relation services | **194,035** | — |
| Amortization of deferred gain on sale and leaseback of building | **(102,629)** | (105,071) |
| Stock compensation | **429,325** | 540,883 |
| CHANGES IN OPERATING ASSETS AND LIABILITIES: | | |
| Accounts receivable | **(949,869)** | (705,118) |
| Inventories | **(100,407)** | 523,406 |
| Prepaid expenses and other assets | **(158,128)** | (93,258) |
| Accounts payable | **16,729** | 169,539 |
| Accrued expenses and other current liabilities | **212,261** | 156,746 |
| **NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES** | **267,935** | **(199,258)** |
| INVESTING ACTIVITIES | | |
| Increase in restricted cash | **(237,741)** | — |
| Proceeds from maturity of certificate of deposit | **—** | 27,062 |
| Capital expenditures | **(124,190)** | (251,687) |
| **NET CASH USED IN INVESTING ACTIVITIES** | **(361,931)** | **(224,625)** |
| FINANCING ACTIVITIES | | |
| Proceeds from exercise of stock options | **1,400** | 4,200 |
| Proceeds from exercise of common stock warrants | **—** | 2,045,000 |
| Payments on note payable, bank | **—** | (500,000) |
| Dividend paid on preferred stock | **(15,200)** | (7,206) |
| Payments on capital lease obligations | **—** | (21,980) |
| **NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES** | **(13,800)** | **1,520,014** |
| Effect of exchange rate changes on cash | **160,123** | (76,547) |
| **Net increase in cash** | **52,327** | **1,019,584** |
| Cash at beginning of year | **1,775,066** | 755,482 |
| **CASH AT END OF YEAR** | **$ 1,827,393** | **$ 1,775,066** |
| Supplemental Cash Flow Disclosures: | | |
| Interest paid | **$ —** | $ 7,500 |
| Supplemental Schedules of Non-cash Investing and Financing Activities: | | |
| Common stock issued for payment of preferred stock dividends | **$ 150,026** | $ 149,959 |
| Preferred dividends declared | **11,201** | 11,201 |
| Issuance of restricted stock to employees | **839,800** | 131,625 |
| Accrued expense incurred for restricted common stock granted to employees and consultants | **130,912** | — |

*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 "FC Female Condom" 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 108 countries. The product is marketed in 10 countries by various country-specific commercial partners. The Company's credit terms are primarily on a net 30-day basis.

**Use of estimates:** The preparation of financial statements 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:

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.

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 concentration:** Substantially all of the Company's cash is maintained in one financial institution located in London, England.

**Accounts receivable and credit risk:** Accounts receivable are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a periodic basis. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Management also periodically evaluates individual customer receivables and considers a customer's financial condition, credit history, and the current economic conditions. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

A significant portion of the Company's product is being sold to developing countries and the stability of the political environment within these countries could have a material effect on the operations of the Company.

**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 are computed using primarily the straight-line method. Depreciation and amortization are computed over the estimated useful lives of the respective assets which range as follows:

| | |
|---|---|
| Equipment | 5 - 10 years |
| Furniture and fixtures | 3 years |

Depreciation on leased assets and leasehold improvements is computed over the lesser of the remaining lease term or the estimated useful lives of the assets. Depreciation on leased assets is included with depreciation on owned assets.

**Patents and trademarks:** The Company currently holds product and technology patents on the Female Condom in the United States, Japan, the United Kingdom, France, Italy, Germany, Spain, the European Patent Convention, Canada, the People's Republic of China, Brazil, South Korea and Australia. The Company has the registered trademark "FC Female Condom" in the United States and has trademarks on the names "femidom," "femy," "Reality," and others in certain foreign countries. Patents are amortized on a straight-line basis over their estimated useful life of 12 years. Patents and trademarks have no carrying value in the accompanying balance sheet at September 30, 2006.

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

**Research and development costs:** Research and development costs are expensed as incurred. The amount of costs expensed for the years ended September 30, 2006 and 2005, was approximately $211,000 and $274,000, respectively.

