FEMALE HEALTH CO
Form 10QSB
August 12, 2008

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

(MARK ONE)
[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2008

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from __________ to ____________

Commission File Number 1-13602

THE FEMALE HEALTH COMPANY
(Exact Name of Small Business Issuer as Specified in Its Charter)

Wisconsin (State or Other Jurisdiction of Incorporation or Organization)	39-1144397 (I.R.S. Employer Identification No.)
515 North State Street, Suite 2225, Chicago, IL (Address of Principal Executive Offices)	60654 (Zip Code)

312-595-9123
(Issuer's Telephone Number, Including Area Code)

Not applicable
(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

Check whether the issuer: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the issuer was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. YES [X] NO [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b2 of the Exchange Act). YES [ ] NO [X]

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practical date:
Common Stock, $.01 Par Value – 26,957,908 shares outstanding as of August 6, 2008

Transitional Small Business Disclosure Format (check one):
YES [ ] NO [X]

FORM 10-QSB

THE FEMALE HEALTH COMPANY AND SUBSIDIARIES

INDEX

PART I. FINANCIAL INFORMATION AND MANAGEMENT'S DISCUSSION AND ANALYSIS

CAUTIONARY STATEMENT REGARDING
FORWARD LOOKING STATEMENTS

Certain statements included in this quarterly report on Form 10-QSB which are not statements of historical fact are intended to be, and are hereby identified as "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The Company cautions readers that forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievement expressed or implied by such forward-looking statements. Such factors include, among others, the following: the Company's inability to secure adequate capital to fund working capital requirements and advertising and promotional expenditures; factors related to increased competition from existing and new competitors including new product introduction, price reduction and increased spending on marketing; limitations on the Company's opportunities to enter into and/or renew agreements with international partners, the failure of the Company or its partners to successfully market, sell and deliver its product in international markets, and risks inherent in doing business on an international level, such as laws governing medical devices that differ from those in the U.S., unexpected changes in the regulatory requirements, political risks, export restrictions, tariffs and other trade barriers and fluctuations in currency exchange rates; the disruption of production at the Company's manufacturing facilities due to raw material shortages, labor shortages and/or physical damage to the Company's facilities; the Company's inability to manage its growth and to adapt its administrative, operational and financial control systems to the needs of the expanded entity and the failure of management to anticipate, respond to and manage changing business conditions; the loss of the services of executive officers and other key employees and the Company's continued ability to attract and retain highly-skilled and qualified personnel; the costs and other effects of litigation, governmental investigations, legal and administrative cases and proceedings, settlements and investigations; and developments or assertions by or against the Company relating to intellectual property rights.

THE FEMALE HEALTH COMPANY AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	June 30, 2008	September 30, 2007
Current Assets:		
Cash	$ 1,586,842	$ 799,421
Restricted cash	236,887	86,435
Accounts receivable, net	5,964,736	6,080,153
Inventories, net	2,161,161	1,372,582
Prepaid expenses and other current assets	415,311	399,536
Deferred income taxes	1,369,000	825,000
TOTAL CURRENT ASSETS	11,733,937	9,563,127
Other Assets	248,753	251,536
EQUIPMENT, FURNITURE AND FIXTURES		
Equipment not yet in service	-	444,275
Equipment, furniture and fixtures	6,515,163	5,967,082
Total equipment, furniture and fixtures	6,515,163	6,411,357
Less accumulated depreciation and amortization	5,011,944	5,032,472
	1,503,219	1,378,885
TOTAL ASSETS	$ 13,485,909	$ 11,193,548
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current Liabilities:		
Accounts payable	$ 1,073,434	$ 806,134
Accrued expenses and other current liabilities	2,281,822	1,555,346
Preferred dividends payable	27,654	53,025
TOTAL CURRENT LIABILITIES	3,382,910	2,414,505
Deferred gain on sale of facility	963,862	1,074,339
Deferred grant income	235,268	257,245
TOTAL LIABILITIES	4,582,040	3,746,089
STOCKHOLDERS’ EQUITY:		
Convertible preferred stock, Class A Series 1	-	560
Convertible preferred stock, Class A Series 3	3,234	4,734
Convertible preferred stock, Class B	-	-
Common stock	269,169	264,379
Additional paid-in-capital	65,233,626	64,954,610
Accumulated other comprehensive income	865,056	1,051,156
Accumulated deficit	(55,939,262)	(58,428,233)
Treasury stock, at cost	(1,527,954)	(399,747)
TOTAL STOCKHOLDERS’ EQUITY	8,903,869	7,447,459
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 13,485,909	$ 11,193,548

See notes to unaudited condensed consolidated financial statements.

THE FEMALE HEALTH COMPANY AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007
Product sales	$ 5,657,418	$ 4,623,190
Royalty income	707	-
Net revenues	5,658,125	4,623,190
Cost of sales	3,480,400	2,810,291
Gross profit	2,177,725	1,812,899
Advertising and promotion	50,969	38,056
Selling, general and administrative	1,715,515	1,371,339
Research and development	14,865	32,927
Total operating expenses	1,781,349	1,442,322
Operating income	396,376	370,577
Interest, net and other income	(13,964)	(10,804)
Foreign currency transaction loss	36,680	23,905
Income before income taxes	373,660	357,476
Income tax benefit	(167,000)	-
Net income	540,660	357,476
Preferred dividends, Class A, Series 1	2,782	2,792
Preferred dividends, Class A, Series 3	28,811	37,410
Net income attributable to common stockholders	$ 509,067	$ 317,274
Net income per basic common share outstanding	$ 0.02	$ 0.01
Basic weighted average common shares outstanding	26,144,583	25,902,539
Net income per diluted common share outstanding	$ 0.02	$ 0.01
Diluted weighted average common shares outstanding	28,117,178	28,753,523

See notes to unaudited condensed consolidated financial statements.

THE FEMALE HEALTH COMPANY AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Nine months Ended June 30,	
	2008	2007
Product sales	$ 17,788,503	$ 14,145,663
Royalty income	5,650	-
Net revenues	17,794,153	14,145,663
Cost of sales	10,577,665	9,020,269
Gross profit	7,216,488	5,125,394
Advertising and promotion	161,345	131,020
Selling, general and administrative	4,899,747	4,336,715
Research and development	202,241	156,668
Total operating expenses	5,263,333	4,624,403
Operating income	1,953,155	500,991
Interest, net and other income	(30,629)	(35,220)
Foreign currency transaction (gain) loss	(73,625)	7,908
Income before income taxes	2,057,409	528,303
Income tax benefit	(544,000)	-
Net income	2,601,409	528,303
Preferred dividends, Class A, Series 1	8,397	8,377
Preferred dividends, Class A, Series 3	104,041	112,228
Net income attributable to common stockholders	$ 2,488,971	$ 407,698
Net income per basic common share outstanding	$ 0.10	$ 0.02
Basic weighted average common shares outstanding	26,117,888	24,609,431
Net income per diluted common share outstanding	$ 0.09	$ 0.02
Diluted weighted average common shares outstanding	28,101,867	26,853,041

See notes to unaudited condensed consolidated financial statements.

THE FEMALE HEALTH COMPANY AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine months Ended June 30, 2008	Nine months Ended June 30, 2007
OPERATIONS		
Net income	$ 2,601,409	$ 528,303
Adjustment for noncash items:		
Depreciation and amortization	143,482	100,949
Amortization of deferred gain on sale/leaseback	(85,620)	(85,032)
Amortization of deferred income from grant - BLCF	(15,995)	-
Interest added to certificate of deposit	(1,925)	(1,832)
Amortization of unearned consulting fees	57,000	175,000
Employee stock compensation	225,766	509,851
Deferred income taxes	(544,000)	-
Loss on disposal of fixed assets	6,380	-
Changes in operating assets and liabilities	223,008	(486,064)
Net cash provided by operating activities	2,609,505	741,175
INVESTING ACTIVITIES		
(Increase) decrease in restricted cash	(150,452)	168,481
Proceeds from disposal of fixed assets	14,062	-
Capital expenditures	(344,056)	(799,677)
Net cash used in investing activities	(480,446)	(631,196)
FINANCING ACTIVITIES		
Proceeds from exercise of stock options	196,250	96,600
Proceeds from exercise of warrants	422,500	-
Purchases of common stock for treasury shares	(1,128,206)	(241,034)
Redemption and repurchase of preferred stock	(580,500)	-
Dividends paid on preferred stock	(137,822)	(7,200)
Net cash used in financing activities	(1,227,778)	(151,634)
Effect of exchange rate changes on cash	(113,860)	69,777
Net increase in cash	787,421	28,122
Cash at beginning of period	799,421	1,827,393
CASH AT END OF PERIOD	$ 1,586,842	$ 1,855,515
Schedule of noncash financing and investing activities:		
Common stock issued for payment of preferred stock dividends	$ -	$ 112,227
Reduction of accrued expense upon issuance of shares	51,203	142,999
Preferred dividends declared	27,654	8,377
Liability for preferred stock redemption	15,000	-

See notes to unaudited condensed consolidated financial statements.

