



building bonds



strengthening relationships

The Female Health Company 2004 Annual Report



Dear Shareholders:

2004 was a pivotal year in the development of two underlying strategies designed to expand FHC's global opportunities. The first strategy focused on building and strengthening our relationships to broaden the FC Female Condom (FC) availability and FC programming in both the public and private sectors. The second, in which we made significant progress, was in finalizing the development of our second-generation female condom, FC2.

New bonds, stronger relationships

In 2003 we focused on working from the ground up — going into the villages and working with women where they live. Through these efforts we learned the difficulties that result when the user — the woman in the village — isn't the buyer. There is strong demand for FC in the village where she lives, but the difficulty lies in getting FC into her hands.

To better reach FC users, in 2004 we have **expanded our strategic focus to the buying decision-makers** — governments, social marketing organizations, NGOs and private donors. While continuing work at the village level and seeking to increase our stakeholder meetings in Africa, we strengthened alliances and partnerships that will build our base of cooperative support throughout Africa and the rest of the world. We expect that these alliances will help pave the way for the successful integration of FC into global prevention programs implemented in the villages where FC's ultimate users are.

A call from the Congo a few months ago demonstrates how a private/public partnership can work. We learned that it was not safe for women in the war camps there to leave their tents in the morning for fear of being raped. To protect themselves, they wanted to insert FC every morning before they left their tents to gather the food and water for the day.

Could we help make FC available to these women? Yes. We called the United Nations Population Fund (UNFPA), with whom we are developing a long-term female condom strategy, to see if they could help us meet this desperate need. They could and did. Within a few weeks, female condoms were delivered and education outreach programs were implemented for the women at risk.

We are actively pursuing **new alliances to increase unit volume sales** by broadening the geographical availability of FC. We continue to work rigorously with our partner in India, Hindustan Latex Ltd (HLL), to understand the cultural needs and support for Indian women to use FC. We also seek to understand the context in which progress can be made to encourage government support for FC programming.

In China we met with government officials and with various NGOs and social marketing organizations such as The Futures Group and PSI (Population Services International) to gain a better understanding of the requirements to initiate programs for the prevention of HIV/AIDS in China.

In France, the FC program continues to expand, nurtured by the **strong public/private partnership** between our distributor, Terpan, and the Ministry of Health.

FC2 to address persistent challenges

The reason most often given for why governments or donors do not purchase larger volumes of our female condom is price. To address this issue, we initiated a project to investigate ways to lower unit costs by evaluating the feasibility of changing FC's material and the resulting manufacturing process. This project is now at the end stage of completion with an expected **2005 availability of FC2**. We anticipate that by offering the second generation product at significantly reduced cost, the availability of FC Female Condom will experience considerable growth.

A brighter financial future

FHC's results for 2004 were mixed. Operationally, the Company's expectations were generally met with the exception of the interruption of a large order for Brazil. In May the Brazilian Ministry of Health publicly reported a fraud in the purchasing of certain products and suspended all purchases while an investigation and reorganization was undertaken. The fraud did not involve FHC or the FC Female Condom but it did halt the purchase of health care products including FC. We have been advised by Brazilian authorities that the very successful HIV/AIDS prevention program, which includes FC, will be reinitiated in 2005.

Events such as the Brazil situation do not stop the need for prevention. The HIV/AIDS pandemic continues to spread and with it the demand and need for FC, providing FHC with a growing long-term opportunity to make a significant humanitarian contribution and to achieve significant volume.

Another important aspect of FHC's financial strategy is that as of September 30, 2004, the Company reduced its outstanding debt by \$2.4 million to \$0.5 million, increasing working capital and shareholders' equity to \$2.5 million and \$1.8 million respectively compared to \$0.9 million and \$0.5 million as of September 30, 2003.

Stronger bonds will leverage and enlarge our sphere of influence. Although from a financial standpoint 2004 exemplified the difficult arena in which FHC operates, we are confident that our long-term strategies for progress will make a significant difference — improving the prospects for our Company as well as for the women who use the FC Female Condom.

The introduction of FC2 and the strengthening and broadening of the alliances, friendships and working dialogues — particularly with UNFPA, HLL, PSI, The Futures Group, and country ministries of health such as France's — will strengthen FHC as a company, and significantly facilitate the role we play in attacking the spread of HIV/AIDS. We continue to rely upon you, our shareholders, in the support of this vital mission.



O.B. Parrish
Chairman and Chief Executive Officer



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

FHC + China

More women, more need for more protection

With over 500 million women and girls, the largest female population of any country on earth lives right now in The People's Republic of China.

As one of the world's fastest growing economies for the past twenty years, China has undergone remarkable change — most notably in its achievement of maintaining one of the highest rates of growth in per capita income and lifting more than 200 million people out of poverty.

Despite such progress, as recently as 2003 HIV/AIDS was not a priority or even a topic of discussion for the country's leadership. Family planning and reproductive health were consistently addressed within the context of China's rigid

of a small minority of researchers and academics.

Faced with the unparalleled scale of China's population, FHC is building alliances where the need is strongest.

In Fall 2003, FHC brought together technical experts, program managers, marketing organizations, business leaders, government representatives and funding agencies from public and private sectors to examine the potential role of FC in China's national health plans. At the same time, FHC is exploring the country's emerging commercial and social markets for the introduction of FC in national, regional and provincial health product distribution systems.

China's new era of progress has enabled FHC to build new alliances and to broaden choices by bringing FC to women who want and need it. Without new alliances, these women would not have access to the protection of FC and the education programs that make it effective.



one-child population policy. Sex work, condom promotion and intravenous drug use were considered social evils and behaviors punishable by law. Prevention programs offering sexual and reproductive health education and services remained an elusive ideal

“Women hold up
half the sky.”

– ancient Chinese proverb



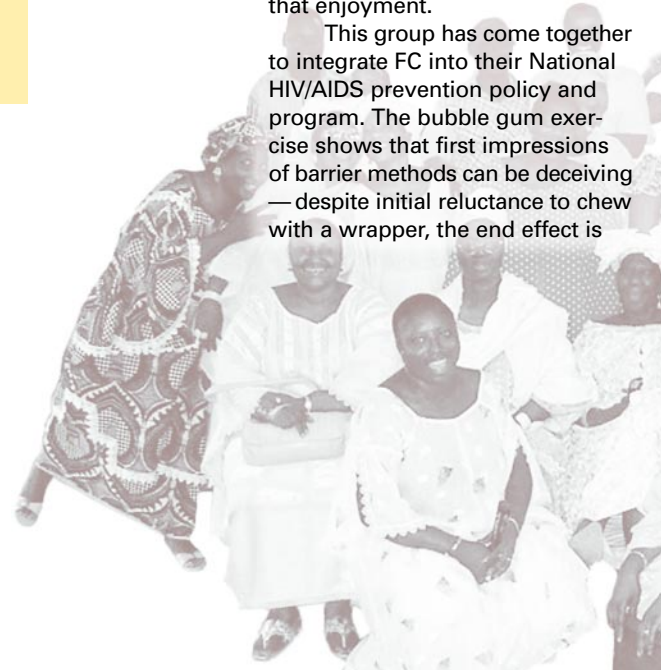
Building relationships with
establish a successful an

FHC + South Africa

Working with stakeholders in Africa

It is ten o'clock on a hot sunny morning in Manzini, Swaziland. An unlikely mix of nineteen people — an army officer, a correctional service sergeant, doctors, business leaders, Ministry of Health officials, religious dignitaries, media representatives and health care providers — sit in a circle, looking at each other and eagerly chewing bubble gum. Some chew it with the wrapper off and some with the wrapper on. The former group speaks of their instant enjoyment; the latter group describes a slow build-up to that enjoyment.