**Restricted cash:** Restricted cash relates to security provided to one of the Company's UK banks for performance bonds issued in favor of customers. Such security has been extended infrequently and only on occasions where it has been a contract term expressly stipulated as an absolute requirement by the funds' provider. The expiration of the bond is defined by the completion of the event such as, but not limited to, delivery of goods or at a period of time after product has been distributed.

**Revenue recognition:** The Company recognizes revenue from product sales when each of the following conditions has been met: an arrangement exists, delivery has occurred, there is a fixed price, and collectibility is reasonably assured.

**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*, and related interpretations. Accordingly, no stock-based compensation cost has been recognized, as all options granted under the Company's stock option plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net losses and losses per share had compensation cost for all of the stock-based compensation plans been determined based on the grant date fair values of awards (the method prescribed by Financial Accounting Standard No. 123, *Accounting for Stock-Based Compensation*):

| *Year Ended September 30* | *2006* | *2005* |
|---|---|---|
| Net income (loss) attributable to common stockholders, as reported | $ 120,778 | $ (1,516,863) |
| Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards | (492,086) | (824,930) |
| Pro forma net loss | $ (371,308) | $ (2,341,793) |
| Basic and diluted income (loss) per common share: | | |
| As reported | $ 0.01 | $ (0.07) |
| Pro forma | $ (0.02) | $ (0.10) |

**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 and the exercise of stock options and warrants and upon restrictions lapsing on contingent shares, for all periods.

**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.

Over the years, the Parent Company has financed the operations of its subsidiaries through an intercompany loan with The Female Health Company, plc. which was eliminated upon consolidation. The Company has designated the intercompany loan to be long-term in nature as prescribed by FAS 52. Further, the Company followed the guidance of FAS 52 paragraph 20. b. when translating the subsidiary's balance sheet for consolidation purposes. This paragraph states that "gains and losses on intercompany foreign currency transactions that are of a long-term investment nature (that is, settlement is not planned or anticipated in the foreseeable future) would not be included in the computation of net income when the entities to the transaction are consolidated."

**New accounting pronouncements:** The Financial Accounting Standards Board has issued Statement of Financial Accounting Standards No. 123 (revised), *Share-Based Payment*. SFAS 123(R) is a replacement of SFAS 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related interpretive guidance.

SFAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. The effect of the standard will be to require entities to measure the cost of employee services received in exchange for stock options based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award.

The Company will be required to apply Statement 123(R) as of the beginning of its interim reporting period that began October 1, 2006.

SFAS 123(R) allows two methods for determining the effects of the transition: the modified prospective transition method and the modified retrospective method of transition. Under the modified prospective transition method, an entity would use the fair-value-based accounting method for all employee awards granted, modified, or settled after the effective date. As of the effective date, compensation cost related to the nonvested portion of awards outstanding as of that date would be based on the grant-date fair value of those awards as calculated under the original provisions of Statement No. 123; that is, an entity would not remeasure the grant-date fair value estimate of the unvested portion of awards granted prior to the effective date of the final Statement. Under the modified retrospective method of transition, an entity would recognize employee compensation cost for prior periods presented in accordance with the original provisions of Statement No. 123; that is, an entity would recognize employee compensation cost in the amounts reported in the pro forma disclosures provided in accordance with Statement No. 123.

The Company will elect the modified prospective transition method. Under this method, the Company estimates that the adoption of SFAS 123(R) will require the Company to record approximately $125,000 of stock compensation expense in the year ending September 30, 2007, related to employee options issued and outstanding at September 30, 2006, and those issued by the Company subsequent to year-end.

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes – an interpretation of SFAS 109, Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 developed a two-step process to evaluate a tax position and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. Management has not yet determined the impact that adoption will have on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The requirements of SFAS 157 are effective for fiscal years beginning after November 15, 2007. The Company does not believe the adoption of SFAS 157 will have a material effect on its consolidated financial statements.

In September 2006, the SEC staff issued Staff Accounting Bulletin (SAB) No. 108. The intent of SAB 108 is to reduce diversity in practice for the method companies use to quantify financial statement misstatements, including the effect of prior year uncorrected errors. SAB 108 establishes an approach that requires quantification of financial statement errors using both an income statement and cumulative balance sheet approach. The requirements of SAB No. 108 are effective for fiscal years ending after November 15, 2006. The Company does not believe the adoption of SAB 108 will have a material effect on its consolidated financial statements.