7

THE FEMALE HEALTH COMPANY AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - Basis of Presentation

The accompanying financial statements are unaudited but in the opinion of management contain all the adjustments (consisting of those of a normal recurring nature) considered necessary to present fairly the financial position and the results of operations and cash flow for the periods presented in conformity with generally accepted accounting principles for interim financial information and the instructions to Form 10-QSB and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by United States generally accepted accounting principles for complete financial statements.

Operating results for the three months and nine months ended June 30, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2008. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-KSB for the fiscal year ended September 30, 2007.

Principles of consolidation and nature of operations:

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, The Female Health Company – UK, and its wholly owned subsidiary, The Female Health Company - UK, plc as well as The Female Health Company (M) SDN. BHD, a wholly owned subsidiary of The Female Health Company-UK. 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, the female condom. The original female condom is known as the “FC Female Condom” in the U.S., and "femidom" or "femy" outside the U.S; the second generation product is known as FC2 throughout the world. The Female Health Company - UK, is the holding company of The Female Health Company - UK, plc, which operates a 40,000 sq. ft. leased manufacturing facility located in London, England. The Female Health Company (M) SDN.BHD leases a 16,000 sq. ft. manufacturing facility located in Selangor D.E., Malaysia.

The product is currently sold or available in either or both commercial (private sector) and public sector markets in 116 countries. The product is marketed in 15 countries by various country-specific commercial partners. The Company's standard credit terms vary from 30 to 90 days, depending on the class of trade and customary terms within a territory, so accounts receivable is affected by the mix of purchasers within the quarter. As is typical in the Company's business, extended credit terms may occasionally be offered as a sales promotion. For the past twelve months, the Company's average days sales outstanding has averaged approximately 94 days. Over the past five years, the Company’s bad debt expense has been less than .01% of sales.

Under an interim agreement, the Company authorized Hindustan Latex Limited ("HLL") to produce FC2 for sale in India in exchange for a royalty per unit. The companies are in the process of negotiating a permanent agreement.

Restricted cash:

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

Reclassification:

Certain items in the financial statements for the three and nine months ended June 30, 2007 have been reclassified to be consistent with the presentation shown for the three and nine months ended June 30, 2008

NOTE 2 - Earnings per Share

Basic EPS is computed by dividing income attributable to common stockholders by the weighted average number of common shares outstanding for the period. In the diluted earnings per share calculation, the numerator is the sum of net income attributable to common stockholders and preferred dividends. Diluted EPS is computed giving effect to all dilutive potential common shares that were outstanding during the period. Dilutive potential common shares consist of the incremental common shares issuable upon conversion of convertible preferred shares and the exercise of stock options and warrants and unvested shares granted to employees.

	Three Months Ended June 30,		Nine months Ended June 30,	
	2008	2007	2008	2007
Denominator:				
Weighted average common shares outstanding – basic	26,144,583	25,902,539	26,117,888	24,609,431
Net effect of dilutive securities:				
Options	837,587	1,249,258	845,130	820,224
Warrants	744,131	854,349	747,972	676,009
Convertible preferred stock	323,377	529,377	323,377	529,377
Unvested restricted shares	67,500	218,000	67,500	218,000
Total net effect of dilutive securities	1,972,595	2,850,984	1,983,979	2,243,610
Weighted average common shares outstanding – diluted	28,117,178	28,753,523	28,101,867	26,853,041
Income per common share – basic	$ 0.02	$ 0.01	$ 0.10	$ 0.02
Income per common share – diluted	$ 0.02	$ 0.01	$ 0.09	$ 0.02

Warrants to purchase approximately 50,000 shares of common stock at an exercise price of $2.65 that were outstanding during the three and nine months ended June 30, 2008, were not included in the computation of diluted net income per share because the effect would have been anti-dilutive. These warrants expire in July 2009. Warrants to purchase approximately 450,000 shares of common stock at exercise prices ranging from $2.25 to $3.10 per share that were outstanding during the three and nine month periods ended June 30, 2007, were not included in the computation of diluted net income per share because their effect was anti-dilutive. In March 2008, 400,000 of these warrants expired. The remaining 50,000 will expire in July 2009.

NOTE 3 - Comprehensive Income

Total comprehensive income was $566,889 for the three months ended June 30, 2008 and $479,861 for the three months ended June 30, 2007. Total comprehensive income was $2,415,309 for the nine months ended June 30, 2008 and $871,533 for the nine months ended June 30, 2007.

NOTE 4 - Inventories

The components of inventory consist of the following:

	June 30, 2008	September 30, 2007
Raw material and work in process	$ 1,369,125	$ 1,082,083
Finished goods	838,036	358,499
Inventory, gross	2,207,161	1,440,582
Less: inventory reserves	(46,000)	(68,000)
Inventory, net	$ 2,161,161	$ 1,372,582

NOTE 5 – Share-Based Compensation

Stock Option Plans

Under the Company’s previous share based long-term incentive compensation plan, the 1997 Stock Option Plan, the Company granted non-qualified stock options to employees. There are no shares available for grant under the plan which expired on December 31, 2006. Options issued under that plan expire in 10 years and generally vested 1/36 per month, with full vesting after three years.

In March 2008, the Company’s shareholders approved the 2008 Stock Incentive Plan which will be utilized to provide equity opportunities and performance –based incentives to attract, retain and motivate those persons who make (or are expected to make) important contributions to the Company. A total of 2,000,000 shares are available for issuance under the plan. As of June 30, 2008, 20,000 shares had been issued under the plan.

The Company recognized share-based compensation expense for stock options of approximately $12,000 and $45,000 in selling, general and administrative expenses in the statement of operations for the three and nine months ended June 30, 2008, respectively, and $28,000 and $90,000 for the three and nine months ended June 30, 2007, respectively.

The Company granted 180,000 stock options during the first nine months of fiscal 2007. The Company did not grant any options during the first nine months of fiscal 2008. The table below outlines the weighted average assumptions for options granted during the nine months ended June 30, 2007:

		Nine months Ended June 30, 2007
Weighted Average Assumptions:		
Expected volatility		61.2%
Expected dividend yield		0%
Risk-free interest rate		5.10%
Expected term (in years)		10.0
Fair value of options granted	$	0.95

The following table summarizes the Company's option activity during the nine months ended June 30, 2008:

Option Activity:

	Number of Shares	Weighted Average Exercise Price	
Outstanding at September 30, 2007	2,745,980	$	1.37
Granted	0		-
Exercised	136,000		1.44
Expired or forfeited	15,000		1.27
Outstanding at June 30, 2008	2,594,980	$	1.36

During the three and nine months ended June 30, 2008, proceeds of $14,000 and $196,250, respectively, were received from the exercise of stock options. During the nine months ended June 30, 2007, proceeds of approximately $96,000 were received from stock option exercises. No options were exercised during the three months ended June 30, 2007. The intrinsic value of the options exercised was $13,000 and $127,200, respectively, for the three and nine months ended June 30, 2008. The intrinsic value of the options exercised during the nine months ended June 30, 2007 was $46,230. There was no realized tax benefit from options exercised for the three and nine months ended June 30, 2008 and 2007, based on the "with and without" approach.

