

FEMALE HEALTH CO
Form 10-Q
February 03, 2015
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2014

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 1-13602

The Female Health Company

(Name of registrant as specified in its charter)

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Wisconsin
(State of Incorporation)

39-1144397
(I.R.S. Employer Identification No.)

515 N. State Street, Suite 2225

Chicago, IL
(Address of principal executive offices)

60654
(Zip Code)

312-595-9123

(Registrant's telephone number, including area code)

N/A

(Former Name or Former Address, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as determined by Rule 12b-2 of the Exchange Act). Yes No

As of February 2, 2015, the registrant had 28,814,215 shares of \$0.01 par value common stock outstanding.

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CAUTIONARY STATEMENT REGARDING

FORWARD LOOKING STATEMENTS

Certain statements included in this quarterly report on Form 10-Q 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. Forward-looking statements can be identified by the use of forward-looking words or phrases such as "anticipate," "believe," "could," "intend," "may," "opportunity," "plan," "predict," "potential," "estimate," "will," "would" or the negative of these terms or other words of similar meaning. 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, advertising and promotional expenditures and strategic initiatives; factors related to increased competition from existing and new competitors including the potential for reduced sales, pressure on pricing for FC2 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; the Company's ability to identify, successfully negotiate and complete suitable acquisitions or other strategic initiatives, the Company's ability to successfully integrate acquired businesses, technologies or products; and developments or assertions by or against the Company relating to intellectual property rights. Such uncertainties and other risks that may affect the Company's performance are discussed further in Part I, Item 1A, "Risk Factors," in the Company's Form 10 K for the year ended September 30, 2014. The Company undertakes no obligation to make any revisions to the forward-looking statements contained in this report or to update them to reflect events or circumstances occurring after the date of this report.

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Item 1. Financial Statements

THE FEMALE HEALTH COMPANY

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2014	September 30, 2014
ASSETS		
Current Assets:		
Cash	\$ 4,568,570	\$ 5,796,223
Accounts receivable, net	5,835,850	2,943,850
Inventory, net	3,464,673	2,983,447
Prepaid expenses and other current assets	452,795	638,243
Deferred income taxes	129,000	711,000
TOTAL CURRENT ASSETS	14,450,888	13,072,763
Other assets	156,958	166,084
PLANT AND EQUIPMENT		
Equipment, furniture and fixtures	4,870,250	4,913,271
Less accumulated depreciation and amortization	(3,397,083)	(3,310,964)
Plant and equipment, net	1,473,167	1,602,307
Deferred income taxes	16,832,000	16,832,000
TOTAL ASSETS	\$ 32,913,013	\$ 31,673,154
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 1,152,867	\$ 1,124,859
Accrued expenses and other current liabilities	1,956,283	1,816,508
Accrued compensation	338,075	436,843
TOTAL CURRENT LIABILITIES	3,447,225	3,378,210
Deferred rent	31,899	39,105
Deferred income taxes	178,281	190,513
TOTAL LIABILITIES	3,657,405	3,607,828

Commitments and Contingencies

STOCKHOLDERS' EQUITY:

Preferred stock	—	—
Common stock	310,009	309,587
Additional paid-in-capital	68,869,832	68,484,889
Accumulated other comprehensive loss	(581,519)	(581,519)
Accumulated deficit	(31,537,059)	(32,341,976)
Treasury stock, at cost	(7,805,655)	(7,805,655)
TOTAL STOCKHOLDERS' EQUITY	29,255,608	28,065,326
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 32,913,013	\$ 31,673,154

See notes to unaudited condensed consolidated financial statements.

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THE FEMALE HEALTH COMPANY

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended December 31,	
	2014	2013
Net revenues	\$ 6,659,206	\$ 6,690,195
Cost of sales	2,839,533	3,011,701
Gross profit	3,819,673	3,678,494
Operating expenses	2,365,824	2,094,858
Operating income	1,453,849	1,583,636
Non-operating income (expense):		
Interest and other income (expense), net	652	(1,732)
Foreign currency transaction gain (loss)	20,846	(18,426)
Total non-operating income (expense)	21,498	(20,158)
Income before income taxes	1,475,347	1,563,478
Income tax expense	670,430	98,875
Net income	\$ 804,917	\$ 1,464,603
Net income per basic common share outstanding	\$ 0.03	\$ 0.05
Basic weighted average common shares outstanding	28,502,560	28,479,597
Net income per diluted common share outstanding	\$ 0.03	\$ 0.05
Diluted weighted average common shares outstanding	28,778,710	28,798,400
Cash dividends declared per common share	\$ —	\$ 0.14

See notes to unaudited condensed consolidated financial statements.

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THE FEMALE HEALTH COMPANY

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended December 31,	
	2014	2013
OPERATING ACTIVITIES		
Net income	\$ 804,917	\$ 1,464,603
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	127,939	143,749
Share-based compensation	199,676	203,753
Deferred income taxes	569,768	(2,726)
Loss on disposal of fixed assets	3,483	430
Changes in current assets and liabilities	(2,925,956)	(628,150)
Net cash (used in) provided by operating activities	(1,220,173)	1,181,659
INVESTING ACTIVITIES		
Capital expenditures	(2,282)	(81,902)
Net cash used in investing activities	(2,282)	(81,902)
FINANCING ACTIVITIES		
Dividends paid on common stock	(5,198)	(2,031,000)
Net cash used in financing activities	(5,198)	(2,031,000)
Net decrease in cash	(1,227,653)	(931,243)
Cash at beginning of period	5,796,223	8,922,430
CASH AT END OF PERIOD	\$ 4,568,570	\$ 7,991,187
Supplemental Disclosure of Cash Flow Information:		
Cash payments for income taxes	\$ 61,430	\$ 441,142
Schedule of noncash financing and investing activities:		
Reduction of accrued expense upon issuance of shares	\$ 239,580	\$ 297,806
Dividends payable	—	2,023,175

See notes to unaudited condensed consolidated financial statements.