This group has come together to integrate FC into their National HIV/AIDS prevention policy and program. The bubble gum exercise shows that first impressions of barrier methods can be deceiving — despite initial reluctance to chew with a wrapper, the end effect is



country stakeholders helps
and sustainable program.

the same. By implication, wearing FC will be no barrier to ultimate enjoyment and it has the added satisfaction of protecting yourself and your partner.

The exercise works because it is fun, helps start a discussion about sensitive issues, and unites the group to address a common task. Stakeholder meetings, which include representatives from NGOs, governments and donor organizations, engage and build support among all interested agencies in how FC is integrated into the country. Building the relationships with country stakeholders is a primary strategy for FC integration and for establishing a successful and sustainable program.

In 2004, stakeholder meetings took place in several African countries: Swaziland, Namibia, Malawi, Zambia and South Africa, as well as with several multinational companies. In each case, agencies have begun a strategic planning process that will lead to the full integration of FC into their program. **Working together, these agencies can ensure that female condoms become a real and lasting choice for men and women in all walks of life.**

Find out more | femalehealth.com/countryprof.html



FHC+ France

Euro success: FC in France

The female condom has enjoyed a success in France not yet seen in other European countries. Sales in the commercial sector have expanded threefold, bringing total FC distribution in France to over three million.

Femme: mon corps "in control"

FC was first introduced in France in 1997 as part of a pilot study implemented in the Bouche du Rhone region, selected on the basis of its high HIV rates. The intervention aimed to reduce HIV/STD risk through counseling on a variety of protection methods, including FC. The intervention campaign theme "*Femme: mon corps et moi*" ("Woman: my body and me") was extremely successful, with 56% of respondents reported trying FC at least once. Its most well-liked aspect was that the woman was "in control."

In 1999 the intervention was expanded to a national scale with an emphasis on providing education on and access to FC as a new prevention method for women. Since then, the French government has pledged to provide family planning associations and related organizations with free supplies of FC—a commitment that continues today. Educational materials were developed by Terpan, a social marketing organization that has generated high demand for FC in

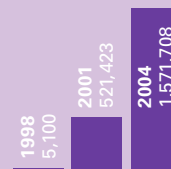


the commercial sector while working in partnership with the public Ministry of Health.

1 euro, 1 FC

In 2003 SIDA Information Service coordinated a national campaign to promote FC in pharmacies. The "1 euro, 1 FC" campaign launched in November 2003, accompanied by radio spots, press promotion and an endorsement petition signed by over 350 well-known French female celebrities. All female condoms supplied to pharmacists sold out within three weeks. In March 2004, the "1 euro, 1 FC" campaign was further rolled out to the Alsace region.

French distribution of FC has steadily increased since its introduction. Over one million female condoms were distributed in 2004, a success supported by the government's allocation of resources and its active commitment to promote FC as an additional means of protection for women.



Find out more | femalehealth.com/countries/France.html



Left: SURVIVAL, by Fiona Kirkwood, 23.5' x 5'. Made with female and male condoms for Tangencya to display in Durban, South Africa, to raise awareness of the female condom. The artist has been a cultural activist in the field of HIV/AIDS since 1998.



FHC + FC2

A strategy for the future

2004 was a breakthrough year in achieving one of our most significant objectives: making FC more affordable.

With a less expensive FC, we can help protect more women for the same amount of capital. Because the users (the women) are not the purchasers (typically, ministries of health), our strategy was to develop a less costly FC to make it competitive with male condoms — the primary factor cited by those who make the buying decisions.



We are pleased to report that our second-generation product, FC2, looks very similar to FC1 and is made of a less expensive material. FC2 performs in the same way as FC1 and is found to be highly acceptable in safety and acceptability studies.

FHC intends to file for the European Union CE mark and with

the World Health Organization Essential Products Listing. Thereafter we will make FC2 available to developing countries as soon as possible for purchase in 2005. Longer term strategies include applying for U.S. Food and Drug Administration registration for the modification of material and process.

Thanks to FC2's new material and manufacturing process, its advantages will enable FHC to:

- **Expand FC business and our potential for revenue**
- **Address the needs of decision-making buyers**
- **Protect more women**



FC2 is dipped instead of welded for a seamless product.



FC2 will enable FHC to expand FC business, address the needs of buyers, and protect more women.



FHC + UNFPA

The face of AIDS is increasingly female

Women and girls now represent half of all AIDS cases in the world and, in some areas, as much as 60% or more.

The United Nations Population Fund (UNFPA), which works to ensure universal access to reproductive health, has renewed its commitment to assure that FC is available to women across the globe. With our participation, UNFPA is leading an initiative to drive successful in-country programming efforts that support sustainable access and use of the only female-controlled barrier method.

Efforts are underway in Africa, Asia, Latin America and Eastern Europe with situation analyses being conducted in 16 pilot countries. Specific programming needs, key

partner identification within the country, political and cultural environmental factors, distribution mechanisms and training needs are being evaluated.

UNFPA's collaborative approach assures that the final recommendations and global work plan are developed with the input and recommendations of all in-country partners. **This shared participation and ownership for the initiative will facilitate final implementation** — helping to achieve sustainability not only within the pilot programs but also in building a model for expansion across the developing world.

Find out more | www.unfpa.org

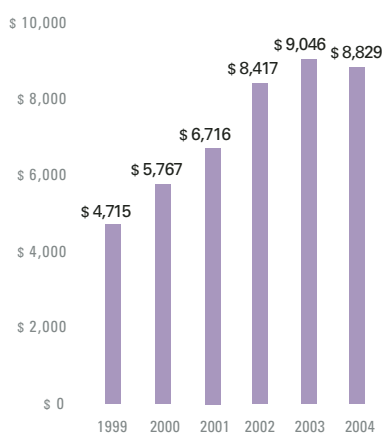


Financial Highlights 2004

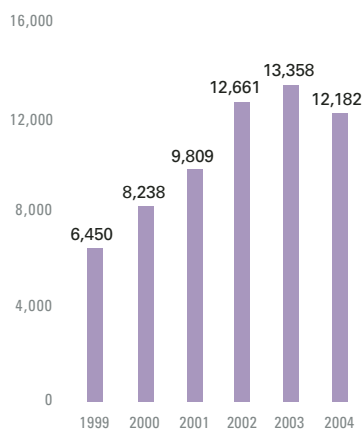
The selected financial data from continuing operations for the three years ending September 30, 2004, are derived from the audited Consolidated Financial Statements. The information here should be read in conjunction with "Management's Discussion and Analysis," the Consolidated Financial Statements, and related notes, all of which are included in the financial report to follow.

	2004	2003	2002
Net Revenues	\$ 8,829	\$ 9,046	\$ 8,417
Net Loss	(2,019)	(2,370)	(3,481)
Net Loss per Common Share Outstanding	(0.11)	(0.13)	(0.22)
Selling, General and Administrative Expenses	4,203	3,778	3,190
Weighted Average Common Shares Outstanding	19,926	19,020	16,245
Preferred Shares Outstanding	529	56	66

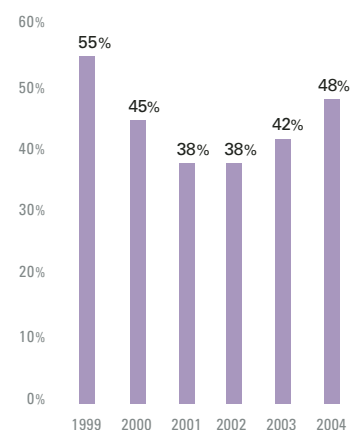
Years Ended September 30 *In thousands, except per-share data*



Net Revenues
In thousands



Unit Sales
In thousands



Selling, General and Administrative Expenses as a Percent of Sales

Overview

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

The Company has begun the process of developing the commercial market for the Female Condom around the world. As part of this plan, the Company has completed a number of distribution agreements and is pursuing other arrangements for the marketing and sale of the Female Condom. Management believes that as the number of markets in which the Female Condom is sold increases, sales will grow and at certain levels the Company will become profitable. However, there can be no assurance that such level of sales will be achieved in the near term or at all.