The following table summarizes the stock options outstanding and exerciserable at June 30, 2008:

	Number Outstanding At 6/30/08	Wghted. Avg. Remaining Life	Wghted. Avg. Exercise Price	Aggregate Intrinsic Value	Number Exerciserable At 6/30/08	Wghted. Avg. Exercise Price	Aggregate Intrinsic Value	Wghted. Avg. Remaining Life
Total	2,594,980	5.03	$1.36	$ 3,335,225	2,532,480	$1.37	$3,248,975	4.95

The aggregate intrinsic value in the table above is before income taxes, based on the Company's closing stock price of $2.65 as of the last business day of the period ended June 30, 2008. As of June 30, 2008, the Company had unrecognized compensation expenses of $61,619 related to unvested stock options. These expenses will be recognized over approximately 1.29 years.

Restricted Stock

The Company issues restricted stock to employees and consultants. Such issuances may have vesting periods that range from one to two years or the issuances may be contingent on continued employment for periods that range from one to two years. In addition, the Company has issued restricted stock awards to certain employees that contain vesting provisions.

As of June 30, 2008, there was approximately $23,000 of total unrecognized compensation cost related to non-vested restricted stock compensation arrangements granted under the incentive and retention plans. The expense will be recognized over approximately 4 months.

The Company granted 38,000 shares of restricted stock during the first nine months of fiscal 2008. The fair value of the awards granted was approximately $88,000. All such shares of restricted stock vest between September 30 and November 1, 2008, provided the grantee has not voluntarily terminated service or been terminated for cause prior to the vesting date. The Company granted 236,250 shares of restricted stock during the first nine months of fiscal 2007. The fair value of the awards granted was approximately $379,000. All of these shares vested between September 30, 2007 and April 15, 2008.

The Company recognized share-based compensation expense for restricted stock of approximately $41,000 and $238,000 for the three and nine months ended June 30, 2008, respectively, and $225,000 and $594,000 for the three and nine months ended June 30, 2007, respectively, in selling, general and administrative expenses in the statements of income for those periods.

No shares of restricted stock were forfeited during the three months and nine months ended June 30, 2008. During the three and nine months ended June 30, 2007, 2,500 shares of restricted stock were forfeited.

Common Stock Purchase Warrants

No warrants were issued in the three and nine months ended June 30, 2008 or the same periods in 2007.

During the nine months ended June 30, 2008, proceeds of $422,500 were received from the exercise of warrants. No warrant exercises occurred during the three months ended June 30, 2008. During the same period in fiscal 2007, no warrant exercises occurred.

At June 30, 2008, 1,226,500 warrants were outstanding and exercisable with weighted average remaining contractual lives of 5.48 years.

NOTE 6 – Warrant Settlement Program

During the third quarter of fiscal 2007, the Company offered certain holders of warrants a program under which they could settle the warrants for fully vested common stock. The subject warrants had exercise prices ranging from $0.40 per share to $1.50 per share. Warrant holders who elected to participate in the program tendered 2,762,500 warrants to acquire 1,782,645 shares of common stock, which were issued during the third quarter of fiscal 2007. Since the fair value of the warrants tendered was greater than the value of the common stock received, no expense was recorded related to this program.

NOTE 7 - Stock Repurchase Program

On January 17, 2007, the Company announced a Stock Repurchase Program under the terms of which up to a million shares of its common stock could be purchased during the subsequent twelve months. Later in 2007, the buy-back period was extended to December 31, 2008. In late March 2008, the Board approved expansion of the repurchase program up to a total of 2,000,000 shares to be acquired through December 31, 2009. Through June 30, 2008, the Company has purchased 613,000 shares.

Issuer Purchases of Equity Securities:

Details of Treasury Stock Purchases to Date

Period:	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Program	Maximum Number of Shares that May Yet be Purchased Under the Program
January 17, 2007 – September 30, 2007	173,400	$ 2.12	173,400	826,600
October 1, 2007 – December 31, 2007	137,000	$ 2.59	310,400	689,600
January 1, 2008 – March 31, 2008	112,000	$ 2.45	422,400	1,577,600
April 1, 2008 – April 30, 2008	81,400	$ 2.54	503,800	1,496,200
May 1, 2008 – May 31, 2008	58,200	$ 2.70	562,000	1,438,000
June 1, 2008 – June 30, 2008	51,000	$ 2.67	613,000	1,387,000
Quarterly Subtotal	190,600	$ 2.62	190,600	1,387,000
Total	613,000	$ 2.44	613,000	1,387,000

NOTE 8 – Repurchase of Class A Series 3 Convertible Preferred Stock

In April 2008, the Company repurchased 150,000 shares of Class A Series 3 Convertible Preferred Stock, which is subject to a 10% dividend, paid quarterly. The shares were repurchased at $3.17 per share for a total of approximately $475,000. The shares were purchased at the same per share price at which they were sold to the shareholder. The repurchased preferred shares have been retired. There was no unpaid dividend as of June 30, 2008 for this repurchase.

NOTE 9 – Redemption of Class A Series 1 Convertible Preferred Stock

In May 2008, the Company elected to exercise its right to redeem all of the 56,000 outstanding shares of its Class A Series 1 Convertible Preferred Stock (the "Series 1 Preferred Stock"), subject to the right of the holders to elect to convert their shares of Series 1 Preferred Stock into Common Stock in lieu of redemption. On the redemption dates in June 2008, 42,000 of the outstanding shares of Series 1 Preferred Stock were acquired by the Company pursuant to the redemption and cancelled and the remaining 14,000 outstanding shares of Series 1 Preferred Stock were converted into 14,000 shares of Common Stock and cancelled. The Series 1 Preferred Stock was subject to an 8% dividend, paid annually. The Company paid a redemption price per share equal to the liquidation value per share (which was $2.50 per share plus accrued and unpaid dividends) for the 42,000 shares that were redeemed. Shareholders who elected to convert received one common share for each share of Series 1 Preferred Stock plus accumulated dividends. There were approximately $2,100 of unpaid dividends for the converted 14,000 shares of Series 1 Preferred Stock as of June 30, 2008. These dividends were paid in July 2008.

13

NOTE 10 - Industry Segments and Financial Information About Foreign and Domestic Operations

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

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

(Amounts in thousands)

	Net Sales to External Customers For the Nine months Ended June 30,		Long-Lived Assets As of	
	2008	2007	June 30, 2008	September 30, 2007
South Africa	$ 3,367(1) (2)	$ 3,210(1)	$ -	$ -
Zimbabwe	2,700(1)	2,426(1)	-	-
France	*	986	-	-
United States	1,540	1,834(1)	204	226
Brazil	2,077(1)	*	-	-
Zambia	*	843	-	-
Namibia	*	*	-	-
Tanzania	*	*	-	-
India	*	*	203	225
United Kingdom	*	*	395	315
Malaysia	*	*	950	864
Other	8,110	4,847	-	-
	$ 17,794	$ 14,146	$ 1,752	$ 1,630

* Less than 5 percent of total net sales
(1)Comprised of a customer that is considered to be a major customer (exceeds 10% of net sales).
(2)$1,505,000 of the revenue amount is a current outstanding accounts receivable balance as of June 30, 2008. Thirty-three percent of the receivable was paid by the date of this filing.

NOTE 11 - Contingent Liabilities

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

NOTE 12 - Deferred Grant Income

The Company received grant monies from the British Linkage Challenge Fund to help the Company defray certain expenses and the cost of capital expenditures related to a specific project. The underlying project relates to the development of a linkage between the UK subsidiary and HLL in India to do end-stage manufacturing of the female condom and develop the market for the product in that country. The grant received was split between the Company and HLL pro-rata to their respective expenditure on the project.

The Company utilized the general precepts of U.S. GAAP and the principles of matching and conservatism to determine how to account for the grant monies received. The Company also utilized the guidance of International Accounting Standard No. 20 – Accounting for Government Grants and Disclosure of Government Assistance to further support the Company's accounting treatment of the grant received. The Company allocates its share of the grant monies to capital and expense pro-rata to the respective cost allocated to the project. Grant proceeds for expenses are credited to income in the quarter incurred. Grant proceeds for capital expenditure are deferred and released to income in line with the depreciation of the relevant assets. In the three and nine months ended June 30, 2008, the reimbursement of project-related expenses was zero and $1,836, respectively, versus $116,788 and $160,302, respectively, in the same periods of 2007. In the three and nine months ended June 30, 2008, amortization of deferred grant proceeds were $7,815 and $15,995 respectively. There was no amortization of deferred grant proceeds in 2007.