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THE FEMALE HEALTH COMPANY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - Basis of Presentation

The accompanying condensed consolidated 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-Q 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 ended December 31, 2014, are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2015. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the fiscal year ended September 30, 2014.

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 subsidiaries, The Female Health Company-UK, plc and The Female Health Company (M) SDN.BHD. 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 FC2 Female Condom ("FC2"). The Female Health Company-UK, is the holding company of The Female Health Company-UK, plc, which is located in a 6,400 sq. ft. leased office facility located in London, England. The Female Health Company (M) SDN.BHD leases a 45,800 sq. ft. manufacturing facility located in Selangor D.E., Malaysia.

Since the Company began distributing FC2 in 2007, it has been shipped to either or both commercial (private sector) and public health sector markets in 144 countries. It is marketed to consumers through distributors, public health programs and retailers in 16 countries.

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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 62 days. Over the past five years, the Company's bad debt expense has been less than 0.04 percent of product sales. The balance in the allowance for doubtful accounts was \$48,068 at December 31, 2014 and September 30, 2014.

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. The Company has a facility of \$250,000 for such performance bonds. 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, a period of time after the product has been distributed or expiration of the product shelf life. Restricted cash was \$87,760 and \$55,806 at December 31, 2014 and September 30, 2014, respectively, and is included in cash on the accompanying Unaudited Condensed Consolidated Balance Sheets.

Foreign Currency and Change in Functional Currency

The Company recognized a foreign currency transaction gain of \$20,846 for the three months ended December 31, 2014 compared to a loss of \$18,426 for the three months ended December 31, 2013. The consistent use of the U.S. dollar as functional currency across the Company reduces its foreign currency risk and stabilizes its operating results. As a result of the U.S. dollar being the functional currency of the Company and all of its subsidiaries, comprehensive income is equivalent to the reported net income.

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Reclassifications

Certain items in the December 31, 2013 and the September 30, 2014 consolidated financial statements have been reclassified to conform to the December 31, 2014 presentation.

NOTE 2 – Earnings per Share

Basic EPS is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted EPS is computed by dividing net income by the weighted average number of common shares outstanding during the period after 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 the exercise of stock options and unvested shares granted to employees and directors.

Denominator	Three Months Ended	
	December 31,	
	2014	2013
Weighted average common shares outstanding - basic	28,502,560	28,479,597
Net effect of dilutive securities:		
Options	70,094	169,967
Unvested restricted shares	206,056	148,836
Total net effect of dilutive securities	276,150	318,803
Weighted average common shares outstanding - diluted	28,778,710	28,798,400
Income per common share – basic	\$ 0.03	\$ 0.05
Income per common share – diluted	\$ 0.03	\$ 0.05

All the outstanding stock options and unvested restricted shares were included in the computation of diluted net income per share for the three months ended December 31, 2014 and 2013.

NOTE 3 - Inventory

Inventory consists of the following components at December 31, 2014 and September 30, 2014:

	December 31, 2014	September 30, 2014
Raw material	\$ 978,404	\$ 1,091,703
Work in process	99,895	15,962
Finished goods	2,437,378	1,936,655
Inventory, gross	3,515,677	3,044,320
Less: inventory reserves	(51,004)	(60,873)
Inventory, net	\$ 3,464,673	\$ 2,983,447

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NOTE 4 – Line of Credit

On August 1, 2014, the Company entered into an amendment to the Second Amended and Restated Loan Agreement (as amended, the “Loan Agreement”) with Heartland Bank to extend the term of the Company’s revolving line of credit to August 1, 2015. The credit facility consists of a single revolving note for up to \$2 million with Heartland Bank, with borrowings limited to a borrowing base determined based on 70 percent to 80 percent of eligible accounts receivable plus 50 percent of eligible inventory. Significant restrictive covenants in the Loan Agreement include prohibitions on any merger, consolidation or sale of all or a substantial portion of the Company’s assets and limits on the payment of dividends or the repurchase of shares. The Loan Agreement does not contain any financial covenants that require compliance with ratios or amounts. Dividends and share repurchases are permitted as long as after giving effect to the dividend or share repurchase the Company has a ratio of total liabilities to total stockholders’ equity of no more than 1:1. Borrowings on the revolving note bear interest at the national prime rate published by the Wall Street Journal (3.25 percent at December 31, 2014). The note is collateralized by substantially all of the assets of the Company. No amounts were outstanding under the Loan Agreement at either December 31, 2014 or September 30, 2014.

NOTE 5 – Share-Based Payments

In March 2008, the Company’s shareholders approved the 2008 Stock Incentive Plan which is 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 million shares are available for issuance under this plan. As of December 31, 2014, 1,096,268 shares had been granted under the plan, of which 150,000 shares were in the form of stock options and the remainder were in the form of restricted stock or other share grants.