**Reclassifications:** Certain items in the 2005 financial statements have been reclassified to conform to the 2006 presentation. The reclassifications have had no effect on the net income (loss) for the years then ended.

## Note 2. Inventories

The components of inventory consist of the following at September 30, 2006:

| | |
|---|---|
| Raw materials | $ 738,166 |
| Work in process | 171,886 |
| Finished goods | 154,620 |
| Less allowance for obsolescence | (53,000) |
| | **$ 1,011,672** |

## Note 3. Acquired Intangible Asset

The Company follows SFAS 142, *Goodwill and Other Intangible Assets*. The following is a summary of acquired intangible assets at September 30, 2006:

| | *Gross Carrying Amount* | *Accumulated Amortization* |
|---|---|---|
| Subject to amortization: | | |
| Patents | **$ 1,123,214** | **$ 1,123,214** |

Amortization expense recognized on all amortizable intangible assets totaled $43,809 and $136,818 for the years ended September 30, 2006 and 2005, respectively.

As a result of the patents becoming fully amortized as of March 31, 2006, no additional amortization expense will be incurred in the future.

## Note 4. Notes Payable and Long-Term Debt

As of September 30, 2004, the Company had $500,000 remaining due under a credit facility with Heartland Bank. The credit facility was recorded at September 30, 2004, net of unamortized discount of $46,252. The remaining due amount of $500,000 was paid off as part of the warrant exercise program discussed in detail in Note 7, *Common Stock Purchase Warrants*.

Presently, the Company has two revolving notes with Heartland Bank that allow the Company to borrow up to $1,500,000 and expire July 1, 2007. The two notes total $1,500,000 and bear interest payable at a rate of prime plus 1% (prime rate was 8.25% at September 30, 2006). No new warrants were issued as part of the extension of these notes. These notes are collateralized by substantially all of the assets of the Company. No amounts are outstanding under the revolving notes at September 30, 2006.

Interest expense to related parties for the year ended September 30, 2005, was $53,752. There was no interest expense to related parties for the year ended September 30, 2006, due to the retirement of the related notes payable in the prior fiscal year.

## Note 5. Operating Leases and Rental Expense

The Company renewed and expanded its lease agreement to 5,100 square feet of office space with an unrelated third party which expires October 31, 2011. The lease requires monthly payments of $6,297 plus real estate taxes, utilities, and maintenance expenses. The Company is no longer required to make a security deposit related to the office space or maintain a certificate of deposit and letter of credit as collateral for said deposit.

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 $483,168 (£268,125) per year payable quarterly until 2016. The lease is renewable through December 2027. The Company was also required to make an initial security deposit of $483,168 (£268,125) which has been reduced to $182,481 (£97,500) and is included in other assets in the consolidated balance sheet at September 30, 2006. 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, 2006, was $1,092,775 (£583,873).

On June 1, 2005, the Company entered into a lease agreement to utilize 1,900 square feet of a facility located in Selangor D.E., Malaysia, for warehousing and manufacturing FC2. The lease expired May 31, 2006, and has since been renewed for two additional six-month periods currently expiring May 31, 2007. The lease requires an annual payment of $7,233. The lease shall automatically renew for an additional six-month period unless either party gives written notice of termination. The Company was not required to make an initial security deposit.

The Company also leases equipment under a number of lease agreements which expire at various dates between March 2009 and May 2011. The aggregate monthly rental was $1,559 at September 30, 2006.

Details of operating lease expense, including real estate taxes and insurance, are as follows:

| *Years Ended September 30* | *2006* | *2005* |
|---|---|---|
| Operating lease expense: | | |
| Factory and office leases | $ 832,547 | $ 856,525 |
| Other | 18,718 | 11,314 |
| | **$ 851,265** | **$ 867,839** |

Future minimum payments under operating leases consisted of the following at September 30, 2006:

| | *Operating Leases* |
|---|---|
| 2007 | $ 571,211 |
| 2008 | 568,664 |
| 2009 | 566,310 |
| 2010 | 567,145 |
| 2011 | 568,570 |
| Thereafter | 2,401,954 |
| **Total minimum payments** | **$ 5,243,854** |