NOTE 13 – Income Taxes

The Company accounts for income taxes using the liability method, which requires the recognition of deferred tax assets or liabilities for the tax-effected temporary differences between the financial reporting and tax bases of our assets and liabilities, and for net operating loss and tax credit carryforwards.

In evaluating our ability to realize our deferred tax assets we consider all available positive and negative evidence including our past operating results and our forecast of future taxable income. In determining future taxable income, we make assumptions to forecast U.S. federal, U.S. state, and international operating income, the reversal of temporary differences, and the implementation of any feasible and prudent tax planning strategies. These assumptions require significant judgment regarding the forecasts of future taxable income, and are consistent with the forecasts used to manage our business. Our income tax expense recorded for the three months and nine months ended June 30, 2008 has been reduced by an offsetting decrease in our valuation allowance. In the three months and nine months ending June 30, 2008, a tax benefit of $167,000 and $544,000, respectively, was recognized. No tax benefit was recognized in the three and nine months ended June 30, 2007. We intend to maintain the remaining valuation allowance until sufficient further positive evidence exists to support further reversals of the valuation allowance.

A reconciliation of income tax expense and the amount computed by applying the statutory Federal income tax rate to income before taxes as of June 30, 2008 and June 30, 2007, is as follows:

	June 30 2008	June 30 2007
Income tax expense at statutory rates	$ 700,000	$ 180,000
Non-deductible expenses	76,000	73,000
State income tax, net of federal benefits	109,000	28,000
Recognition of net operating loss, decrease in valuation allowance	(544,000)	-
Utilization of NOL carryforwards	(894,000)	(506,000)
Benefit of net operating loss not recognized, increase in valuation allowance	9,000	225,000
Income tax benefit	$ (544,000)	$ -

In September 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 developed a two-step process to evaluate a tax position and also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted this interpretation on October 1, 2007. The Company has not recorded a reserve for any tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. The Company files tax returns in all appropriate jurisdictions. The open tax years are those years ending September 30, 2004 to September 30, 2007, which statutes expire in 2008-2011. As of June 30, 2008, the Company has no recorded liability for unrecognized tax benefits. The adoption and implementation of FIN 48 had no effect on the Company's income from operations, net income or basic and diluted earnings per share for the period ended June 30, 2008.

The Company recognizes interest and penalties related to uncertain tax positions as income tax expense as incurred. No expense for interest and penalties was recognized for the nine months ended June 30, 2008.

NOTE 14 - Recent Accounting Pronouncements

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" (SFAS 161) as an amendment to SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. SFAS 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008. We are currently evaluating whether adoption of SFAS 161 will have an impact on our consolidated financial statements.

In May 2008, the FASB issued FAS No. 162 "The Hierarchy of Generally Accepted Accounting Principles" ("FAS 162"). FAS 162 identifies the sources of accounting generally accepted accounting principles in the United States. FAS 162 is effective sixty days following the SEC's approval of PCAOB amendments to AU Section 411, "The Meaning of 'Present fairly in conformity with generally accepted accounting principles'". The Company is currently evaluating the potential impact, if any, of the adoption of FAS 162 on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 163, "Accounting for Financial Guarantee Insurance Contracts – An interpretation of FASB Statement No. 60". SFAS 163 requires that an insurance enterprise recognize a claim liability prior to an event of default when there is evidence that credit deterioration has occurred in an insured financial obligation. It also clarifies how Statement 60 applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities, and requires expanded disclosures about financial guarantee insurance contracts. It is effective for financial statements issued for fiscal years beginning after December 15, 2008, except for some disclosures about the insurance enterprise's risk-management activities. SFAS 163 requires that disclosures about the risk-management activities of the insurance enterprise be effective for the first period beginning after issuance. Except for those disclosures, earlier application is not permitted. The adoption of this statement is not expected to have a material effect on the Company's future reported financial position or results of operations.

THE FEMALE HEALTH COMPANY AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS

General

The Female Health Company ("FHC" or the "Company") manufactures, markets and sells the female condom (FC), the only product under a woman's control that is approved by the U.S. Food and Drug Administration (FDA) to provide dual protection against unintended pregnancy and sexually transmitted diseases ("STDs"), including HIV/AIDS.

FC has undergone extensive testing for efficacy, safety and acceptability, not only in the United States but also in many countries around the world. Certain of these studies show that having FC available allows women to have more options, resulting in an increase in protected sex acts and a decrease in STDs, including HIV/AIDS.

The product is currently sold or available through various channels in 116 countries. It is commercially marketed directly to consumers in 15 countries by various country specific partners, including in the United States, the United Kingdom, Canada and France. Currently, public sector female condom programs in various stages are ongoing in over 90 countries.

Product

FC is made of polyurethane, a thin but strong material which is resistant to rips and tears during use. FC consists of a soft, loose fitting sheath and two flexible O rings. One of the rings is used to insert the device and helps to hold it in place. The other ring remains outside the vagina after insertion. FC lines the vagina, preventing skin-to-skin contact during intercourse. FC is pre-lubricated and disposable and is recommended for use during a single sex act.

In September 2005, FHC announced that it had completed development of FC2, its second generation female condom. FC2 has the same physical design, safety and efficacy profile as FC. Manufactured from a nitrile polymer, FC2 can be produced more economically than the first generation product. FC2 has received the CE Mark which allows the Company to market FC2 throughout the European Union ("EU"). In August 2006, the Company was notified by the World Health Organization (WHO) that after a stringent technical review process regarding design, product characteristics, quality control and manufacturing technology, FC2 is in principle being manufactured to at least the same standard as the polyurethane female condom, FC. In addition, the design and physical characteristics of FC2, supported by the clinical data, suggest that FC and FC2 are functionally equivalent, when used correctly. Based on this assessment, WHO has stated that FC2 is acceptable for bulk procurement by UN agencies subject to the standard quality assurance measures being applied prior to procurement.

The FC2 pre-market approval application (PMA) submitted by the Company on January 8, 2008, was accepted for FDA review on January 28, 2008. The acceptance began the FDA review process, which generally can take up to 180 active review days. As is typical for the process, the FDA has asked various questions regarding the submission, to which the Company has responded. The time during which the FDA awaits answers to its questions is not counted as active review process time. It is likely that additional questions will be asked and answered as the FDA works through the review process. Following the FDA review, the submission's merits will be reviewed and discussed by FDA's OB-GYN Device Advisory Panel. The final step to approval is negotiation and approval of the product's labeling. The entire process may typically take up to 360 days.

Raw Materials

Polyurethane is the principal raw material the Company uses to produce FC. The Company has entered into a supply agreement with Deerfield Urethane, Inc. for the purchase of the Company's requirement of polyurethane. Under this agreement, the parties negotiate pricing on an annual basis. While the term of the agreement expires on December 31, 2008, the agreement automatically renews for additional one year periods unless either party gives at least 12 months prior written notice of termination.

The principal raw material used to produce FC2 is a nitrile polymer. While general nitrile formulations are available from a number of suppliers, the Company chose to work closely with the technical market leader in synthetic polymers to develop a grade ideally suited to the bio-compatibility and functional needs of a female condom. The supplier has agreed that the Company is the sole and exclusive owner of the unique polymer formulation that was developed for FC2.

Global Market Potential

It is more than twenty years since the first clinical evidence of AIDS was noted. HIV/AIDS is the most devastating pandemic that humankind has faced in recorded history. The Joint United Nations Programme on HIV/AIDS (“UNAIDS”) in its December 2007 Aids Epidemic Update reported that 33 million people globally were living with HIV. Approximately 2.5 million new cases of HIV will be reported this year while about 2 million people will have died from the disease. Women now comprise the majority of the new cases in many areas of the world. In a published paper by Dr. Colin Mathers and Dejan Loncar of the WHO, “Projections of Global Mortality and Burden of Disease from 2002 to 2030," they estimate that at least 117 million people will have died of or will have AIDS by 2030.