Stock Options

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 this plan which expired on December 31, 2006. Options issued under this plan expire 10 years after the date of grant and generally vested 1/36 per month, with full vesting after three years. Under the Company’s 2008 Stock Incentive Plan, options issued expire 10 years after the date of grant and vest 1/36 per month, with full vesting after three years. The Company did not grant any options during the three months ended December 31, 2014 or 2013.

Compensation expense is recognized only for share-based payments expected to vest. The Company estimates forfeitures at the date of grant based on historical experience and future expectations. No stock compensation expense

related to options was recognized for the three months ended December 31, 2014 or 2013.

No stock options were exercised during the three months ended December 31, 2014 or 2013.

The following table summarizes the stock options outstanding and exercisable at December 31, 2014:

Options	Wghted. Avg.	Wghted.	Aggregate
Outstanding and Exercisable	Remaining Life	Avg.	Intrinsic
at December 31, 2014	(years)	Exercise Price	Value
Total 180,000	3.09	\$ 2.60	\$ 238,500

The aggregate intrinsic value in the table above is before income taxes, based on the closing price of the Company's common stock of \$3.92 per share as of the last business day of the period ended December 31, 2014. As of December 31, 2014, the Company had no unrecognized compensation expense relating to outstanding stock options as all outstanding stock options were fully vested.

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Restricted Stock

The Company issues restricted stock to employees, directors and consultants. Such issuances may have vesting periods that range from one to three years. In addition, the Company has issued stock awards to certain employees that provide for future issuance contingent on continued employment for periods that range from one to three years.

The Company granted a total of 43,500 shares of restricted stock or shares issuable pursuant to promises to issue shares of common stock during the three months ended December 31, 2014. The fair value of the awards granted was approximately \$144,000. All such shares of restricted stock vest and all such shares must be issued at the end of the applicable period, provided the grantee has not voluntarily terminated service or been terminated for cause prior to the vesting or issuance date. There were no shares of restricted stock forfeited during the three months ended December 31, 2014.

The Company granted a total of 118,910 shares of restricted stock or shares issuable pursuant to promises to issue shares of common stock during the three months ended December 31, 2013. The fair value of the awards granted was approximately \$1,054,000. All such shares of restricted stock vest and all such shares must be issued at the end of the applicable period, provided the grantee has not voluntarily terminated service or been terminated for cause prior to the vesting or issuance date. There were no shares of restricted stock forfeited during the three months ended December 31, 2013.

The Company recognized share-based compensation expense for restricted stock or promises to issue shares of common stock of approximately \$200,000 and \$204,000 for the three months ended December 31, 2014 and 2013, respectively, \$54,000 and \$62,000 of which was included in accrued expenses at the three months then ended since the related shares had not yet been issued at December 31, 2014 and 2013, respectively. This compensation expense was included in operating expenses on the accompanying Unaudited Condensed Consolidated Statements of Income for the three months ended December 31, 2014 and 2013. As of December 31, 2014, there was approximately \$980,000, representing approximately 150,000 unvested shares, of total unrecognized compensation cost related to non-vested restricted stock compensation arrangements granted under the Company's equity compensation plans. This unrecognized cost will be recognized over the weighted average period of the next 1.45 years.

NOTE 6 - Stock Repurchase Program

The Company's Stock Repurchase Program was announced on January 17, 2007. At initiation, the program's terms specified that up to 1,000,000 shares of its common stock could be purchased during the subsequent twelve months. Subsequently, the Board has amended the program a number of times to both extend its term and increase the maximum number of shares which could be repurchased. Currently, the program allows for a maximum repurchase of up to 3,000,000 shares through the period ending December 31, 2015. From the program's onset through December

31, 2014, the total number of shares repurchased by the Company is 2,183,454. The total number of shares that may yet be purchased under the program is 816,546. The Stock Repurchase Program authorizes purchases in privately negotiated transactions as well as in the open market. In October 2008, the Company's Board of Directors authorized repurchases in private transactions under the Stock Repurchase Program of shares issued under the Company's equity compensation plans to directors, employees and other service providers at the market price on the effective date of the repurchase request. Total repurchases under this provision currently are limited to an aggregate of 450,000 shares per calendar year and to a maximum of 50,000 shares annually per individual. There were no repurchases of any kind under the program for the three months ended December 31, 2014 or 2013.

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Total repurchase activity through December 31, 2014 is as follows:

Issuer Purchases of Equity Securities	Details of Treasury Stock Purchases to Date through December 31, 2014		
	Total Number	Average Price	Cost of Treasury
	of Shares	Paid	Treasury
	Purchased	Per Share	Stock
Period:			
January 1, 2007 – September 30, 2014	2,183,454	\$ 3.57	\$ 7,805,655
October 1, 2014 - October 31, 2014	—	—	—
November 1, 2014 - November 30, 2014	—	—	—
December 1, 2014 - December 31, 2014	—	—	—
Quarterly Subtotal	—	—	—
Total	2,183,454	\$ 3.57	\$ 7,805,655

NOTE 7 - Industry Segments and Financial Information About Foreign and Domestic Operations

The Company currently operates 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 (in thousands):

	Net Revenues to External Customers for the Three Months Ended		Long-Lived Asset As Of	
	December 31, 2014	December 31, 2013	December 31, 2014	September 30, 2014
Brazil	\$ 3,502 (1)	\$ *	\$ —	\$ —
Zimbabwe	963 (1)	*	—	—

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South Africa	686 (1)	1,656 (1)	—	—
United States	541	710 (1)	77	88
Cameroon	488	*	—	—
Angola	*	2,476 (1)	—	—
Congo	*	650	—	—
Malaysia	—	—	1,412	1,528
United Kingdom	—	—	141	152
Other	479	1,198	—	—
Total	\$ 6,659	\$ 6,690	\$ 1,630	\$ 1,768

* Less than 5 percent of total net revenues.