Effective September 26, 2002, the holders of outstanding options to purchase a total of 2,365,980 shares of common stock agreed to exchange all of their outstanding stock options for (i) a total of 469,000 shares of restricted common stock in the case of U.S. option holders or the right to receive a total of 122,495 shares of deferred common stock on September 26, 2003 in the case of U.K. option holders and (ii) the right to receive new options to purchase a total of 2,365,980 shares of common stock on the first business day that is at least six months and one day after the effective date of the exchange. The Company recorded \$728,430 of amortized compensation expense in fiscal 2003 relating to issuance of the restricted and deferred common stock. See "Stock Option Plans" in *Note 8* in the financial statements for additional information regarding the option exchange.

Results of Operations

Fiscal Year Ended September 30, 2004 ("2004") Compared to Fiscal Year Ended September 30, 2003 ("2003")

The Company had net revenues of \$8,829,255 and a net loss attributable to common stockholders of \$(2,125,889) or \$(0.11) per share in 2004 compared to net revenues of \$9,045,560 and a net loss attributable to common stockholders of \$(2,381,593) or \$(0.13) per share in 2003.

Gross profit increased \$35,295, or 1%, to \$3,622,293 for 2004 from \$3,586,998 for 2003. The slight increase was a result of declining net revenues offset by a more than proportionate decrease in cost of products sold.

Net revenues decreased \$216,305, or 2%, in 2004 over the prior year. The lower net revenues resulted from decreased unit sales shipped to global public sector customers. Increased shipments in the countries of Congo, Kenya, France and Zimbabwe were offset by a reduction of South Africa and Brazilian shipments.

On May 20, 2004, the Brazilian Ministry of Health publicly reported a fraud in the purchasing of certain products by the ministry and several individuals involved were arrested. Purchases of products were suspended while the investigation was ongoing. The fraud does not involve the Female Health Company or the Female Condom. However, the Company's anticipated 4 million unit order for 2004 has been delayed due to the suspension and investigation. The Company has been advised by Brazilian authorities that the very successful HIV/AIDS prevention program, which includes the Female Condom, is expected to continue in 2005. During 2003, the Company shipped 2,000,000 units to Brazil, compared to 65,000 units in 2004.

Cost of products sold decreased \$251,600, or 5%, to \$5,206,962 for 2004 from \$5,458,562 for 2003. The decline in cost of products sold is a result of lower indirect production and direct material costs partially offset by higher direct labor costs for the current fiscal year compared to the prior fiscal year. Lower polyurethane, helium and nitrogen costs were the primary factors causing the reduction in indirect production and material costs. Direct labor costs increased as a result of an across the board 3% raise for hourly labor in fiscal 2004 whereas such raise had only been provided for less than half of the prior fiscal year.

Advertising and promotional expenditures increased \$11,068 to \$47,601 from \$36,533 for the same period in the prior year.

Selling, general and administrative expenses increased \$424,934, or 11%, from \$3,778,015 in 2003 to \$4,202,949 in 2004. The increase was a result of non-cash expenses associated with implementation of the Company's executive compensation program in 2004, outside consulting fees and an overall increase in U.K. operating expenses. The higher U.K. operating costs were partly as a result of adverse exchange rate fluctuations experienced in 2004 compared to 2003.

Research and development costs increased \$119,033 to \$179,201 from \$60,168 for the same period in the prior year. The Company filed a patent on a second generation product (FC2) in the latter part of the 2003 fiscal year. The Company has initiated a development program in the current fiscal year. The increase in costs is due to costs related to the safety and acceptability studies for the FC2 program.

Stock compensation decreased \$787,329, or 75%, from \$1,047,398 in 2003 to \$260,069 in 2004. During 2003, the Company recorded charges primarily related to accounting for changes in stock option plans (\$0.7 million) and compensation for investor relation services (\$0.4 million). During 2004, the Company recorded charges for investor relation services (\$0.2 million) and for common stock purchase warrants issued as an incentive for exercising existing stock warrants (\$0.1 million). No additional charges related to the Company's stock option plan occurred in 2004.

The Company's operating loss decreased \$267,589 from \$(1,335,116) in 2003 to \$(1,067,527) in 2004 as a result of a slightly improved gross profit coupled with a reduction in operating expenses. Operating expenses decreased \$232,294 from \$4,922,114 in 2003 to \$4,689,820 in 2004 as a result of the reduction in stock compensation partially offset by increases in advertising, selling, general and administrative and research and development expenditures.

Net interest and non-operating expenses decreased \$83,692, or 8%, to \$951,361 for 2004 compared to \$1,035,053 for 2003. The decrease exists because the Company had a lower level of debt outstanding during fiscal year 2004 than fiscal year 2003. The result is a lower amount of non-cash expenses incurred from the amortization of discounts on notes payable in 2004 than in the prior year.

Preferred dividends increased \$95,577 to \$107,001 for 2004 compared to \$11,424 for 2003. The increase occurred as a result of the Company's issuance of 473,377 shares of Series 3 Preferred Stock to eleven investors during February 2004. The Company received \$1,500,602 in proceeds from the issuance of the Series 3 Preferred Stock. Holders of shares of the Series 3 Preferred Stock are entitled to a dividend at the rate of 10% of the original issuance price (\$3.17 per share) per annum, payable at the Company's option in cash or shares of the Company's common stock.

The Company was able to cover fixed manufacturing overhead costs and exceeded break-even at the gross profit level. However, the Company must achieve cumulative annual unit sales of approximately 18.1 million Female Condoms based upon the current average selling price per unit in order to cover operating and non-operating expenses or approximately 30% of manufacturing capacity.

Factors That May Affect Operating Results and Financial Condition

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

Reliance on a Single Product

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

Distribution Network

The Company's strategy is to act as a manufacturer and to develop a global distribution network for the product by completing partnership arrangements with companies with the necessary marketing and financial resources and local market expertise. To date, this strategy has resulted in numerous in-country distributions in the public sector, particularly in Africa and Latin America. Several partnership agreements have been completed for the commercialization of the Female Condom in private sector markets around the world. However, the Company is dependent on country

governments as well as city and state public health departments within the United States to continue their commitment to prevention of STDs, including AIDS, by including Female Condoms in their programs. The Company is also dependent on finding appropriate partners for the private sector markets around the world. Once an agreement is completed, the Company is reliant on the effectiveness of its partners to market and distribute the product. Failure by the Company's partners to successfully market and distribute the Female Condom or failure of country governments to implement prevention programs which include distribution of barrier methods against the AIDS crisis, or an inability of the Company to secure additional agreements for the AIDS crisis, or an inability of the Company to secure additional agreements for new markets either in the public or private sectors, could adversely affect the Company's financial condition and results of operations.

Inventory and Supply

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

Global Market and Foreign Currency Risks

The Company manufactures the Female Condom in a leased facility located in London, England. Further, a material portion of the Company's future sales are likely to be in foreign markets. Manufacturing costs and sales to foreign markets are subject to normal currency risks associated with changes in the exchange rate of foreign currencies relative to the United States dollar. In 2004, 53% of the Company's net revenues, 86% of the Company's cost of products sold and 49% of the Company's operating expenses were affected by changes in the exchange rate of foreign currencies relative to the United States dollar. Approximately 17% and 13% of net revenues in 2004 were attributable to the Company's customers in Zimbabwe and France, respectively. 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. In 2004, the Company estimates that the net adverse impact of the unfavorable exchange rate fluctuations was approximately \$381,000.

Government Regulation

The Female Condom is subject to regulation by the U.S. Food and Drug Administration (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. Cash used in continuing operations was \$0.2 million for 2004. In fiscal 2003 the Company experienced a positive cash flow from operations of \$0.3 million.