In 2006, the U.S. Centers for Disease Control and Prevention (CDC) reported that the HIV/AIDS epidemic is taking an increasing toll on women and girls in the United States. Women of color, particularly Black women, have been especially hard hit and represent the majority of new HIV and AIDS cases among women, and the majority of women living with the disease. Black women accounted for 67% of AIDS cases among women aged 13 and older diagnosed in 2005, but only 12% of the U.S. population of women. Latinas accounted for 16% of estimated AIDS cases in 2005, compared to 13% of the female population aged 13 and over.

For the most recent year in which data are available (2004), CDC reported that HIV infection was:

- the leading cause of death for African American women aged 25-34 years;
- the 3rd leading cause of death for African American women aged 35-44 years; and
- the 4th leading cause of death for African American women aged 45-54 years and for Hispanic women aged 35-44.

18

Most HIV/AIDS diagnoses among women are due to high-risk heterosexual contact (80% in 2005). The rate of AIDS diagnosis for black women was approximately 23 times the rate for white women and 4 times the rate for Hispanic women.

In March 2008, CDC announced that a recent study indicated that 26% of female adolescents in the United States have at least one of the most common sexually transmitted infections (STI's). Led by CDC's Sara Forhan, the study is the first to examine the combined national prevalence of common STI's among adolescent women in the United States.

In addition to overall STI prevalence, the study found that by race, African American teenage girls had the highest prevalence, with an overall prevalence of 48 percent compared to 20 percent among both whites and Mexican Americans. Overall, approximately half of all the teens in the study reported ever having sex. Among these girls, the STI prevalence was 40 percent.

The Condom Market

The global male condom market (public and private sector) is estimated to be $3 billion. The global public sector market for male condoms is estimated to be between 11 and 13 billion units annually. Given the rapid spread of HIV/AIDS in India and China, UNAIDS estimates that the annual public sector demand for condoms, both male and female, will reach 19 billion units within the next ten years.

The FC Female Condom and the Male Condom

Currently, there are only three FDA approved products marketed that prevent the transmission of HIV/AIDS through sexual intercourse: the male latex condom, the male polyurethane condom and the FC female polyurethane condom. FC is the only FDA approved product whose use is controlled by women that prevents sexually transmitted diseases including HIV/AIDS. It provides women dual protection against STD's (including HIV/AIDS) and unintended pregnancy. It is also an alternative when male condoms are not used for reasons of latex sensitivity or choice.

Studies show that both FC's polyurethane and FC2's nitrile polymer are safe, strong materials and that method failure rates are similar to that of male condoms. The female condom offers a number of benefits over natural rubber latex, the material that is most commonly used in male condoms. Unlike natural rubber latex, both polyurethane and the nitrile polymer quickly transfer heat, so the female condom immediately warms to body temperature when it is inserted, which may enhance pleasure and sensation during use. Unlike the male condom, the female condom may be inserted in advance of arousal, eliminating disruption during sexual intimacy. It is not dependent on the male erection, does not require immediate withdrawal and is not tight or constricting. The female condoms can be used with both oil and water-based lubricants, unlike natural rubber latex male condoms which can be used with water-based lubricants only. The products also offer an alternative to natural rubber latex sensitive users (7% to 20% of the population) who are unable to use male condoms without irritation. To the Company's knowledge, there is no reported allergy to either FC polyurethane or the FC2 nitrile polymer.

Numerous clinical and behavioral studies have been conducted regarding use of FC. Studies show that FC is found acceptable by women and their partners in many cultures. Importantly, studies also show that when FC is made available as an option to using male condoms there is a significant increase in protected sex acts. The increase in protected sex acts varies by country and averages between 10% and 35%.

Cost Effectiveness

A study entitled "Cost-effectiveness of the female condom in preventing HIV and STDs in commercial sex workers in South Africa" was reported in the Journal of Social Science and Medicine in 2001. This study shows that making FC available is highly cost effective in reducing public health costs in developing countries as well as in the U.S.

In October 2006, a study regarding FC2 entitled “Country-wide distribution of the nitrile female condom (FC2) in Brazil and South Africa: a cost effectiveness analysis” was published in AIDS. The study concludes that expanded distribution of FC2 in Brazil and South Africa may avert hundreds to thousands of HIV infections annually at an incremental cost to government or donors that is less than that of antiretroviral therapy. The study also found that if only 16.6 million female condoms were distributed in
South Africa, almost 10,000 HIV infections would be prevented. If 53.7 million female condoms were distributed, 32,000 HIV infections would be prevented. Comparing the dollar value of health care costs averted with the cost of distributing the female condoms, the total cost savings would be between $5.3 million and $35.7 million. Similarly, if 26.2 million female condoms were distributed in Brazil, 600 HIV infections would be averted. If 84.8 million female condoms were distributed, 2,000 new HIV infections would be prevented. In total, the savings in Brazil alone could range from $1.1 million to $27 million.

Female Condom Reuse

Studies have shown that FC can be reused up to five times. WHO’s website includes the proper procedure for the washing and preparation of FC if it is going to be reused. WHO, UNAIDS and FHC concur that FC should only be reused when a new female condom is not available. FC2 is not reusable.

Worldwide Regulatory Approvals

FC received Pre-Market Approval ("PMA") as a Class III Medical Device from the FDA in 1993. The extensive clinical testing and scientific data required for FDA approval laid the foundation for approvals throughout the rest of the world, including receipt of a CE Mark in 1997 which allows the Company to market FC throughout the European Union. In addition to the United States and the EU, several other countries have formally reviewed and approved FC for sale, including Canada, Australia, Japan and India.

The Company believes that FC's PMA and FDA classification as a Class III Medical Device create a significant barrier to entry in the U.S. market. The Company estimates that it would take a minimum of four to six years to implement, execute and receive FDA approval of a PMA to market another type of female condom.

FC2 received the CE mark which allows it to be marketed throughout the European Union. FC2 has also been approved by regulatory authorities in both Brazil and India. The Company submitted a pre-market approval application (PMA) for FC2 which was accepted for FDA review on January 28, 2008.

The Company believes there are no material issues or material costs associated with the Company's compliance with environmental laws related to the manufacture and distribution of FC and FC2.

Strategy

The Company’s strategy is to fully develop the market for FC and FC2 on a global basis. In doing so, it has developed contacts and relationships with global public health sector organizations such as WHO, the United Nations Population Fund (UNFPA), UNAIDS, the U.S. Agency for International Development (USAID), country-specific health ministries and non-governmental organizations (NGOs), and commercial partners in various countries. Because the Company has unique distribution channels and minimum sales and marketing expense, volume increases will not result in a corresponding increase in operating expenses. To provide its customers with technical sales support, the Company has placed representatives in the major regions of the world: Asia, Africa, Europe, North America and Latin America. The Company manufactures the first generation product, FC, in London, England. The second generation product, FC2, is being manufactured in Selangor D.E., Malaysia and in conjunction with FHC’s partner Hindustan Latex Limited ("HLL"), in Kochi, India.

To accelerate market penetration and increase volume, the Company developed FC2, a nitrile polymer product which is less costly to manufacture than FC. In August 2006, the Company received notice from WHO that after a stringent technical review process regarding design, product characteristics, quality control and manufacturing technology, FC2 is in principle being manufactured to at least the same standard as the polyurethane female condom, FC. In addition, the design and physical characteristics of FC2, supported by the clinical data, suggest that FC and FC2 are functionally equivalent, when used correctly. Based on this assessment, WHO has stated that FC2 is acceptable for bulk procurement by UN agencies subject to the standard measures being applied prior to procurement.

Commercial Markets - Direct to Consumers

The Company markets FC directly in the United Kingdom. The Company has distribution agreements with commercial partners which market directly to consumers in 15 countries, including the United States, Brazil, Canada, Mexico, Spain, France, Japan and India. These agreements are generally exclusive for a single country. Under these agreements, the Company manufactures and sells the female condom to the distribution partners, who, in turn market and distribute the product to consumers in the established territory.