(1) Exceeds 10 percent of total net revenues.

NOTE 8 – 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 million for FHC's consumer health care product.

NOTE 9 – 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 its assets and liabilities, and for net operating loss and tax credit carryforwards.

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The Company completes a detailed analysis of its deferred income tax valuation allowances on an annual basis or more frequently if information comes to our attention that would indicate that a revision to our estimates is necessary. In evaluating the Company's ability to realize its deferred tax assets, management considers all available positive and negative evidence on a country-by-country basis, including past operating results and forecast of future taxable income. In determining future taxable income, management makes assumptions to forecast U.S. federal and state, U.K. and Malaysia 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 the future taxable income in each tax jurisdiction, and are consistent with the forecasts used to manage the Company's business. It should be noted that the Company realized significant losses through 2005 on a consolidated basis. Since fiscal year 2006, the Company has consistently generated taxable income on a consolidated basis, providing a reasonable future period in which the Company can reasonably expect to generate taxable income. In management's analysis to determine the amount of the deferred tax asset to recognize, management projected future taxable income for each tax jurisdiction.

As of December 31, 2014, the Company had U.S. federal and state net operating loss carryforwards of approximately \$17,269,000 and \$17,020,000, respectively, for income tax purposes expiring in years 2018 to 2027. The Company's U.K. subsidiary, The Female Health Company-UK, plc has U.K. net operating loss carryforwards of approximately \$62,870,000 as of December 31, 2014, which can be carried forward indefinitely to be used to offset future U.K. taxable income. The Company's Malaysia subsidiary had no net operating loss carryforwards as of December 31, 2014. With the demand for and profitability of FC2, the Company expects utilization of its net operating losses in both the U.K. and the U.S. will continue. The Company's net operating loss carryforwards will be utilized to reduce cash payments for income taxes based on the statutory rate in effect at the time of such utilization.

A reconciliation of income tax expense and the amount computed by applying the statutory federal income tax rate to income before income taxes for the three months ended December 31, 2014 and 2013, is as follows:

	Three Months Ended	
	December 31,	
	2014	2013
Income tax expense at statutory rates	\$ 502,000	\$ 532,000
State income tax, net of federal benefits	93,000	98,000
Non-deductible expenses	2,000	2,000
Effect of AMT expense	27,000	—
Effect of lower foreign income tax rates	20,734	(114,211)
Effect of share-based compensation	—	(214,000)
Other	25,696	(204,914)
Income tax expense	\$ 670,430	\$ 98,875

Note 10 – Dividends

Beginning February 16, 2010, through May 7, 2014, the Company paid 18 quarterly cash dividends. The first 9 were paid at a quarterly rate per share of \$0.05 through February 9, 2012, 4 were paid at a quarterly rate per share of \$0.06 from May 9, 2012 through February 6, 2013, and 5 were paid at a quarterly rate per share of \$0.07 from May 8, 2013 through May 7, 2014. Cumulative dividends paid totaled \$29.4 million through September 30, 2014. The Company paid cash dividends of approximately \$2.0 million during the three months ended December 31, 2013. On July 14, 2014, the Company announced that its Board of Directors has elected to suspend the payment of quarterly cash dividends in order to devote operating cash flows towards strategic growth initiatives.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

The Female Health Company manufactures, markets and sells the FC2 Female Condom. FC2 is the only currently available female-controlled product approved by the U.S. Food and Drug Administration (FDA) and cleared by the World Health Organization (WHO) for purchase by U.N. agencies that provides dual protection against unintended pregnancy and sexually transmitted infections ("STIs"), including HIV/AIDS. The Company's first generation product was the FC1 Female Condom, a Class III medical device approved by FDA in 1993. The Company's second generation product, FC2, has been available globally since 2007, and in the U.S. since 2009 after it was approved by the FDA as a Class III medical device. To date, FHC has manufactured and sold approximately 455 million FC1 and FC2 Female Condoms.

Products

Currently, there are only two FDA approved and marketed products that prevent the transmission of HIV/AIDS through sexual intercourse: the male condom and FC2. FC2 is currently the only FDA approved and marketed female-controlled product that prevents STIs, including HIV/AIDS. Used consistently and correctly, FC2 provides women dual protection against STIs, including HIV/AIDS, and unintended pregnancy. When used correctly the protection rates against unintended pregnancies and STIs are 95 percent for female condoms compared to 98 percent for male condoms according to the FDA. FC2 is not seen as directly competing with the male condom; it provides an alternative to either unprotected sex or male condom usage.

An economic analysis of the cost effectiveness of an FC2 HIV/AIDS prevention program conducted by Dr. David Holtgrave, the chairman of the Department of Health Behavior and Society at the Johns Hopkins Bloomberg School of Public Health was featured in the March 26, 2012 issue of AIDS and Behavior. The study showed that the Washington, D.C. FC2 prevention program, a public-private partnership to provide and promote FC2, prevented enough HIV infections in the first year alone to save over \$8 million in avoided future medical care costs (over and above the cost of approximately \$445,000 for the program). This means that for every dollar spent on the program, there was a cost savings of nearly \$20. In the article Dr. Holtgrave concluded, "These results clearly indicate that delivery of, and education about, Female Condoms is an effective HIV prevention intervention and an outstanding public health investment." Washington, D.C. began its program in 2010 to fight a disease that is at epidemic levels. At least 3 percent of Washington, D.C. residents have HIV or AIDS, a prevalence rate that is the highest of any U.S. city.