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. In 2003, the Company did not require such funding and no new debt or equity transactions were consummated. However, in 2004, the Company issued \$1.5 million of Series 3 Preferred Stock convertible into common stock. The majority of the proceeds from the issuance were used to retire outstanding debt. With the proceeds of the exercise of outstanding common stock purchase warrants pursuant to a warrant exercise program conducted by the Company between September and December 2004, the Company retired its remaining long-term debt in the first quarter of fiscal 2005.

While the Company believes that revenue from sales of the Female Condom will exceed operating costs, and operations will generate sufficient funds to meet capital requirements, the Company can make no assurance that it will maintain such a level of operations in the near term or at all. If the Company does need to raise additional capital, the Company can make no assurance that the Company will be able to source required capital through the sale of debt or equity or, if raised, the amount will be sufficient to operate. In addition, any funds raised may be costly to the Company and/or dilutive to its shareholders.

Below are some recent financing transactions the Company has entered into and their present status:

The Company had a \$1 million note due March 25, 2004 to Mr. Stephen Dearholt, a Director of the Company. The Company paid off the entire balance on February 29, 2004 from the proceeds of its issuance of Series 3 Preferred Stock.

On March 30, 2001 the Company issued a \$250,000 convertible debenture to one accredited investor. The debenture was due March 30, 2004, bore interest payable at a rate of 12% per annum and was convertible into the Company's common stock based on a price of \$0.50 per share. The Company did not issue warrants in connection with the issuance of the convertible debenture. On January 8, 2003, the investor converted his debenture into 500,000 shares of the Company's common stock.

On June 1, 2001 the Company issued an aggregate of \$200,000 of convertible debentures to two accredited investors. The debentures were due May 30, 2004, bore interest payable at a rate of 10% per annum, and were convertible into the Company's common stock based on a price per share equal of \$0.50. The Company did not issue warrants in connection with the issuance of the convertible debentures. On December 5, 2002, each investor converted his debenture into 200,000 shares of the Company's common stock.

On May 18, 2001, the Company entered into an agreement with Heartland Bank providing for a \$2,000,000 credit facility. The unpaid balances on the credit facility were due May 18, 2004 and bore interest payable at a rate of 10% per year. The agreement contained certain covenants which included restrictions on the payment of dividends and distributions and on the issuance of warrants, which the Company was in violation of at September 30, 2002. Under the terms of the agreement, Heartland Bank would have had the right to demand payment of the entire balance of the credit facility as a result of this violation. On December 16, 2003, the Company obtained a waiver from Heartland Bank which was utilized through the end of the term of the credit facility, May 18, 2004. On April 19, 2004, the Company repaid \$900,000 of the unpaid credit facility balance.

In order to provide working capital when it may become necessary, the Company entered into a line of credit agreement with Heartland Bank on December 17, 2002. The line of credit facility allows the Company to borrow up to \$1,000,000 in \$100,000 increments and matured on December 1, 2004. The term of this facility was extended to July 1, 2005 under an amended agreement as described below. Interest was due monthly at the prime rate plus 1% (prime was 4.00% on September 30, 2003) and it is collateralized by the Company's inventory and accounts receivable backed by letter of credit issued by the World Bank. The Company has not borrowed any portion of the line of credit.

The Company also entered into an additional line of credit agreement with Heartland Bank on April 2, 2003. The line of credit facility allows the Company to borrow up to \$500,000 and matured April 1, 2004. The line of credit agreement was extended to June 1, 2005 and then extended to July 1, 2005 under an amended agreement described below. Interest is due monthly at the prime rate plus 2% (prime was 4.00% on September 30, 2003) and is collateralized by accounts receivable not associated with a letter of credit issued by the World Bank. On December 8, 2003, the Company borrowed \$250,000 from this line of credit agreement. On January 17, 2004 the Company paid back the entire \$250,000 borrowed from this line of credit agreement.

Effective May 19, 2004, the Company amended its previous credit facility and two line of credit agreements with Heartland Bank and established three promissory notes totaling \$2,500,000. The first promissory note replaced the previous credit facility which had an outstanding balance as of May 19, 2004 of \$1,000,000, bore interest payable at a rate of 10% per year and effectively extended the due date of the credit facility from May 18, 2004 to July 1, 2006. On September 30, 2004 the Company repaid \$500,000 of the unpaid balance of the credit facility. On November 23, 2004, the Company paid off the remaining outstanding balance.

The two additional promissory notes which replaced the Company's two previous lines of credit are for \$500,000 and \$1,000,000, respectively. Interest is due monthly at the prime rate plus 2% (prime was 4.75% on September 30,

2004) and the due date of any borrowings is July 1, 2005. The Company has not borrowed any monies under either of the two additional promissory notes.

The Company issued 473,377 shares of Series 3 Preferred Stock to eleven 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% of the original issuance price (\$3.17 per share) per annum, payable 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% 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. The Company may redeem any share of Series 3 Preferred Stock at any time that is after the second anniversary of the date of the 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% of the original issuance price of \$3.17 per share. The Company used the proceeds from the February issuance to pay off balances due on the Company's note payable to Mr. Stephen Dearholt and the Company's credit facility with Heartland Bank.

In an effort to generate funds for operating needs and to retire outstanding debt, between September and December 2004 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% of the aggregate number of common stock purchase warrants exercised or (2) new common stock purchase warrants equal to 20% 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. Under the incentive program, one investor exercised 500,000 warrants as of September 30, 2004 and received 550,000 shares of the Company's common stock, including 50,000 incentive shares. Between October and December 2004, three investors exercised a total of 900,000 warrants and received 990,000 shares of the Company's common stock, including 90,000 incentive shares, and two investors exercised a total of 1,200,000 warrants and received 1,200,000 shares of the Company's 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 six persons participating in this program were three of the Company's directors (Stephen M. Dearholt, Richard E. Wenninger and O.B. Parrish). The Company received aggregate proceeds of \$2.4 million from the exercise of the outstanding warrants. With the proceeds, the Company paid off the remaining outstanding balance of its long-term debt.

Additionally, the Company entered into two formal agreements during the past two fiscal years which it expects to contribute to continued improved sales volumes and operations.

On September 30, 2003, the Company entered into an agreement with the U.S. Agency for International Development ("USAID"). Under this agreement, the Company may supply up to 25 million units of FC Female Condoms to USAID through December 31, 2006 principally for use in family planning programs supported by USAID in developing countries. USAID has ordered 3 million units of FC Female Condoms for delivery between September 30, 2003 and December 31, 2004 and has the option to order up to an additional 6 million units during that period. USAID also has the option to order up to 8 million units of FC Female Condoms for the 2005 and 2006 calendar years. USAID has the right to terminate the agreement at any time for its sole convenience, and no assurance can be given as to the amount of FC Female Condoms that USAID will purchase during the term of the agreement. As of December 20, 2004, USAID has purchased 3.0 million units.

On March 25, 2004, the Company appointed Global Protection Corporation ("Global") as the exclusive distributor of the Female Condom 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 20, 2004, Global has purchased 179,000 units.

As of December 20, 2004, the Company had approximately \$0.9 million in cash, net trade accounts receivable of \$0.8 million and current trade accounts payable of \$0.4 million. As noted above, the Company retired its remaining long-term debt in the first quarter of 2005. The Company is obligated to make dividend payments on its Series 3 Preferred Stock, which it anticipates will total \$150,000 in fiscal 2005.

If the Company is unable to raise adequate financing when needed, the Company may be required to sharply curtail the Company's efforts to promote the Female Condom, to attempt to sell certain of its assets and rights or to curtail certain of its operations and may ultimately be forced to cease operations. Currently, the Company is focused on growing its business and, therefore, the Company has made no plans to sell any assets nor has it identified any assets to be sold or potential buyers.

Impact of Inflation and Changing Prices

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

New Accounting Pronouncements

Please see "New 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, 2004, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years ended September 30, 2004 and 2003. 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 provided 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, 2004, and the results of their operations and their cash flows for the years ended September 30, 2004 and 2003, in conformity with U.S. generally accepted accounting principles.