Relationships and Agreements with Public Sector Organizations

The Company has an agreement with UNAIDS to supply FC to developing countries at a reduced price which can be negotiated each year based on the Company's cost of production. The current price per unit ranges between £0.42 and £0.445 (British pounds sterling), or approximately $0.84 to $0.89, depending on contractual volumes. Under the agreement, UNAIDS and the Company cooperate in educational efforts and marketing FC in developing countries. Sales of FC are made directly to international public agencies and to public health authorities in each country at the price established by the agreement with UNAIDS. The agreement expires on December 31, 2008, but is automatically renewed for one year unless either party gives at least 90 days prior written notice of termination. FC is available in over 90 countries through public sector distribution.

In May 2006, the Company received an initial order for 500,100 FC female condoms from the National AIDS Control Organization (NACO) of the Ministry of Health & Family Welfare, Government of India. The order, placed through UNFPA, supplied female condoms for NACO's year-long pre-program prevention and acceptability study. The female condoms were distributed to 60,000 women at 13 sites in eight states. Because the pilot project was highly successful showing consistent use of FC, NACO decided to scale up the program under which women are trained on how to use the Female Condom. In June 2008, the Company's technical collaboration with HLL in India was successful in winning an order from the National AIDS Control Organization of India. The order, for 1.5 million female condoms, will be manufactured in Kochi, India, in HLL's newly commissioned factory and used in the scaled up prevention program.

The Company sells the female condom in the United States to city and state public health clinics as well as not-for-profit organizations such as Planned Parenthood. The female condom is currently available in 95 locations in New York City, including both community based organizations and the N.Y.C. Department of Health and Mental Hygiene units. It is being distributed as part of New York City's Female Condom Education and Distribution Project being conducted by the Bureau of HIV/AIDS Prevention and Control. In June 2008, the New York City Department of Health & Mental Hygiene awarded the Company a bid for two million female condoms for use in that program. The program may be increased at the discretion of the NYC Department of Health.

Manufacturing Facilities

FC

The Company manufactures FC in a 40,000 square-foot leased facility in London, England. Manufacturing capacity at this facility is expandable to 60 million units per year at a capital expenditure of less than $1 million for the purchase of additional equipment.

FC2

The Company began end-stage production of FC2 within a 1,900 square foot leased facility located in Selangor D.E., Malaysia. On September 1, 2007, the Company leased 16,000 sq. ft. of a production facility, also in Selangor D.E., Malaysia, to house the expanding manufacturing. Operations were re-located to the newly leased facility in December 2007, at which time the lease on the original space terminated. The Company's FC2 manufacturing capacity in Malaysia is 30 million units annually.

The Company's India-based FC2 end-stage production capacity is located at a facility owned by its India business partner, HLL in the Kochi Special Export Zone. Production began at that facility in December 2007. The present FC2 capacity at that facility is 7.5 million units per year. Under an interim agreement, HLL is authorized to produce FC2 for sale in India in exchange for a royalty per unit. The companies are in the process of negotiating a permanent agreement such as a joint venture which does require the approval of the Indian government.

FHC's total FC2 production capacity is currently 37.5 million units annually. The Company intends to expand its capacity at existing locations and/or manufacture at additional locations as the demand for FC2 increases.

Government Regulation

In the U.S., FC is regulated by the FDA. Pursuant to section 515(a)(3) of the Safe Medical Amendments Act of 1990 (the "SMA Act"), the FDA may temporarily suspend approval and initiate withdrawal of the PMA if the FDA finds that FC is unsafe or ineffective, or on the basis of new information with respect to the device, which, when evaluated together with information available at the time of approval, indicates a lack of reasonable assurance that the device is safe or effective under the conditions of use prescribed, recommended or suggested in the labeling. Failure to comply with the conditions of FDA approval invalidates the approval order. Commercial distribution of a device that is not in compliance with these conditions is a violation of the SMA Act. The Company submitted a pre-market approval application (PMA) for FC2 which was accepted for FDA review on January 28, 2008.

Competition

The Company's female condom participates in the same market as male condoms but is not seen as directly competing with male condoms. Rather, the Company believes that providing FC is additive in terms of prevention and choice. Latex male condoms cost less and have brand names that are more widely recognized than FC. In addition, male condoms are generally manufactured and marketed by companies with significantly greater financial resources than the Company.

Medtech Products Ltd. ("MP"), a male latex condom company with a manufacturing facility in Chennai, India, has developed a natural latex female condom. MP's female condom has been marketed under various names including V-Amour, VA Feminine Condom and L'Amour. PATH, an international, nonprofit organization based in the United States, has a female condom product in early stage development. USAID and Family Health International (FHI) are currently evaluating the MP female condom for consideration along with the PATH woman's condom and FC2 to qualify for an in-depth Phase 3 clinical study evaluation. The MP product's manufacturing process has a CE mark for distribution in Europe and may be available in other countries. MP received the Indian Drug Controller approval in January 2003. Neither the MP female condom nor the PATH woman's condom have received FDA approval or been listed as essential products for procurement by WHO.

It is also possible that other parties may develop a female condom. These competing products could be manufactured, marketed and sold by companies with significantly greater financial resources than those of the Company.

Patents and Trademarks

The Company currently holds product and technology patents for FC in the United States. The Company's current United States patents expire between 2009 and 2014. The Company understands these U.S. patents to cover FC as sold. The patents are generally directed to the structural aspects of the product. While there can be no assurance, these patents could provide the Company with protection against copycat products entering the U.S. market during the pendency of the patents. The Company also has patents covering technology and products relating to FC in Japan, the United Kingdom, France, Italy, Germany, Spain, the European Patent Convention, Canada, the People's Republic of China, South Korea and Australia. These patents expire from 2008 to 2013. Patent applications for FC2 are pending in the U.S. and in other countries around the world through the Patent Cooperation Treaty. The applications cover the key aspects of the second generation female condom, including its overall design and manufacturing process.

The Company has the registered trademark “FC Female Condom” in the United States. The Company has also secured, or applied for, 12 trademarks in 22 countries to protect the various names and symbols used in marketing the product around the world. These include "femidom" and "femy", “Reality” and others. In addition, the experience that has been gained through years of manufacturing the FC female condom has allowed the Company to develop trade secrets and know-how, including certain proprietary production technologies that further secure its competitive position. The Company has registered the trademark “FC2 Female Condom” in the United States.

Overview

The Company manufactures, markets and sells the FC female condom, the only FDA-approved product under a woman's control which provides dual protection against unintended pregnancy and sexually transmitted diseases, including HIV/AIDS. During 2003, the Company started developing a second generation female condom, FC2, which was completed in 2006. The first substantial sales of FC2 occurred in the second quarter of fiscal 2007.The Company believes that availability of the lower priced FC2 will accelerate growth while increasing prevention for women and improving profitability.

Revenues. Most of the Company's revenues are derived from sales of the female condom, its only product, and are recognized upon shipment of the product to its customers. Beginning in fiscal 2008, the Company also derives revenue from licensing its intellectual property. Such revenue appears as royalty income on the Unaudited Condensed Consolidated Statements of Income for the three and nine months ended June 30, 2008.

The Company's strategy is to develop a global market and distribution network for its product by completing partnership arrangements with companies with the necessary marketing and financial resources and local market expertise. The Company's customers include the following:

- The Company sells the female condom to the global public sector under the umbrella of its agreement with UNAIDS. This agreement facilitates the availability and distribution of the female condom at a reduced price based on the Company's cost of production. The current price per unit ranges between £0.42 and £0.445 (British pounds sterling), or approximately $0.84 to $0.89. Currently, the female condom is available in over 90 countries through public sector distribution.

- The Company sells FC to the U.S. Agency for International Development (USAID) for use in USAID prevention programs in developing countries.

- The Company sells the female condom in the United States to city and state public health clinics as well as not-for-profit organizations such as Planned Parenthood. The female condom is currently available in 95 locations in New York City, including both community-based organizations and the N.Y.C. Department of Health and Mental Hygiene units. It is being distributed as part of New York City‘s Female Condom Education and Distribution Project being conducted by the Bureau of HIV/AIDS Prevention and Control. In June 2008, the New York City Department of Health & Mental Hygiene awarded the Company a bid for two million female condoms for use in that program.