In May 2014, a business case was published by Global Health Visions, LLC, commissioned by Rutgers WPF, the advocacy partner of the Universal Access to Female Condoms (UAFRC) Joint Programme. Part of the publication was a study comparing total expected costs with total estimated economical benefits and it determined there was an excellent return on investment for female condoms in sub-Saharan Africa. For example, in Nigeria an investment of \$1 offers a \$3.20 return on investment to the country's economy.

Numerous clinical and behavioral studies have been conducted regarding use of the female condom. Studies show that in many cultures, the female condom is found acceptable by women and their partners. Importantly, studies also show that when the female condom is made available as an option along with male condoms there is a significant increase in protected sex acts with a concurrent decrease in STIs. The increase in protected sex acts varies by country and averages between 10 percent and 35 percent.

FC2 has basically the same physical design, specifications, safety and efficacy profile as FC1. Manufactured from a nitrile polymer formulation that is exclusive to the Company, FC2 is produced more economically than FC1, which was made from a more costly raw material, polyurethane. FC2 consists of a soft, loose fitting sheath and two rings: an external ring of rolled nitrile and a loose internal ring, made of flexible polyurethane. FC2's soft sheath lines the vagina, preventing skin-to-skin contact during intercourse. Its external ring remains outside the vagina, partially covering the external genitalia. The internal ring is used for insertion and helps keep the device in place during use.

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FC2's primary raw material, a nitrile polymer, offers a number of benefits over natural rubber latex, the raw material most commonly used in male condoms. FC2's nitrile polymer is stronger than latex, reducing the probability that the female condom sheath will tear during use. Unlike latex, FC2's nitrile polymer quickly transfers heat. FC2 warms to body temperature immediately upon insertion which may enhance the user's sensation and pleasure. Unlike the male condom, FC2 may be inserted in advance of arousal, eliminating disruption during sexual intimacy. FC2 is also an alternative to latex sensitive users who are unable to use male condoms without irritation. For example, 7 percent to 20 percent of the individuals with significant exposure to latex rubber (i.e., healthcare workers) experience such irritation. To the Company's knowledge, there is no reported allergy to the nitrile polymer. FC2 is pre-lubricated, disposable and recommended for use during a single sex act. FC2 is not reusable.

Raw Materials

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 has chosen 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

Because FC2 offers a woman dual protection against both unintended pregnancy and STIs, including HIV/AIDS, its market encompasses both family planning and disease prevention.

DISEASE PREVENTION

The first clinical evidence of AIDS was noted more than thirty years ago. Since then, HIV/AIDS has become the most devastating pandemic facing humankind in recorded history. In November 2009, WHO released statistics indicating that on a world-wide basis, HIV/AIDS is now the leading cause of death in women 15 to 44 years of age. According to WHO, in 2012 worldwide women comprised 50 percent of all the adults living with HIV and approximately 58 percent of all new adult cases of HIV/AIDS in Sub-Saharan Africa were women. In the United States the Centers for Disease Control and Prevention (CDC) and FDA both list heterosexual sex as the most common method of HIV transmission in women.

For sexually active couples, male condoms and FC2 are the only barrier methods approved by the FDA for preventing sexual transmission of HIV/AIDS. In recent years, scientists have sought to develop alternative means of preventing HIV/AIDS. Based on the complexities of such research, a viable prevention alternative is unlikely to be available in the foreseeable future. To date, it is clear that condoms, male and female, continue to play a key role in the prevention of STIs, including HIV/AIDS. FC2, when used consistently and correctly, gives a woman control over her sexual health by providing dual protection against STIs, including HIV/AIDS, and unintended pregnancy.

In the United States, the CDC continues to report that the HIV/AIDS epidemic is taking an increasing toll on women and girls. Women of color, particularly black women, have been especially hard hit. Women of color comprise both the majority of new HIV and AIDS cases among women, and the majority of women living with the disease. In 2010, the CDC listed the rate of new HIV infection for black women as approximately 8 times the rate for white women in the United States. In 2010, in the United States, it estimated that one in 32 black women would be diagnosed with HIV in her lifetime, compared to the one in 526 incidence rate amongst white women.

The CDC estimates there are 20 million new STIs in the U.S. each year. It is also estimated that over 24,000 women each year in the U.S. lose the ability to conceive or carry a pregnancy to term due to undiagnosed or untreated STIs. In March 2008, the CDC announced that a study indicated that 26 percent of female adolescents in the U.S. have at least one of the most common STIs. Led by the CDC's Sara Forhan, the study is the first to examine the combined national prevalence of common STIs among adolescent women in the U.S. 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.

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On November 29, 2012, in conjunction with World AIDS Day, U.S. Secretary of State Hillary Clinton, as part of the President's Emergency Plan For AIDS Relief ("PEPFAR"), issued a blueprint for an AIDS Free Generation. In the blueprint it states that female condoms are unique in providing a female-controlled HIV prevention option and that PEPFAR will work with partner governments and other donors to promote female condoms wherever effective programs can build a sustained demand.