## Note 6. Income Taxes

A reconciliation of income tax expense (credit) and the amount computed by applying the statutory federal income tax rate to loss before income taxes as of September 30, 2006 and 2005, is as follows:

| *Years Ended September 30* | *2006* | *2005* |
|---|---|---|
| Income tax expense (credit) at statutory rates | $ 96,000 | $ (461,000) |
| Nondeductible expenses | 142,000 | 66,000 |
| State income tax, net of federal benefits | (13,000) | (64,000) |
| Utilization of NOL carryforwards | (225,000) | — |
| Benefit of net operating loss not recognized, increase in valuation allowance | — | 459,000 |
| | **$ —** | **$ —** |

As of September 30, 2006, the Company had federal and state net operating loss carryforwards of approximately $47,211,000 and $25,570,000, respectively, for income tax purposes expiring in years 2007 to 2026. 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 carry-forwards for income tax purposes aggregating approximately $16,000 at September 30, 2006, which expires in the year 2007. The Company's UK subsidiary, The Female Health Company - UK, plc has UK net operating loss carryforwards of approximately $81,560,000 as of September 30, 2006. These UK net operating loss carryforwards can be carried forward indefinitely to be used to offset future UK taxable income.

Significant components of the Company's deferred tax assets and liabilities are as follows at September 30, 2006:

| Deferred tax assets: | |
|---|---|
| Federal net operating loss carryforwards | $ 16,566,000 |
| State net operating loss carryforwards | 1,278,000 |
| Foreign net operating loss carryforwards | 27,731,000 |
| Foreign capital allowances | 2,028,000 |
| Tax credit carryforwards | 15,000 |
| Other | (30,000) |
| Total gross deferred tax assets | 47,588,000 |
| Valuation allowance for deferred tax assets | 47,588,000 |
| **Net deferred tax assets** | **$ —** |

The valuation allowance increased by $1,089,000 and $5,942,000 for the years ended September 30, 2006 and 2005, respectively.

## 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 190,528 shares available for future grants as of September 30, 2006. The Company has also granted options to one of its legal counsel and consultants. Certain options are vested and exercisable upon issuance and others vest over periods up to three years.

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

| | *Number of Shares* | *Weighted Average Exercise Price* |
|---|---|---|
| **Outstanding at September 30, 2004** | **2,577,730** | **$ 1.38** |
| Granted | 195,000 | 1.72 |
| Exercised | (3,000) | 1.40 |
| Expired | (108,750) | 1.90 |
| **Outstanding at September 30, 2005** | **2,660,980** | **$ 1.39** |
| Granted | — | — |
| Exercised | (1,000) | 1.40 |
| Forfeited | (15,000) | 2.40 |
| **Outstanding at September 30, 2006** | **2,644,980** | **$ 1.38** |

Option shares exercisable at September 30, 2006 and 2005, are 2,579,162 and 2,070,051, respectively, at weighted average exercise prices of $1.37 and $1.36, respectively.

*Options Outstanding and Exercisable*

| *Exercise Price* | *Number Outstanding At 9/30/06* | *Wghted. Avg. Remaining Life* | *Wghted. Avg. Exercise Price* | *Number Exercisable At 9/30/06* | *Wghted. Avg. Exercise Price* |
|---|---|---|---|---|---|
| $ 0.66 | 150,000 | 5.25 | $ 0.66 | 150,000 | $ 0.66 |
| 1.40 | 2,304,980 | 6.58 | 1.40 | 2,304,980 | 1.40 |
| 1.66 | 180,000 | 8.06 | 1.66 | 116,219 | 1.66 |
| 2.70 | 10,000 | 7.61 | 2.70 | 7,963 | 2.70 |
| **$ 0.66 to $ 2.70** | **2,644,980** | **6.61** | **$ 1.38** | **2,579,162** | **$ 1.37** |

The Company granted 195,000 options in 2005 to employees and outside directors with exercise prices equal to fair market value of the Company's stock at the date of grant. Therefore, no compensation expense was recognized related to these options under APB 25 at the date of grant. No options were issued in 2006.