- The Company markets FC directly in the United Kingdom. The Company has distribution agreements with commercial partners which market directly to consumers in 15 countries, including the United States, Brazil, Canada, Mexico, Spain, France, Japan and India. These agreements are generally exclusive for a single country. Under these agreements, the Company manufactures and sells the female condom to the distributor partners, who, in turn market and distribute the product to consumers in the established territory.

Quarterly financial results may vary significantly from one quarter to another due to the timing and shipment of large orders rather than from any fundamental change in the Company's business. Because the Company manufactures FC in a leased facility located in London, England and FC2 in a leased facility located in Malaysia, a portion of the Company's operating costs occur in foreign currencies. While a material portion of the Company's future sales are likely to be global versus domestic, all sales are denominated in British pounds sterling or United States dollars only. Manufacturing costs and sales to foreign markets are subject to normal currency risks associated with changes in the exchange rate of the British pound sterling relative to the United States dollar. For the first nine months of fiscal 2008, 58% of the Company’s net revenues, 84% of the Company’s cost of products sold and 31% of the Company’s operating expenses were affected by changes in the exchange rate of foreign currencies relative to the United States dollar.

On an ongoing basis, management continues to evaluate its commercial transactions and is prepared to employ currency hedging strategies when it believes such strategies are appropriate. In addition, some of the Company's future international sales may be in developing nations where dramatic political or economic changes are possible. Such factors may adversely affect the Company's results of operations and financial condition. For the first nine months of fiscal 2008, the Company estimates that the net adverse impact of the exchange rate fluctuations was not significant.

Expenses. The Company manufactures FC at its facility located in the United Kingdom and FC2 at its facility located in Selangor D.E., Malaysia. The Company's cost of products sold consists primarily of direct material costs, direct labor costs and indirect production and distribution costs. Direct material costs include raw materials used to make the female condom, principally polyurethane for FC and a nitrile polymer for FC2. Indirect product costs include logistics, quality control, and maintenance expenses, as well as costs for helium, nitrogen, electricity and other utilities. All of the key components for the manufacture of the female condom are essentially available from either multiple sources or multiple locations within a source.

The Company’s costs of sales, supplies, salaries and benefits, and general and administrative expenses have increased. In the first nine months of fiscal 2008, the Company has, where possible, increased selling prices to offset such increases in costs.

As noted above, the Company's manufacturing costs are subject to currency risks associated with changes in the exchange rate of British pounds sterling relative to the United States dollar. To date, the Company's management has not deemed it necessary to utilize currency hedging strategies to manage its currency risks. A decrease of the value of the U.S. dollar compared to British pounds sterling has the effect of increasing the Company's cost of sales and decreasing its gross profit margin.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 2008 COMPARED TO THREE MONTHS ENDED JUNE 30, 2007

The Company had net revenues of $5,658,125 and net income attributable to common stockholders of $509,067, or $0.02 per diluted share, for the three months ended June 30, 2008 compared to net revenues of $4,623,190 and net income attributable to common stockholders of $317,274, or $0.01 per diluted share, for the three months ended June 30, 2007.

Gross profit increased $364,826, or 20%, to $2,177,725 for the three months ended June 30, 2008 from $1,812,899 for the three months ended June 30, 2007. Gross profit for the three months ended June 30, 2008 was positively impacted by increased volume.

Net revenues increased $1,034,935, or 22%, for the three months ended June 30, 2008 compared with the same period last year. The revenue increase is primarily attributable to growth in demand.

Significant quarter to quarter variations result from time to time due to the timing and shipment of large orders and production scheduling rather than fundamental change in the business. The Company routinely notes the potential for such variations in its press releases and SEC filings.

Cost of sales increased $670,109, or 24%, to $3,480,400 for the three months ended June 30, 2008 from $2,810,291 for the same period last year. The increase is due primarily to increased unit sales, and to a lesser extent, increased costs of labor and materials.

Advertising and promotion expenditures increased $12,913 to $50,969 for the three months ended June 30, 2008 from $38,056 for the same period in the prior year. The increase relates to a public relations program designed to increase product awareness in specific locations.

Selling, general and administrative expenses increased $344,176, or 25%, to $1,715,515 for the three months ended June 30, 2008 from $1,371,339 for the three months ended June 30, 2007. During the third quarter of fiscal 2008, FHC recorded an expense accrual for incentive compensation based on the probability of achievement of fiscal 2008 plan compared to the third quarter of fiscal 2007 when there was a reversal of an expense accrual due to a change in accounting estimate. A year-to-year comparison of operating expense shows a 23.5% increase, 71% of which is attributable to the accrual mentioned above. Costs in the 2008 quarter also increased due to Sarbanes-Oxley 404 compliance consulting fees.

Research and development cost decreased $18,062 to $14,865 for the three months ended June 30, 2008 from $32,927 for the same period in the prior year. The third quarter costs in both fiscal year 2007 and fiscal year 2008 are related to the FC2 PMA submission.

Operating income for the three months ended June 30, 2008, was $396,376 versus $370,577 in the same period last year, an increase of $25,799 or 7%. The increase was primarily due to the improved gross profit reduced by the increased operating expenses.

Interest, net and other income for the three months ended June 30, 2008 was $13,964, a change of $3,160 from the same period in fiscal year 2007, when net interest income was $10,804. The impact of foreign currency transactions for the third quarter of fiscal year 2008 was a loss of $36,680 compared to a loss of $23,905 for the same period last year.

26

Under the Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, an entity is able to recognize a tax benefit for current or past losses when it can demonstrate that the tax loss carry forward will be utilized before expiration. Management believes that the Company's recent and projected future growth and profitability has made it more likely than not that the Company will utilize its net operating carryforwards in the future. The Company has recorded a tax benefit in the amount of $167,000 during the three months ended June 30, 2008.

NINE MONTHS ENDED JUNE 30, 2008 COMPARED TO NINE MONTHS ENDED JUNE 30, 2007

The Company had net revenues of $17,794,153 and net income attributable to common stockholders of $2,488,971, or $0.09 per diluted share, for the nine months ended June 30, 2008 compared to net revenues of $14,145,663 and net income attributable to common stockholders of $407,698, or $0.02 per diluted share, for the nine months ended June 30, 2007.

Gross profit increased $2,091,094 or 41%, to $7,216,488 for the nine months ended June 30, 2008 from $5,125,394 for the nine months ended June 30, 2007. Gross profit for the nine months ended June 30, 2008 was positively impacted by product mix, with a higher percentage of FC2 unit sales in 2008 versus the same period last year. The improved FC average sales price per unit in the nine months ended June 30, 2008, compared to the same period in fiscal year 2007 also enhanced the gross margin.

Net revenues increased $3,648,490, or 26%, for the nine months ended June 30, 2008 compared with the same period last year. The stronger revenue performance reflects the increased global demand for the female condom.

Significant quarter to quarter variations result from time to time due to the timing and shipment of large orders and production scheduling rather than fundamental change in the business. The Company routinely notes the potential for such variations in its press releases and SEC filings.

Cost of sales increased $1,557,396 or 17%, to $10,577,665 for the nine months ended June 30, 2008 from $9,020,269 for the same period last year. The increase is mainly derived from increased unit sales, higher direct material, labor and indirect production costs as well as one-time costs of approximately $55,000 related to the move to and start-up of the new Malaysian facility.

Advertising and promotion expenditures increased $30,325 to $161,345 for the nine months ended June 30, 2008 from $131,020 for the same period in the prior year. The increase relates to public relations program designed to raise product awareness in specific locations.

Selling, general and administrative expenses increased $563,032, or 13%, to $4,899,747 for the nine months ended June 30, 2008 from $4,336,715 for the nine months ended June 30, 2007. The Company incurred higher employee-related costs due to staff expansion in the past twelve months as well as some consulting fees related to Sarbanes-Oxley 404 compliance.

Research and development cost increased $45,573 to $202,241 for the nine months ended June 30, 2008 from $156,668 for the same period in the prior year. The costs in 2007 relate both to initiating commercial production of FC2 in Malaysia and preparation of the FC2 PMA submission. Expenses incurred in fiscal 2008 relate to preparation of the FC2 PMA and the one-time FDA PMA application fee of $46,250.

For the nine months ended June 30, 2008, operating income was $1,953,155, an increase of $1,452,164, or 290%, over operating income of $500,991 in the same period last year. The increase was due to higher volume and improved gross margin, somewhat offset by the increased operating expenses.