On December 3, 2013, donors pledged \$12 billion, which includes \$1.5 billion from the U.K. Government, over a 3 year period to the Global Fund to Fight AIDS, Tuberculosis and Malaria.

CONTRACEPTION

The feminization of HIV/AIDS has increased the relevance of FC2 for the prevention of unintended pregnancies as well as disease prevention. Unintended pregnancy may result in maternal and infant death, babies with HIV/AIDS, AIDS orphans and increased health care costs.

On July 11, 2012, World Population Day, the U.K. Government and the Bill and Melinda Gates Foundation held a Summit on Family Planning in London, England (the "London Summit"). It was attended by public health officials, government officials, and private sector companies that supply contraceptives and related products. FHC was one of only fourteen companies, and the only condom manufacturer, invited to attend the London Summit. The primary goal of the London Summit was to increase access to contraceptives to an additional 120 million poor women in 69 developing countries by 2020.

The Condom Market

The global public health sector market for male condoms is estimated to be greater than 6-7 billion units annually. The private sector market for male condoms is estimated at 10-15 billion units annually. The combined global male condom market (public and private sector) is estimated at a value of \$4.5 billion annually. The female condom market represents a very small portion of the total global condom market.

Strategy

The Company's strategy is to fully develop global markets for FC2 for both contraception and STI prevention, including HIV/AIDS. Since the introduction of its first generation product, FC1, the Company has developed contacts and relationships with global public health sector organizations such as WHO, United Nations Population Fund ("UNFPA"), United States Agency for International Development ("USAID"), through its facilitator, John Snow, Inc., the United Nations Joint Programme on HIV/AIDS ("UNAIDS"), country-specific health ministries and non-governmental organizations ("NGOs"), and commercial partners in various countries. The Company has representatives in various locations around the world to provide technical sales support and assist with its customers' prevention and family planning programs.

In July 2014, the Company announced a new growth strategy with two key elements. The first element seeks to accelerate demand for FC2 by strengthening key customer relationships and creating greater awareness of FC2 in our current markets through more effective sales and marketing efforts. A portion of our training and education resources have been redeployed to support the sales and marketing activities, and the Company is also examining the potential for FC2 in the U.S. consumer market. The Company appointed a new executive in July 2014, who has responsibility for directing resources to implement the FC2 growth strategy. The Company remains strongly committed to realizing the market potential for FC2, both in the global public sector and potentially as a consumer product in developed countries, and believes that increased spending on sales and marketing activities will accelerate and grow global demand for FC2. The second element of the Company's new growth strategy involves product diversification. The Company is actively evaluating the potential acquisition of additional products, technologies and businesses that are complementary to FC2 in terms of market segment, product category and/or channel presence.

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Commercial Markets - Direct to Consumers

The Company has distribution agreements and other arrangements with commercial partners which market to consumers through distributors and retailers in 16 countries, including the United States, Brazil, Spain, France, and the United Kingdom. These agreements are generally exclusive for a single country. Under these agreements, the Company sells FC2 to the distributor partners, who market and distribute the product to consumers in the established territory.

In the U.S., FHC initiated the FC2 College Health Mini-Grant Program in early 2013. The objective is to create awareness and sexual health knowledge that results in online/in store retail purchasing by young women and men. Education and training is the key content element for this program, similar to the public sector. College health and wellness centers were contacted and advised that they could apply to participate in the FC2 Program. If accepted, FHC would provide a mini-grant (\$50-\$500) and related education and training materials to help start or enhance an on-campus FC2 program. Grants would be awarded based on a school's intention to (1) raise awareness of FC2 on campus, (2) increase access to FC2 on campus, and (3) enhance students' capacity to effectively and accurately use FC2. The pilot regions for The FC2 College Campus Program were determined through selection of the following four American College Health Associations Regional Affiliates: New England, New York, South and South West College Health Associations. In total 30 colleges were chosen to receive grants for The FC2 College Campus Program, including Colgate University, Tulane University and Duke University plus student groups from institutions such as Boston College and University of Florida. Due to the pilot program's success, the program has been implemented for the 2014 – 2015 academic year with 20 schools chosen to receive grants between \$500 and \$1,000.

Relationships and Agreements with Public Health Sector Organizations

The Company's customers are primarily large global agencies, NGOs, ministries of health and other government agencies which purchase and distribute FC2 for use in HIV/AIDS prevention and family planning programs. The Company offers uniform, volume-based pricing to such agencies, rather than entering into long-term supply agreements.

In the U.S., FC2 is sold to city and state public health clinics as well as not-for-profit organizations such as Planned Parenthood. Municipal and state departments of health have been increasing access to FC2 within established condom programming. Chicago, Los Angeles, San Francisco, New York and Washington, D.C., are all examples of cities with programs providing female and male condoms free of charge. In New York City, at December 31, 2014 FC2 has been distributed in 1,672 locations, up 12% over 1,495 locations at December 31, 2013.

The Company has encouraged growth in the U.S. through education and program development support. To make health professional education broadly available, the Company introduced its FC2 On-line Training Program in March 2012.

The National Female Condom Coalition (NFCC) and Universal Access to Female Condoms (UAFC) sponsored the third annual Global Female Condom Day on September 16, 2014. The 2014 Global Female Condom Day drew greater attention and participation than in the previous year. Public events highlighting the need for access to female condoms and promoting their use in family planning and disease prevention were organized around the world and in the U.S., including events specifically initiated or co-sponsored by the Company. The Company assembled five internationally recognized health experts and sexual health advocates to record their insights on the challenges and opportunities facing female condom use in the U.S. and around the world, which was made available on Global Female Condom Day.