The weighted average fair value of employee options granted for the year ended September 30, 2005, was $1.16. The fair value of options was estimated at the date of grant using the Black-Scholes option pricing model using the following weighted average assumptions: expected volatility of 52.83 percent, risk-free interest rate of 4.02 percent, expected life of ten years and no dividend yield.

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.

**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 200,000 warrants to purchase common stock in 2006, although none were issued in 2005. The fair value of warrants was estimated at the date of grant using the Black-Scholes option pricing model assuming expected volatility of 61.2 percent, risk-free interest rate of 5.10 percent, expected life of ten years, and no dividend yield. The warrants were valued at $194,035 and recorded by the Company in selling, general and administrative expense.

In an effort to generate funds for operating needs and to retire outstanding debt, between September 2004 and January 2005, the Company conducted a program to induce the holders of the Company's outstanding common stock purchase warrants to exercise their warrants. Pursuant to this program, the Company offered an incentive to such holders providing for issuance of (1) shares of the Company's common stock equal to 10 percent of the aggregate number of common stock purchase warrants exercised or (2) new common stock purchase warrants equal to 20 percent of the aggregate number of outstanding warrants exercised containing an exercise price per share equal to the closing price of the Company's common stock as reported on the OTC Bulletin Board on the date the holder committed to exercise the outstanding warrants.

Between October 2004 and January 2005, four investors opted to exercise 1,000,000 warrants and receive 1,100,000 shares of common stock, which include 100,000 incentive shares, and two investors opted to exercise 1,200,000 warrants and received 1,200,000 shares of common stock and 240,000 incentive warrants with an exercise price in each case of $1.50 per share and an expiration date of November 23, 2007. Among the persons participating in this program were three of the Company's directors. The Company received aggregate proceeds of $2.5 million from the exercise of the outstanding warrants. The incentive shares and warrants were valued at $342,076 and recorded by the Company in selling, general and administrative expense.

As a result of the inducement program, during 2005, 2,200,000 warrants were exercised. No such program was utilized in 2006.

At September 30, 2006, the following warrants were outstanding and exercisable:

| | *Number Outstanding* |
|---|---|
| Warrants issued in connection with: | |
| Convertible debentures | 2,150,000 |
| Investor relations | 200,000 |
| Note payable, bank | 340,000 |
| Notes payable, related party | 1,599,000 |
| **Outstanding at September 30, 2006** | **4,289,000** |

### Warrants Outstanding and Exercisable

| *Range of Exercise Prices* | *Number Outstanding and Exercisable at 9/30/06* | *Wghted. Avg. Remaining Life* | *Wghted. Avg. Exercise Price* |
|---|---|---|---|
| $ 0.40 to $ 0.50 | 364,000 | 3.48 | $ 0.40 |
| 0.51 to 1.00 | 2,575,000 | 1.42 | 0.96 |
| 1.01 to 3.00 | 1,350,000 | 4.71 | 1.31 |
| **$ 0.40 to $ 3.00** | **4,289,000** | **2.63** | **$ 1.03** |

### Issuance of Stock

The Company has issued common stock to consultants for providing investor relation services. In 2005, the Company issued 275,000 shares of common stock with a market value of $423,750 which was recorded as unearned consulting fees and is being recognized over the terms of the agreement. In 2006, the Company issued 170,000 shares of common stock with a market value of $285,000 which was recorded as unearned consulting fees and is being recognized over the terms of the agreement.

### Stock-Based Compensation Expense

The Company has issued common stock or common stock purchase warrants to outside consultants, employees, and certain warrant holders and restrictive common stock to employees. Total stock-based compensation was $952,809 and $928,731 for the years ended September 30, 2006 and 2005, respectively, and is included in selling, general and administrative expense in the consolidated statements of operations.

## Note 8. Preferred Stock

The Company has 56,000 outstanding shares of 8 percent cumulative convertible Series 1 Preferred Stock. Each share of preferred stock is convertible into one share of the Company's common stock. 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 Series 1 Preferred Stock. The Series 1 Preferred Stock may be redeemed at the option of FHC, in whole or in part, 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 Series 1 Preferred Stock would have priority over the Company's common stock.