Interest, net and other income for the nine months ended June 30, 2008 was $30,629, a change of $4,591 from the same period in fiscal year 2007, when net interest income was $35,220. The foreign currency transaction impact for the nine months ended June 30, 2008 was a net gain of $73,625 compared to a loss of $7,908 for the same period last year.

Under the Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, an entity is able to recognize a tax benefit for current or past losses when it can demonstrate that the tax loss carry forward will be utilized before expiration. Management believes that the Company's recent and projected future growth and profitability has made it more likely than not that the Company will utilize its net operating carryforwards in the future. The Company has recorded a tax benefit in the amount of $544,000 during the nine months ended June 30, 2008.

Factors That May Affect Operating Results and Financial Condition

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

Reliance on a Single Product

The Company expects to derive the vast majority, if not all, of its future revenues from the female condom, its sole current product. While management believes the global potential for the female condom is significant, the ultimate level of consumer demand around the world is not yet known.

Distribution Network

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

Inventory and Supply

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

Global Market and Foreign Currency Risks

The Company manufactures FC in a leased facility located in London, England and FC2 in a leased facility located in Malaysia. A material portion of the Company's future sales are likely to be in foreign markets. Manufacturing costs and sales to foreign markets are subject to normal currency risks associated with changes in the exchange rate of foreign currencies relative to the United States dollar. For the first nine months of fiscal 2008, 58% of the Company’s net revenues, 84% of the Company’s cost of products sold and 31% of the Company’s operating expenses were affected by changes in the exchange rate of foreign currencies relative to the United States dollar.

For the first nine months of fiscal 2008, the Company estimates that the net adverse impact of the exchange rate fluctuations was not significant. On an ongoing basis, management continues to evaluate its commercial transactions and is prepared to employ currency hedging strategies when it believes such strategies are appropriate. In addition, some of the Company's future international sales may be in developing nations where dramatic political or economic changes are possible. Such factors may adversely affect the Company's results of operations and financial condition.

Government Regulation

The female condom is subject to regulation by the FDA pursuant to the federal Food, Drug and Cosmetic Act (the "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

In the first nine months of fiscal 2008, the Company generated $2.6 million in positive cash flow from operations as a result of increased sales volume and improved gross margins. During the first nine months of fiscal 2007, cash provided by operations was $0.7 million.

Accounts receivable decreased from $6,080,153 at September 30, 2007 to $5,964,736 at June 30, 2008. The Company's quarter-end accounts receivable balance is impacted by various factors besides rising sales levels. One factor is the Company's pattern of production and delivery, which causes accounts receivable to increase near quarter end. The Company's U.K. subsidiary produces U.S. labeled FC early in the quarter to be sold by its U.S. parent to customers within the U.S., thus contributing to their sales. The Company tends to produce and ship FC to ex-U.S. customers and the United States Agency for International Development (USAID) later in the quarter, causing quarter-end increases in receivables. The timing of large orders can have a significant impact on the quarter-end balance. The Company's standard credit terms vary from 30 to 90 days, depending on the class of trade and customary terms within a territory, so the accounts receivable balance is also affected by the mix of purchasers within the quarter. As is typical in the Company's business, extended credit terms may occasionally be offered as a sales promotion. For the past twelve months, the Company's average days sales outstanding has been approximately 94. Over the past five years, the Company’s bad debt expense has been less than .01% of sales.

At June 30, 2008, the Company had working capital of $8.4 million and stockholder’s equity of $8.9 million compared to working capital of $7.1 million and stockholder’s equity of $7.4 million as of September 30, 2007.

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

Presently, the Company has two revolving notes with Heartland Bank, expiring July 1, 2009, that allow the Company to borrow up to $1,500,000. These notes were extended under the same terms as the initial notes dated May 19, 2004, with the exception of the interest rate which has been reduced to prime plus 0.5% (prime rate was 5% at June 30, 2008). No new warrants were issued as part of the extension of these notes. These notes are collateralized by substantially all of the assets of the Company. No amounts were outstanding under the revolving notes at June 30, 2008.

Impact of Inflation and Changing Prices

Although the Company cannot accurately determine the precise effect of inflation, the Company has experienced increased costs of product, supplies, salaries and benefits, and increased general and administrative expenses. In fiscal year 2007 and 2008 the Company has, where possible, increased selling prices to offset such increases in costs.

Controls and Procedures

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective. It should be noted that in designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. The Company has designed its disclosure controls and procedures to reach a level of reasonable assurance of achieving desired control objectives and, based on the evaluation described above, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at reaching that level of reasonable assurance.

There was no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Items 1-5.

Item 2(c)

On January 17, 2007, the Company announced a Stock Repurchase Program under the terms of which up to a million shares of its common stock could be purchased during the subsequent twelve months. Later in 2007, the buy-back period was extended to December 31, 2008. In late March 2008, the Board approved expansion of the repurchase program up to a total of 2,000,000 shares to be acquired through December 31, 2009. Through June 30, 2008, the Company has purchased 613,000 shares.

Issuer Purchases of Equity Securities:

Details of Treasury Stock Purchases to Date

Period:	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Program	Maximum Number of Shares that May Yet be Purchased Under the Program
January 17, 2007 – September 30, 2007	173,400	$ 2.12	173,400	826,600
October 1, 2007 – December 31, 2007	137,000	$ 2.59	310,400	689,600
January 1, 2008 – March 31, 2008	112,000	$ 2.45	422,400	1,577,600
April 1, 2008 – April 30, 2008	81,400	$ 2.54	503,800	1,496,200
May 1, 2008 – May 31, 2008	58,200	$ 2.70	562,000	1,438,000
June 1, 2008 – June 30, 2008	51,000	$ 2.67	613,000	1,387,000
Quarterly Subtotal	190,600	$ 2.62	190,600	1,387,000
Total	613,000	$ 2.44	613,000	1,387,000

Item 6. Exhibits

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation. (1)
3.2	Articles of Amendment to the Amended and Restated Articles of Incorporation of the Company increasing the number of authorized shares of common stock to 27,000,000 shares. (2)
3.3	Articles of Amendment to the Amended and Restated Articles of Incorporation of the Company increasing the number of authorized shares of common stock to 35,500,000 shares. (3)
3.4	Articles of Amendment to the Amended and Restated Articles of Incorporation of the Company increasing the number of authorized shares of common stock to 38,500,000 shares. (4)
3.5	Amended and Restated By-Laws. (5)

32

4.1 Amended and Restated Articles of Incorporation (same as Exhibit 3.1).

4.2 Articles of Amendment to the Amended and Restated Articles of Incorporation of the Company (same as Exhibit 3.2).

4.3 Articles of Amendment to the Amended and Restated Articles of Incorporation of the Company increasing the number of authorized shares of common stock to 35,500,000 shares (same as Exhibit 3.3).

4.4 Articles of Amendment to the Amended and Restated Articles of Incorporation of the Company increasing the number of authorized shares of common stock to 38,500,000 shares (same as Exhibit 3.4).

4.5 Articles II, VII and XI of the Amended and Restated By-Laws (included in Exhibit 3.5).

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002) (6)

---

(1) Incorporated herein by reference to the Company's Registration Statement on Form SB-2, filed with the Securities and Exchange Commission on October 19, 1999.

(2) Incorporated by reference to the Company's Registration Statement on Form SB-2, filed with the Securities and Exchange Commission on September 21, 2000.

(3) Incorporated by reference to the Company's Registration Statement on Form SB-2, filed with the Securities and Exchange Commission on September 6, 2002.

(4) Incorporated by reference to the Company's Quarterly Report on Form 10-QSB for the quarter ended December 31, 2003.

(5) Incorporated herein by reference to the Company's Registration Statement on Form S-18, as filed with the securities and Exchange Commission on May 25, 1990.

(6) This certification is not "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE FEMALE HEALTH COMPANY

DATE: August 12, 2008

/s/ O.B.Parrish
O.B. Parrish, Chairman and
Chief Executive Officer

DATE: August 12, 2008

/s/ Donna Felch
Donna Felch, Vice President and Chief
Financial Officer