Globally, the Company has a multilingual website that provides downloadable training and education information in English, Portuguese, Spanish and French, which is viewed approximately 1,500 times per month. The Company also has a multilingual YouTube channel for FC2 animation and instructions which has been viewed more than 10 million times since it was launched in December 2012.

Outside of the U.S., 184 training and education sessions were held in 7 countries, with an estimated 118,000 people participating in the sessions in 2014. In addition, persons in 40 countries asked for and received information and advice on training and education.

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Manufacturing Facilities

The Company leases 25,900 sq. ft. of production space in Selangor D.E., Malaysia for the production of FC2. In 2012, the Company completed the expansion of the facility's manufacturing capacity by 20 percent to approximately 100 million units annually. The cost was approximately \$700,000, which was funded internally.

In fiscal 2014 the Company leased an additional 19,900 sq. ft adjacent to its existing Malaysian facility to support future capacity build-outs which provides sufficient space to add manufacturing capacity of up to an additional 100 million units annually. The Company is currently utilizing this facility for warehouse storage. The Company will consider manufacturing in other locations as the demand for FC2 develops.

Government Regulation

Female condoms as a group were classified by the FDA as a Class III medical device in 1989. Class III medical devices are deemed by the FDA to carry potential risks with use which must be tested prior to FDA approval, referred to as Premarket Approval (PMA), for sale in the U.S. As FC2 is a Class III medical device, prior to selling FC2 in the U.S., the Company was required to submit a PMA application containing technical information on the use of FC2 such as pre-clinical and clinical safety and efficacy studies which were gathered together in a required format and content. The FC2 PMA was approved by the FDA as a Class III medical device in March 2009.

FC2 received the CE Mark which allows it to be marketed throughout the European Union. FC2 has also been approved by regulatory authorities in Brazil, India and other jurisdictions.

In the U.S., FC2 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 FC2 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. As an FDA approved medical device, the facilities in which FC2 is produced and tested are subject to periodic FDA inspection to ensure compliance with current Good Manufacturing Processes. The Company's most recent FDA inspection was completed in September 2010.

The FDA's approval order for FC2 includes conditions that relate to product labeling, including information on the package itself and instructions for use called a "package insert" which accompanies each product. The Company believes it is in compliance with the FDA approval order.

The Company's facility may also be subject to inspection by UNFPA, USAID, International Organization for Standardization (ISO) and country specific ministries of health.

Competition

FC2 participates in the same market as male condoms; however, it is not seen as directly competing with male condoms. Rather, studies show that providing FC2 is additive in terms of prevention and choice. Male condoms cost less and have brand names that are more widely recognized than FC2. In addition, male condoms are generally manufactured and marketed by companies with significantly greater financial resources than the Company.

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Other parties have developed and marketed female condoms. None of these female condoms marketed or under development by other parties have secured FDA approval. FDA approval is required to sell female condoms in the U.S. The Cupid female condom became the second female condom design to successfully complete the WHO prequalification process in July 2012 and be cleared for purchase by U.N. agencies. FC2 has also been competing with other female condoms in markets that do not require either FDA approval or WHO prequalification. We have experienced increasing competition in the global public sector, and competitors including Cupid received part of the last South African tender. Increasing competition in FC2's markets may put pressure on pricing for FC2 or adversely affect sales of FC2, and some customers, particularly in the global public sector, may prioritize price over other features where FC2 may have an advantage. It is also possible that other female condoms may receive FDA approval or complete the WHO prequalification process, which would increase competition from other female condoms in FC2's markets.

Patents and Trademarks

FC2 patents have been issued by the United States, Europe, Canada, Australia, South Africa, the People's Republic of China, Japan, Mexico, Brazil, India and the African Regional Intellectual Property Organization (ARIPO), which includes Botswana, Gambia, Ghana, Kenya, Lesotho, Malawi, Mozambique, Namibia, Sierra Leone, Sudan, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe. Further, the European patent for FC2 has been validated in the following countries: Austria, Belgium, Bulgaria, Switzerland, Republic of Cyprus, Czech Republic, Germany, Denmark, Estonia, Spain, Finland, France, United Kingdom, Greece, Hungary, Ireland, Italy, Luxembourg, Monaco, Netherlands, Portugal, Romania, Sweden, Slovenia, Slovakia, and Turkey. The patents cover the key aspects of FC2, including its overall design and manufacturing process. The patents have expiration dates in 2023 and 2024.

The Company has a registration for the trademark "FC2 Female Condom" in the United States. Furthermore, the Company has filed applications or secured registrations in 39 countries or jurisdictions around the world to protect the various names and symbols used in marketing FC2. In addition, the experience that has been gained through years of manufacturing its Female Condoms (FC1 and FC2) has allowed the Company to develop trade secrets and know-how, including certain proprietary production technologies, that further protect its competitive position.

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Overview

The Company manufactures, markets and sells FC2. FC2 is the only currently available female-controlled product approved by the FDA that provides dual protection against unintended pregnancy and STIs, including HIV/AIDS.

Because FC2's primary usages are for disease prevention and family planning, the public health sector is the Company's main market. Within the public health sector, various organizations supply critical products such as FC2, at no cost or low cost, to those who need but cannot afford to buy such products for themselves.