The Company issued 473,377 shares of Series 3 Preferred Stock to 11 investors during February 2004 and received $1,500,602 in proceeds. Each share of Series 3 Preferred Stock is convertible at any time into one share of the Company's common stock. Holders of shares of the Series 3 Preferred Stock are entitled to cumulative dividends in preference to any dividend on the Company's common stock at the rate of 10 percent of the original issuance price ($3.17 per share) per annum, payable quarterly at the Company's option in cash or shares of the Company's common stock. If dividends are paid in shares of common stock, the dividend rate will be equal to 95 percent of the average of the closing sales prices of the common stock on the five trading days preceding the dividend reference date. The dividend reference date means January 1, April 1, July 1, or October 1 of each year. In the event of a liquidation or dissolution of the Company, the Series 3 Preferred Stock would have priority over the Company's common stock and holders of any other series of preferred stock of the Company. The Company may redeem any share of Series 3 Preferred Stock at any time that is after the second anniversary of the date of issuance of the share, provided that the redemption may not occur until the first day on or after the second anniversary of the date of issuance of such share in which the market value of the Company's common stock is at least 150 percent of the original issuance price of $3.17 per share. The liquidation preference on the Series 3 Preferred Stock is $3.17 per share plus accrued and unpaid dividends.

## Note 9. Employee Benefit Plans

### Employee retirement plan

The Company has 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 $12,500 annual compensation to the plan. The Company has elected to match 100 percent of employee contributions to the plan up to a maximum of 3 percent of employee compensation for the years ended September 30, 2006 and 2005. Annual company contributions were approximately $23,000 for 2005 and 2006.

### Bonus and retention program

During 2004, the Company implemented a management compensation and employee retention program. The Board of Directors' Company's Compensation Committee is responsible for determining the number of shares annually awarded to senior management in the management compensation program. Under the employee retention program, key employees are eligible for shares based on years of service. Shares awarded under either program are issued with restrictions on transfer and vest over either a one- or two-year period.

During 2005, the program provided for the issuance of 80,000 shares of restricted common stock as a bonus to senior management with a market value of $120,000. As of September 30, 2005, the restricted legend was removed. Under the terms of the retention program, employees were granted 13,500 shares of common stock as a retention bonus with a market value of $29,307.

In addition, the Company issued 20,000 shares to new employees during the year ended September 30, 2005. Total expense for these awards was approximately $49,500.

Total expense for all 2005 awards was $198,807 and is included in selling, general and administrative expense in the consolidated statement of operations for the year ended September 30, 2005.

During 2006, the program provided for the issuance of 447,500 shares of restricted common stock as a retention bonus to senior management with a market value of approximately $814,000. In addition, employees were granted 15,375 shares of common stock as a retention bonus with a market value of approximately $26,000. As of September 30, 2006, the restricted legend was removed on 13,250 of these shares.

In addition, the Company issued 25,000 shares to new employees during the year ended September 30, 2006. Total expense for these awards was approximately $39,000 in 2006. The Company also issued 50,000 bonus shares to employees in 2006 as compensation for special projects. This award was for services rendered in the year ended September 30, 2005. Accordingly, the Company recognized approximately $85,000 of stock compensation expense related to these shares in 2005.

Total expense for all 2006 awards was approximately $429,000 and is included in selling, general and administrative expense in the consolidated statement of operations for the year ended September 30, 2006.

## Note 10. 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 by geographic area is as follows.

| | *Net Sales to External Customers* | | *Long-Term Assets* | |
|---|---|---|---|---|
| *Years Ended September 30* | *2006* | *2005* | *2006* | *2005* |
| (Amounts in thousands) | | | | |
| United States | $ 2,074 | $ 2,280 | $ 107 | $ 95 |
| Brazil | 2,718 (1) | * | — | — |
| South Africa | 1,161 | 2,140 (1) | — | — |
| Botswana | * | 1,050 | — | — |
| France | * | 849 | — | — |
| Zimbabwe | 1,065 | 697 | — | — |
| Tanzania | 754 | * | — | — |
| India | * | * | 112 | — |
| Malaysia | * | * | 307 | 208 |
| United Kingdom | * | * | 269 | 333 |
| Other | 7,052 | 4,146 | — | — |
| **Total** | **$ 14,824** | **$ 11,162** | **$ 795** | **$ 636** |