McGladrey & Pullen, LLP

Schaumburg, Illinois
November 18, 2004

Consolidated Balance Sheet

<i>Year Ended September 30</i>	<i>2004</i>
ASSETS	
CURRENT ASSETS	
Cash	\$ 755,482
Accounts receivable, net of allowance for doubtful accounts of \$3,000 and allowance for product returns of \$10,000	1,450,756
Inventories	1,413,315
Prepaid expenses and other current assets	270,539
Total Current Assets	3,890,092
OTHER ASSETS	
Certificate of deposit	72,194
Patents, net of accumulated amortization of \$944,274	178,940
Other	179,683
Total Other Assets	430,817
EQUIPMENT AND FURNITURE AND FIXTURES	
Equipment, furniture and fixtures	4,611,944
Less accumulated depreciation	4,437,583
Net Property, Plant and Equipment	174,361
TOTAL ASSETS	\$ 4,495,270
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES	
Note payable, bank, net of unamortized discount of \$46,252	\$ 453,748
Accounts payable	398,672
Current maturities of obligations under capital leases	21,552
Accrued expenses and other current liabilities	522,199
Preferred dividends payable	11,464
Total Current Liabilities	1,407,635
LONG-TERM LIABILITIES	
Deferred gain on sale of facility	1,262,278
Total Long-Term Liabilities	1,262,278
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, Series 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 20,715,187	207,152
Additional paid-in capital	59,700,265
Unearned consulting fees	(69,547)
Accumulated other comprehensive income	441,634
Accumulated deficit	(58,427,365)
Total Stockholders' Equity	1,857,433
Treasury Stock, at cost, 20,000 shares of common stock	(32,076)
Total Stockholders' Equity and Treasury Stock	1,825,357
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 4,495,270

See Notes to Consolidated Financial Statements.

Consolidated Statements of Operations

<i>Years Ended September 30</i>	<i>2004</i>	<i>2003</i>
NET REVENUES	\$ 8,829,255	\$ 9,045,560
COST OF PRODUCTS SOLD	5,206,962	5,458,562
GROSS PROFIT	3,622,293	3,586,998
OPERATING EXPENSES:		
Advertising and promotion	47,601	36,533
Selling, general and administrative	4,202,949	3,778,015
Research and development costs	179,201	60,168
Stock compensation	260,069	1,047,398
Total Operating Expenses	4,689,820	4,922,114
OPERATING LOSS	(1,067,527)	(1,335,116)
NONOPERATING INCOME (EXPENSE):		
Interest expense	(894,385)	(1,051,184)
Interest income	6,967	16,131
Foreign currency translation loss	(63,943)	-
Total Nonoperating Income (Expense)	(951,361)	(1,035,053)
NET LOSS	(2,018,888)	(2,370,169)
Preferred dividends, Class A Series 1	11,456	11,424
Preferred dividends, Class A Series 3	95,545	0
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ (2,125,889)	\$ (2,381,593)
NET LOSS PER COMMON SHARE OUTSTANDING	\$ (0.11)	\$ (0.13)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	19,925,716	19,020,029

See Notes to Consolidated Financial Statements.

Consolidated Statements of Stockholders' Equity

Years Ended September 30, 2004 and 2003

	Preferred Stock Class A Series 1	Preferred Stock Class A Series 3	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, 2002	\$ 660	\$ —	\$ 180,424	\$ 54,990,237	\$ (173,013)	\$ (641,017)	\$ 224,953	\$ (53,919,883)	\$ (32,076)	\$ 630,285
Issuance of 200,000 shares of Common Stock for consulting services	—	—	2,000	369,000	(371,000)	—	—	—	—	—
Conversion of 10,000 shares of Preferred Stock into 13,888 shares of Common Stock	(100)	—	139	(39)	—	—	—	—	—	—
Issuance of 70,783 shares of Common Stock upon cashless exercise of 106,700 stock options	—	—	708	(708)	—	—	—	—	—	—
Conversion of Convertible Debentures into 900,000 shares of Common Stock	—	—	9,000	441,000	—	—	—	—	—	450,000
Stock compensation (recovery) relating to the Company's stock option plans	—	—	—	(43,000)	—	—	—	—	—	(43,000)
Issuance of 78,000 restricted shares of Common Stock	—	—	780	127,920	—	—	—	—	—	128,700
Issuance of 122,495 unrestricted shares of Common Stock	—	—	1,225	131,529	—	—	—	—	—	132,754
Issuance of 75,592 shares of Common Stock upon cashless exercise of 168,750 stock warrants	—	—	755	(755)	—	—	—	—	—	—
Issuance of warrants with note payable, related party	—	—	—	278,400	—	—	—	—	—	278,400
Issuance of 6,898 shares of Common Stock as payment of interest on debentures	—	—	69	11,108	—	—	—	—	—	11,177
Issuance of 14,948 shares of Common Stock as payment of Preferred Stock dividends	—	—	150	29,448	—	—	—	—	—	29,598
Preferred Stock dividends	—	—	—	—	—	—	—	(11,424)	—	(11,424)
Amortization of deferred compensation	—	—	—	87,413	—	641,017	—	—	—	728,430
Amortization of unearned consulting fees	—	—	—	—	361,968	—	—	—	—	361,968
Comprehensive income (loss):										
Net loss								(2,370,169)		(2,370,169)
Foreign currency translation adjustment							166,413	—		166,413
COMPREHENSIVE INCOME (LOSS)	\$ (2,203,756)									
BALANCE AT SEPTEMBER 30, 2003	\$ 560	\$ —	\$ 195,250	\$ 56,421,553	\$ (182,045)	\$ —	\$ 391,366	\$ (56,301,476)	\$ (32,076)	\$ 493,132

See Notes to Consolidated Financial Statements.

Consolidated Statements of Stockholders' Equity

Years Ended September 30, 2004 and 2003

	Preferred Stock Class A Series 1	Preferred Stock Class A Series 3	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, 2003 (balance forwarded)	\$ 560	\$ —	\$ 195,250	\$ 56,421,553	\$ (182,045)	\$ —	\$ 391,366	\$ (56,301,476)	\$ (32,076)	\$ 493,132
Issuance of 473,377 shares of Preferred Stock, Class A Series 3	—	4,734	—	1,495,868	—	—	—	—	—	1,500,602
Issuance of 41,000 shares of Common Stock for consulting services	—	—	410	72,160	(72,570)	—	—	—	—	—
Issuance of 53,250 shares of Common Stock upon exercise of stock options	—	—	532	74,018	—	—	—	—	—	74,550
Issuance of 5,388 shares of Common Stock upon cashless exercise of 6,667 stock options	—	—	54	(54)	—	—	—	—	—	—
Issuance of 75,000 restricted shares of Common Stock	—	—	750	175,500	—	(176,250)	—	—	—	—
Issuance of 2,250 unrestricted shares of Common Stock	—	—	23	6,750	—	—	—	—	—	6,773
Issuance of 95,008 shares of Common Stock upon cashless exercise of 138,750 stock warrants	—	—	950	(950)	—	—	—	—	—	—
Issuance of warrants with note payable, bank	—	—	—	51,961	—	—	—	—	—	51,961
Issuance of 823,000 shares of Common Stock upon exercise of stock warrants	—	—	8,230	984,371	—	—	—	—	—	992,601
Issuance of 45,303 shares of Common Stock as payment of Preferred Stock dividends	—	—	453	95,033	—	—	—	—	—	95,486
Issuance of 50,000 shares of Common Stock as incentive for exercise of stock warrants	—	—	500	74,500	—	—	—	—	—	75,000
Preferred Stock dividends	—	—	—	—	—	—	—	(107,001)	—	(107,001)
Amortization of deferred compensation	—	—	—	—	—	176,250	—	—	—	176,250
Amortization of unearned consulting fees	—	—	—	—	185,068	—	—	—	—	185,068
Comprehensive income (loss):										
Net loss	—	—	—	—	—	—	—	(2,018,888)	—	(2,018,888)
Foreign currency translation adjustment	—	—	—	—	—	—	299,823	—	—	299,823
Forgiveness of intercompany debt	—	—	—	249,555	—	—	(249,555)	—	—	—
COMPREHENSIVE INCOME (LOSS)	\$ (1,968,620)									
BALANCE AT SEPTEMBER 30, 2004	\$ 560	\$ 4,734	\$ 207,152	\$ 59,700,265	\$ (69,547)	\$ —	\$ 441,634	\$ (58,427,365)	\$ (32,076)	\$ 1,825,357

See Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

<i>Years Ended September 30</i>	<i>2004</i>	<i>2003</i>
OPERATING ACTIVITIES		
Net Loss	\$ (2,018,888)	\$ (2,370,169)
ADJUSTMENTS TO RECONCILE NET LOSS TO NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES:		
Depreciation	241,148	474,966
Amortization of patents	132,947	118,536
Provision for (recovery of) inventory obsolescence	12,805	(7,872)
Provision for (recovery of) doubtful accounts, returns and discounts	554	(10,136)
Interest added to certificate of deposit	(3,573)	(4,221)
Amortization of unearned consulting fees	185,068	361,968
Amortization of discounts on notes payable	678,135	726,632
Amortization of deferred income realized on U.K. grant	(48,503)	(45,423)
Amortization of deferred gain on sale and leaseback of building	(102,098)	(91,031)
Common stock issued for senior management bonuses	199,578	128,700
Stock compensation	75,000	685,430
Loss on sale of equipment and furniture and fixtures	7,796	2,207
CHANGES IN OPERATING ASSETS AND LIABILITIES:		
Accounts receivable	779,228	499,755
Inventories	(235,202)	(112,911)
Prepaid expenses and other assets	(22,962)	24,211
Accounts payable	5,458	(170,564)
Accrued expenses and other current liabilities	(103,255)	79,930
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	(216,764)	290,008
INVESTING ACTIVITIES		
Decrease in restricted cash	129,074	69,530
Proceeds from maturity of certificate of deposit	27,600	29,042
Capital expenditures	(43,990)	(47,233)
Proceeds on sale of equipment and furniture and fixtures	3,404	—
NET CASH PROVIDED BY INVESTING ACTIVITIES	116,088	51,339
FINANCING ACTIVITIES		
Proceeds from issuance of Preferred Stock, Class A Series 3	1,500,602	—
Proceeds from exercise of common stock options	74,550	—
Proceeds from exercise of common stock warrants	992,601	—
Payments on notes payable, bank	(1,400,000)	—
Payments on note payable, related party	(1,000,000)	—
Dividend paid on Preferred Stock, Class A Series 1	(11,200)	(104,396)
Payments on capital lease obligations	(34,730)	(24,986)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	121,823	(129,382)
Effect of exchange rate changes on cash	102,040	43,022
Net increase in cash	123,187	254,987
Cash at beginning of year	632,295	377,308
CASH AT END OF YEAR	\$ 755,482	\$ 632,295
Supplemental Cash Flow Disclosures:		
Interest paid	\$ 210,766	\$ 298,561
Supplemental Schedule of Non-cash Investing and Financing Activities		
Issuance of warrants on notes payable	\$ 51,961	\$ 278,400
Common stock issued for payment of preferred stock dividends	95,486	40,775
Preferred dividends declared	107,001	11,424
Renewal of notes payable with related parties	—	1,000,000
Common stock issued for conversion of convertible debentures	—	450,000
Common stock issued to U.K. employees to satisfy accrued expense	—	132,754
Conversion of preferred stock into common stock	—	100

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 - U.K. and The Female Health Company - U.K., 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 - U.K., is the holding company of The Female Health Company - U.K., 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 87 countries. The product is marketed in 21 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:

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

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

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

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

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. Trademarks have no carrying value in the accompanying balance sheet at September 30, 2004.

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, 2004 and 2003, was approximately \$179,000 and \$60,000, respectively.

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

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*):

<i>Years Ended September 30</i>	<i>2004</i>	<i>2003</i>
Net loss attributable to common stockholders, as reported	\$ (2,125,889)	\$ (2,381,593)
Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards	(769,480)	(338,487)
Pro forma net loss	\$ (2,895,369)	\$ (2,720,080)
Loss per common share:		
As reported	\$ (0.11)	\$ (0.13)
Pro forma	\$ (0.15)	\$ (0.14)

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

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

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

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

During the 4th quarter of 2004, the Company recorded an adjustment of \$249,555 to comprehensive loss. This adjustment relates to the forgiveness of intercompany debt.

New accounting pronouncements: The Financial Accounting Standards Board has proposed 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 begins January 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.

Although it has not yet completed its study of the transition methods, the Company believes it will elect the modified prospective transition method. Under this method, the Company estimates that the adoption of FAS 123(R) will require the Company to record approximately \$235,000 of stock compensation expense in the year ending September 30, 2006, related to employee options issued and outstanding at September 30, 2004.

Reclassifications: Certain items in the 2003 financial statements have been reclassified to conform to the 2004 presentation. The reclassifications have had no effect on net losses for the years then ended.

Note 2. Inventories

The components of inventory consist of the following at September 30, 2004:

Raw materials	\$ 594,766
Work in process	172,703
Finished goods	674,209
Less allowance for obsolescence	(28,363)
	\$ 1,413,315

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, 2004:

	<i>Gross Carrying Amount</i>	<i>Accumulated Amortization</i>
Subject to amortization:		
Patents	\$ 1,123,214	\$ 944,274

Amortization expense recognized on all amortizable intangible assets totaled \$132,947 and \$118,536 for the years ended September 30, 2004 and 2003, respectively.

Estimated aggregate amortization expense for each of the next following years is as follows:

<i>Years Ended September 30</i>	
2005	\$ 132,947
2006	45,993
	\$ 178,940

Note 4. Notes Payable and Long-Term Debt

During 2003, the Company renewed a \$1,000,000 note with Mr. Dearholt, a current director of the Company. The outstanding note payable bears interest at 12% and was payable in full in March 2004. As part of the transaction, the Company issued Mr. Dearholt warrants to purchase 300,000 shares of the Company's common stock at \$1.20 per share which represented 80% of the average trading price for the five trading days prior to the closing date for the transaction and resulted in an initial discount on the note of \$278,400. Any stock issued under the warrants carries certain registration rights. The warrants expire in 2016. The discount, in combination with the note's 12% coupon, resulted in an effective interest rate of 48% on the note. On February 29, 2004, the Company paid off the entire balance of the note.

On May 18, 2001, the Company entered into an agreement with Heartland Bank providing for a \$2,000,000 credit facility. The Company may borrow under this credit facility from time to time subject to a number of conditions, including obtaining personal guarantees of 125% of the amount outstanding under the credit facility. The unpaid balances on the credit facility were due May 18, 2004, and bore interest payable at an annual rate of 10%. On May 18, 2004, the Company had \$1,000,000 outstanding on this facility. This amount was refinanced under an amended agreement as discussed in the fifth paragraph of this note.

On December 17, 2002, the Company entered into a second agreement with Heartland Bank providing for a \$1,000,000 credit facility. Borrowings on the credit facility are collateralized by the Company's accounts receivable and inventories, and bear interest at the prime rate plus 1% (prime rate was 4.75% at September 30, 2004). The credit facility was to expire December 2004 and was extended to July 1, 2005, under an amended agreement as discussed in the fifth paragraph of this note. No borrowings were outstanding on this credit facility as of September 30, 2004.

On April 2, 2003, the Company entered into a third agreement with Heartland Bank providing for a \$500,000 credit facility and matured April 1, 2004. The line of credit agreement was extended to July 1, 2005, under an amended agreement discussed in the fifth paragraph of this note. Borrowings on the credit facility are collateralized by the Company's accounts receivable and bear interest at the prime rate plus 2%.