* Less than 5% of total net sales

(1) Comprised of a single customer considered to be a major customer (exceeds 10% of net sales)

## Note 11. 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.

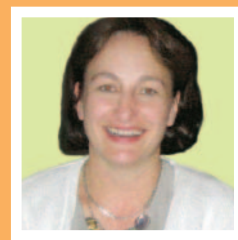
# Not merely a product, FC is a program

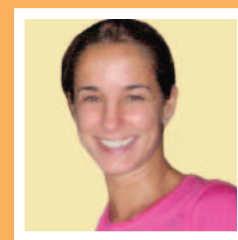
**FC programs succeed through community involvement and a strong emphasis on education.**

Members of our Global Public Sector (GPS) team work with various public sector organizations to establish outreach programs. Women respected in their villages are identified, and discussions result in effective ways to spread the word and instruct women on using FC.

The mass media can increase awareness, but peer educators and service providers appear to have a stronger impact on an individual's motivation to use FC. Research from Zimbabwe and Brazil shows that those most likely to use and continue to use FC are those with access to community outreach programs.

In many regions of the world, men maintain the dominant role in decisions relating to contraception and disease prevention. Studies indicate that, in most cases, effective FC use requires the communication and cooperation of a woman's partner. Survey data suggest that women will not use FC if they think their partners will not like the method. Thus, FHC involves men as well as women in FC introduction.



**GPS team members who have laid the groundwork for outreach and FC access include** (clockwise from top left)**:**

- **Katy Pepper in Cape Town, South Africa;**
- **Patty Weisenfeld in Chiang Mai, Thailand;**
- **Simone Martins in São Paolo, Brazil; and**
- **Tania Nakari in Divonne-les-Bains, France.**

Below, Katy Pepper at a World AIDS Day event at Hokisa, an orphanage for children whose parents have died of HIV.


# The battle goes on

World leaders pledged several years ago to adopt eight Millennium Development Goals, one of which was "to halt and begin to reverse the spread of HIV/AIDS" by 2015. Plans have been made but infection rates are still growing.

- In 2006, 39.5 million people in the world had HIV, according to UNAIDS. The more than 4 million new infections in 2006 represented more than 10 percent of the global total.
- Almost two-thirds of all new infections (2.8 million) in 2006 occurred in sub-Saharan Africa. UNAIDS also reported significant regional increases in Eastern Europe and Central Asia.
- "An estimated 5,000 to 6,000 people aged between 15 and 24 acquire HIV every day," according to Guardian Unlimited, in a report published on World AIDS Day 2006.
- The highest rates of infection are among those between the ages of 15 and 24, and married women in their 20s and 30s, according to UNAIDS.
- The International Labour Organization estimates HIV/AIDS killed almost 3.5 million people of working age last year, adding that more than 3 million people were unable to work because of illness due to AIDS.
- The pandemic has had a devastating impact on families. Children are forced into child labor, preventing young people from being able to study and prepare for rewarding careers as adults. Young people stuck in the poverty trap are at higher risk of contracting and spreading the disease.
- Prevention efforts are reaching fewer than 20 percent of the people in dire need, according to UNAIDS.

**When FC is made available, research points to more protected sexual acts.**

**Correct FC usage can prevent disease transmission, thereby averting the human anguish that results from severe illness and death.**

**In addition, preventative health strategies can reduce medical treatment costs, which are substantial, especially for AIDS-related illnesses.**

# Available in more than 100 countries

**FHC products are available in more than 100 countries, in both developed and developing nations.**

- In fiscal 2006 FHC signed a distribution agreement with Fuji Latex to market the FC Female Condom to consumers in Japan.
- Organizations within the United States accounted for the largest fiscal 2006 FC purchases in developed-world nations, followed by FC sales to organizations in France during the same period.
- Other developed nations where FC is available include Canada, the Netherlands, Spain, Switzerland, and the United Kingdom.

The overwhelming majority of female condoms are purchased for use in developing nations. About 80 percent of FHC worldwide purchases are for public-sector programs.

- Four million FC Female Condoms were purchased for Brazil in fiscal years 2005-2006, with Venezuela as South America's second-largest purchaser during the same time period.
- Other large sales in fiscal 2006 were for South Africa, Zimbabwe, Tanzania, and Kenya, all in the sub-Saharan region hit heaviest by the HIV/AIDS pandemic.
- India is the largest purchaser in Asia, followed by Papua New Guinea.


**Key**

Developed countries Female Condoms available

Developing countries Female Condoms available

Manufacturing locations of Female Condoms


Finland
United Kingdom
Ireland
Netherlands
Germany
Switzerland
France
Italy
Romania
Kosovo
Portugal
Spain
Greece
Turkey
Mongolia
Uzbekistan
Kyrgyzstan
China
Japan
Iran
Afghanistan
Jordan
Pakistan
Nepal
Bhutan
Bangladesh
Egypt
Saudi Arabia
Myanmar
India
Cape
Verde
Mauritania
Mali
Niger
Chad
Senegal
Guinea-Bissau
Guinea
Sierra Leone
Liberia
Burkina Faso
Benin
Cote
d'Ivoire
Togo
Ghana
Nigeria
Cameroon
Central African Rep.
Sudan
Eritrea
Yemen
Djibouti
Ethiopia
Thailand
Cambodia
Vietnam
Sri Lanka
Equatorial Guinea
Sao Tome & Principe
Gabon
Congo
Rwanda
Kenya
Dem. Rep.
of Congo
Burundi
Tanzania
Seychelles
Comoros
Angola
Zambia
Malawi
Zimbabwe
Namibia
Botswana
Mozambique
Madagascar
Mauritius
Swaziland
Lesotho
South Africa
Kiribati
Papua
New Guinea
Solomon Islands
Fiji
Tonga
Australia
New Zealand

# Profile

The Female Health Company (FHC) is the maker of the FC 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 FC. FHC is the sole manufacturer and marketer of FC in the world.

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

FC is currently sold or available through various channels in 108 countries. It is commercially marketed directly to consumers in 10 countries by various country-specific partners, including in the United States, the United Kingdom, Canada and France. Currently, public sector female condom programs in various stages are ongoing in over 90 countries.

# Product

The Female Condom is designed for use by women to help prevent HIV/AIDS, other sexually transmitted diseases and unintended pregnancy. Currently The Female Condom is available in two materials: FC is made of polyurethane and is manufactured in London. FC2 is made of a nitrile polymer and manufactured in Malaysia. The Female Condom's soft, thin sheath lines the vagina and covers the labia during intercourse; it is held in place with a soft ring at each end.

Clinical studies in the United States and Japan show that FC is 95 percent to 98 percent efficacious in protecting against pregnancy when used correctly and consistently. Studies have shown FC 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 FC Female Condom®, FC2 Female Condom®, Reality®, Femidom®, Femy®, and Care® in the rest of the world.

**"Safe Harbor" Statement under the Private Securities Litigation Reform Action of 1995:** The statements in this release which are not historical fact are forward-looking statements based upon the Company's current plans and strategies, and reflect the Company's current assessment of the risks and uncertainties related to its business, including such things as product demand and market acceptance; the economic and business environment and the impact of government pressures; currency risks; capacity; efficiency and supply constraints; and other risks detailed in the Company's press releases, shareholder communication and Securities and Exchange Commission filings. Actual events affecting the Company and the impact of such events on the Company's operations may vary from those currently anticipated.

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Photo page 6, bottom, courtesy of the Global Campaign for Microbicides

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Chief Executive Officer

**Donna Felch**
Chief Financial Officer

**Michael Pope**
Vice President, U.K. Operations

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

**Mary Ann Leeper, Ph.D.**
Senior Strategic Advisor

## Board of Directors

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Chairman of the Board
Chief Executive Officer
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Chicago, Illinois

**Mary Ann Leeper, Ph.D.**
Senior Strategic Advisor
The Female Health Company
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**William R. Gargiulo, Jr.**
Vice President/Secretary (retired)
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**Michael R. Walton**
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**Stock Exchange Listing**
The Female Health Company common shares are traded on the OTC Bulletin Board. Symbol: FHCO

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