Effective May 19, 2004, The Company amended its previous credit facility and two line of credit agreements with Heartland Bank and established three promissory notes totaling \$2,500,000. The first promissory note replaces the previous credit facility, and had an initial outstanding balance of \$1,000,000, bears interest payable at a rate of 10 percent per year and effectively extended the due date of the credit facility to July 1, 2006. Related to this renewal the Company issued the Heartland Bank warrants to purchase 50,000 shares of the Company's common stock at \$2.65 per share. The warrants were valued at \$51,961 and these were recorded by the Company as additional paid-in capital and a discount on the credit facility.

As part of the amended credit facility, the covenants were also amended. The amended agreement contains restrictions relating to the issuance of common stock warrants without prior bank approval.

On September 30, 2004, the 500,000 common stock warrants issued to Heartland Bank were exercised at \$1.00 per share. The Company issued 50,000 shares of the Company's common stock as incentive to complete the transaction. The shares were valued at \$75,000 and the shares were recorded by the Company as stock compensation expense.

As of September 30, 2004, the Company had \$500,000 remaining due under this credit facility. The credit facility is recorded at September 30, 2004, net of unamortized discount of \$46,252.

On March 30, 2001, the Company issued a \$250,000 convertible debenture to one accredited investor. The debenture was due March 30, 2004, bore interest payable at a rate of 12% and was convertible into the Company's common stock based on a price of \$0.50 per share. On January 12, 2003, the investor converted his debenture into 500,000 shares of the Company's common stock.

On June 1, 2001, the Company issued an aggregate \$200,000 of convertible debentures to two accredited investors. The debentures were due May 30, 2004, bore interest payable at a rate of 10% per annum, and were convertible into the Company's common stock based on a price of \$0.50 per share. On December 5, 2002, the investors converted their debentures into an aggregate of 400,000 shares of the Company's common stock.

Interest expense to related parties was \$894,385 and \$388,850 for the years ended September 30, 2004 and 2003, respectively.

Note 5. Capital Leases

The Company leases vehicles under capital leases. The assets and liabilities under the leases were recorded at the present value of future minimum rental payments.

Minimum future lease payments under capital leases as of September 30, 2004, are as follows:

<i>Year Ended September 30</i>	
2005	\$ 25,196
Less the amount representing interest	3,644
Present value of net minimum lease payments	21,552
Less current portion	21,552
Long-term obligations under capital leases	\$ -

The cost and accumulated amortization of the leased assets at September 30, 2004, were approximately \$120,000 and \$61,000, respectively.

Note 6. Operating Leases and Rental Expense

The Company has a lease agreement for office space with an unrelated third party which expires September 2006. The lease requires monthly payments of \$5,907 plus real estate taxes, utilities, and maintenance expenses. The Company was required to make an initial security deposit of \$115,000 which has been reduced to \$46,000 in October 2004. The security deposit is in the form of an irrevocable letter of credit from a bank. The bank presently requires the Company to hold a \$46,000 certificate of deposit as collateral for the letter of credit.

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 \$396,021 (£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 \$396,021 (£268,125) which has been reduced to \$176,377 (£97,500) and is included in other assets in the balance sheet at September 30, 2004. 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, 2004, was \$1,262,278 (£697,777).

The Company also leases equipment under a lease agreement which expires in March 2006. The aggregate monthly rental was \$917 at September 30, 2004.

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

<i>Years Ended September 30</i>	<i>2004</i>	<i>2003</i>
Operating lease expense		
Factory and office leases	\$ 717,414	\$ 708,071
Other	11,007	16,789
	\$ 728,421	\$ 724,860

Future minimum payments under operating leases consisted of the following at September 30, 2004:

<i>Operating Leases</i>	
2005	\$ 564,895
2006	561,221
2007	481,231
2008	481,231
2009	481,231
Thereafter	3,467,855
Total minimum payments	\$ 6,037,664

Note 7. Income Taxes

A reconciliation of income tax expense and the amount computed by applying the statutory Federal income tax rate to loss before income taxes as of September 30, 2004 and 2003, is as follows:

<i>Years Ended September 30</i>	<i>2004</i>	<i>2003</i>
Income tax credit at statutory rates	\$ (686,000)	\$ (806,000)
Non-deductible expenses	124,000	15,000
State income tax, net of federal benefits	(96,000)	(195,000)
Benefit of net operating loss not recognized, increase in valuation allowance	658,000	986,000
Income tax expense	\$ —	\$ —

As of September 30, 2004, the Company had federal and state net operating loss carryforwards of approximately \$44,644,000 and \$26,143,000, respectively, for income tax purposes expiring in years 2010 to 2024. The benefit relating to \$1,537,800 of these net operating losses relates to exercise of common stock options and will be credited directly to stockholders' equity when realized. The Company also has investment tax and research and development credit carryforwards for income tax purposes aggregating approximately \$105,000 at September 30, 2004, expiring in years 2006 to 2010. The Company's U.K. subsidiary, The Female Health Company - U.K., plc has U.K. net operating loss carryforwards of approximately \$69,391,000 as of September 30, 2004. These U.K. net operating loss carryforwards can be carried forward indefinitely to be used to offset future U.K. taxable income. Significant components of the Company's deferred tax assets and liabilities are as follows at September 30, 2004:

Deferred tax assets:	
Federal net operating loss carryforwards	\$ 15,179,000
State net operating loss carryforwards	1,307,000
Foreign net operating loss carryforwards	23,593,000
Foreign capital allowances	363,000
Tax credit carryforwards	105,000
Other	10,000
Total gross deferred tax assets	40,557,000
Valuation allowance for deferred tax assets	40,557,000
Net deferred tax assets	\$ —

The valuation allowance increased by \$3,667,000 and \$1,105,000 for the years ended September 30, 2004 and 2003, respectively.

Note 8. 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 257,778 shares available for future grants as of September 30, 2004. The Company has also granted options to one of its legal counsel, an affiliate and consultants. Certain options are vested and exercisable upon issuance, others over periods up to four years and still others based on the achievement of certain performance criteria by the Company and market prices of its common stock.

Effective September 2002, the holders of outstanding options to purchase a total of 2,365,980 shares of common stock agreed to exchange their options for:

- a total of 469,000 shares of restricted common stock in the case of U.S. option holders or the right to receive a total of 122,495 shares of deferred common stock in September 2003 in the case of U.K. option holders; and
- the right to receive a grant of new options to purchase a total of 2,365,980 shares of common stock on the first business day that is at least six months and one day after the effective date of the exchange.

The shares of restricted common stock and the right to receive the shares of deferred common stock were subject to forfeiture if the participant voluntarily resigned or was terminated for cause on or before September 26, 2003, and were not transferable on or before September 26, 2003. As of September 30, 2002, the Company had issued the restricted common stock to U.S. option holders and accrued for the issuance to U.K. option holders. The restricted and deferred shares were amortized over the employees' one-year service periods. The restricted legend was removed and the deferred shares were issued as of September 26, 2003. The Company recorded \$728,430 of amortization of deferred compensation in the stock compensation portion of the statement of operations for the year ended September 30, 2003.

The new options have an exercise price equal to 100% of the fair market value of the common stock on the grant date and a vesting schedule of 1/36 per month for each of the first 36 months after the date of grant. The new options which were granted on April 22, 2003, at an exercise price of \$1.40 are being accounted for in accordance with fixed plan accounting guidance provided in APB No. 25. Options to purchase a total of 320,000 shares of common stock did not participate in the exchange. As of September 30, 2004, none of the 320,000-share total were outstanding.

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

	<i>Number of Shares</i>	<i>Weighted Average Exercise Price</i>
Outstanding at September 30, 2002	590,000	\$ 0.88
Granted	2,385,980	1.40
Exercised	(106,700)	0.56
Expired or canceled	(203,300)	0.56
Outstanding at September 30, 2003	2,665,980	\$ 1.38
Granted	10,000	2.47
Exercised	(59,917)	1.31
Expired or canceled	(38,333)	1.80
Outstanding at September 30, 2004	2,577,730	\$ 1.38

Option shares exercisable at September 30, 2004 and 2003, are 1,279,017 and 567,497, respectively, at weighted average exercise prices of \$1.34 and \$1.28, respectively.

Options Outstanding and Exercisable

<i>Options Outstanding</i>			<i>Options Exercisable</i>		
<i>Exercise Price</i>	<i>Number Outstanding at 9/30/04</i>	<i>Weighted Average Remaining Life</i>	<i>Weighted Average Exercise Price</i>	<i>Number Exercisable at 9/30/04</i>	<i>Weighted Average Exercise Price</i>
\$ 0.66	150,000	7.25	\$ 0.66	150,000	\$ 0.66
1.40	2,327,730	8.58	1.40	1,068,462	1.40
2.00	90,000	0.20	2.00	60,000	2.00
2.47	10,000	9.83	2.47	555	2.47
\$.66 to \$2.47	2,577,730	8.21	\$ 1.38	1,279,017	\$ 1.34

The Company granted 10,000 options in 2004 and 20,000 options in 2003 to employees 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.

The weighted average fair value of employee options granted for the years ended September 30, 2004 and 2003, was \$1.10 and \$1.04, respectively. The fair value of options was estimated at the date of grant using the Black-Scholes option pricing model assuming expected volatility of 41.1% and 55.2%, respectively, and risk-free interest rates of 4.25% and 3.99%, respectively, expected lives of three years and no dividend yield for the years ended September 30, 2004 and 2003.

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 warrants to purchase common stock.

During 2004, 961,750 warrants were exercised. At September 30, 2004, the following warrants were outstanding and exercisable:

	<i>Number Outstanding</i>
Warrants issued in connection with:	
Convertible debentures	2,250,000
Convertible preferred stock	30,900
Note payable, bank	2,250,000
Notes payable, related party	1,989,000
Outstanding at September 30, 2004	6,519,900

Warrants Outstanding and Exercisable

<i>Range of Exercise Prices</i>	<i>Number Outstanding at 9/30/04</i>	<i>Weighted Average Remaining Life</i>	<i>Weighted Average Exercise Price</i>
\$ 0.40 to \$ 0.50	664,000	4.46	\$ 0.45
0.51 to 1.00	4,475,000	3.18	0.98
1.01 to 3.10	1,380,900	4.82	1.75
\$ 0.40 to \$3.10	6,519,900	3.66	\$ 1.09

Issuance of Stock

The Company has issued common stock to consultants for providing investor relation services. In 2003, the Company issued 200,000 shares of common stock with a market value of \$371,000 which was recorded as unearned consulting fees and is being recognized over the term of the agreement. In 2004, the Company issued 41,000 shares of common stock with a market value of \$72,570 which was recorded as unearned consulting fees and is being recognized over the term of the agreement. In the past the Company also issued options to purchase shares of its common stock. In 2003 and 2004, the Company did not issue any additional options for providing investor relation services.

Note 9. Preferred Stock

The Company has 56,000 outstanding shares of 8% 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 eleven 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% 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% 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% 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 10. 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 \$8,000 annual compensation to the plan. The Company has elected to match 100% of employee contributions to the plan up to a maximum of 3% of employee compensation for the years ended September 30, 2004 and 2003. Company contributions were \$20,100 and \$15,491 for 2004 and 2003, respectively.

Bonus and retention program:

During 2004, the Company implemented a new management compensation and employee retention program. The program provided for the issuance of 75,000 shares of restricted common stock as a bonus to senior management with a market value of \$176,250. As of October 1, 2004, the restricted legend was removed. Under the terms of the retention program, employees were granted 7,750 shares of common stock as a retention bonus with a market value of \$23,328, in which 2,250 shares have been issued and 5,500 shares have been deferred until a U.K. employee tax restriction lapses. Total expense for these bonus awards was approximately \$200,000 and is included in selling, general and administrative expenses in the statement of operations for the year ended September 30, 2004.

Note 11. Industry Segments and Financial Information About Foreign and Domestic Operations

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

The Company operates in foreign and domestic regions. Information about the Company's operations by geographic area is as follows.

Years Ended September 30	Net Sales to External Customers		Long-Term Assets	
	2004	2003	2004	2003
<i>(Amounts in thousands)</i>				
United States	\$ 2,373	\$ 2,537	\$ 103	\$ 133
Zimbabwe	1,480 ⁽¹⁾	946 ⁽¹⁾	—	—
France	1,144 ⁽¹⁾	563	—	—
Kenya	698	*	—	—
South Africa	499	1,490 ^{(1) (2)}	—	—
Congo	489	*	—	—
Brazil	*	1,199 ⁽¹⁾	—	—
Zambia	—	484	—	—
United Kingdom	*	*	502	770
Other	2,146	1,827	—	—
Total	\$ 8,829	\$ 9,046	\$ 605	\$ 903

* Less than 5% of total net sales.

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

⁽²⁾ Outstanding accounts receivable at September 30, 2003, were approximately \$1,163,000.

Note 12. Contingent Liabilities

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

Note 13. Related Parties

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

Corporate Information

Officers

O.B. Parrish
Chief Executive Officer

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

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

Michael Pope
Vice President, U.K. Operations

Board of Directors

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

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

William R. Gargiulo, Jr.
Vice President/Secretary (retired)
The Female Health Company
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Chairman and CEO (retired)
Atrix Laboratories
Fort Collins, Colorado

Stephen M. Dearholt
Partner
Insurance Processing Center
Milwaukee, Wisconsin

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Assistant Professor
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James R. Kerber
Consultant to the insurance industry
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Milwaukee, Wisconsin

Stock Exchange Listing

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

Inquiries

Shareholders, prospective investors,
stockbrokers, financial analysts and
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For more information about The Female
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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 has been made available in 104 countries in the global public-sector and throughout the United States. It is also sold commercially in 20 countries — including the United States, the United Kingdom, Brazil, Canada, Denmark, France, Germany, Holland, Italy, Jamaica, Mexico, Spain, Switzerland, Turkey and Venezuela.

Product

FC is designed for use by women to help prevent HIV/AIDS, other sexually transmitted diseases and unintended pregnancy. Made of polyurethane, the soft, thin sheath lines the vagina and covers the labia during intercourse; 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% to 98% 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® brand name in the United States, and *Reality*®, *Femidom*, *Femy*, *Care*, and *Dominique* 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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Photographs

Cover

Background:

Thai teenagers learn how to use the Female Condom at the 15th International AIDS Conference, Bangkok, Thailand, July, 2004 (*Reuters/Adrees Latif*)

Top row, left to right:

1. Chairman of the newly formed Condom Distribution Committee, formed out of the work with FHC, Swaziland
2. Stakeholder meeting, Beijing, China, 2004
3. Udaan Project, Hydera, India

Center row, left to right:

1. Solidarity March, Senegal
2. Solidarity March, Senegal

Bottom row, left to right:

1. Training of miners and the community leaders at Impala Platinum mine in Rustenburg, South Africa
2. Female Condom on production line
3. Training the trainers in Rwanda

Inside Cover

China: Training Session, Beijing, China, 2004

South Africa: Women's association in South Africa celebrating women

France: "1 euro, 1 FC" campaign

FC2:

1. FC1 and FC2
2. Pharmacy in Sihanoukville, Cambodia (PSI project)
3. FC2 in production, showing the new dipping process

Bottom row, left to right:

1. Meeting government officials, Beijing, China, 2004
2. *Survival*, by Fiona Kirkwood
3. Female Condom training session with village women, Hydera, India
4. Practice using the Female Condom, Training Session, Beijing, China, 2004
5. Strategic planning session with key stakeholders, South Africa
6. Village women in Senegal making bread



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