FC2 has been distributed in 144 countries. A significant number of countries with the highest demand potential are in the developing world. The incidence of HIV/AIDS, other STIs and unwanted pregnancy in these countries represents a remarkable potential for significant sales of a product that benefits some of the world's most underprivileged people. However, conditions in these countries can be volatile and result in unpredictable delays in program development, tender applications and processing orders.

The Company has a relatively small customer base, with a limited number of customers who generally purchase in large quantities. Over the past few years, major customers have included large global agencies, such as UNFPA and USAID. Other customers include ministries of health or other governmental agencies, which either purchase directly or via in-country distributors, and NGOs.

Purchasing patterns vary significantly from one customer to another, and may reflect factors other than simple demand. For example, some governmental agencies purchase through a formal procurement process in which a tender (request for bid) is issued for either a specific or a maximum unit quantity. Tenders also define the other elements required for a qualified bid submission (such as product specifications, regulatory approvals, clearance by WHO, unit pricing and delivery timetable). Bidders have a limited period of time in which to submit bids. Bids are subjected to an evaluation process which is intended to conclude with a tender award to the successful bidder. The entire tender process, from publication to award, may take many months to complete. A tender award indicates acceptance of the bidder's price rather than an order or guarantee of the purchase of any minimum number of units. Many governmental tenders are stated to be "up to" the maximum number of units, which gives the applicable government agency discretion to purchase less than the full maximum tender amount. Orders are placed after the tender is awarded; there are often no set dates for orders in the tender and there are no guarantees as to the timing or amount of actual orders or shipments. Orders received may vary from the amount of the tender award based on a number of factors including vendor supply capacity, quality inspections and changes in demand. Administrative issues, politics, bureaucracy, process errors, changes in leadership, funding priorities and/or other pressures may delay or derail the process and affect the purchasing patterns of public sector customers. As a result, the Company may experience significant quarter-to-quarter sales variations due to the timing and shipment of large orders.

In the past few years, the Company's business model, which includes high gross margins, modest capital expenditures and low expense requirements compared to production volumes, has permitted the Company to sustain profitable operations without debt. Continuation of these accomplishments in the future periods will be contingent on a number of factors, including the degree and period of sales volatility and on the strength of global demand for the Company's product.

In October 2014, we announced that Semina Industria e Comercio Ltda ("Semina"), our distributor in Brazil, has been awarded an exclusive contract under a public tender. The contract is valid through August 20, 2015, and the Brazil Ministry of Health may place orders against this tender in its discretion. Through the date of this report, the Company has received orders for 25 million units in fulfillment of the tender, of which over 5 million units were shipped during the three months ended December 31, 2014.

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Details of the quarterly unit sales for the last five fiscal years are listed below:

Period	2015	2014	2013	2012	2011
October 1 – December 31	12,154,569	11,832,666	17,114,630	15,166,217	6,067,421
January 1 – March 31		7,298,968	16,675,035	13,945,320	8,905,099
April 1 – June 30		13,693,652	12,583,460	15,198,960	5,922,334
July 1 - September 30		9,697,341	8,386,800	17,339,500	11,977,716
Total	12,154,569	42,522,627	54,759,925	61,649,997	32,872,570

Revenues. The Company's revenues are derived from sales of FC2, and are recognized upon shipment of the product to its customers.

The Company's strategy is to further develop a global market and distribution network for its product by maintaining relationships with public health sector groups and completing partnership arrangements with companies with the necessary marketing and financial resources and local market expertise.

The Company's most significant customers are either global public health sector agencies or those who facilitate their purchases and/or distribution of FC2 for use in HIV/AIDS prevention and/or family planning. The Company offers uniform pricing to such agencies, rather than entering into long-term supply agreements. The Company's four largest customers currently are UNFPA, USAID, Sekunjalo Investments Corporation (PTY) Ltd ("Sekunjalo"), and Semina. We sell to the Brazil Ministry of Health either through UNFPA or Semina. In the U.S., FC2 is sold to city and state public health clinics as well as to not-for-profit organizations such as Planned Parenthood.

Because the Company manufactures FC2 in a leased facility located in Malaysia, a portion of the Company's operating costs are denominated in foreign currencies. While a material portion of the Company's future sales are likely to be in foreign markets, all sales are denominated in the U.S. dollar. Effective October 1, 2009, the Company's U.K. and Malaysia subsidiaries adopted the U.S. dollar as their functional currency, further reducing the Company's foreign currency risk.

Expenses. The Company manufactures FC2 at its facility located in Selangor D.E., Malaysia. The Company's cost of sales 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 FC2, principally a nitrile polymer. Indirect production 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 FC2 are essentially available from

either multiple sources or multiple locations within a source.

The Company's operating expenses include costs for sales, marketing, education and training relating to FC2. During the London Summit, the Company announced a program to support the London Summit's goal to provide contraceptives to an additional 120 million women by 2020. This program includes a plan for the Company to invest up to \$14 million over the period from 2013 through 2018 in reproductive health and HIV/AIDS prevention education and training in collaboration with global agencies. Such investment in education and training may increase the Company's operating expenses in future periods, although the Company has not set a specific timetable for any such increased spending on education and training. In connection with the London Summit, the Company implemented a volume purchasing incentive program to award major public sector purchasers with FC2 equal to 5 percent of their total annual units purchased, at no-cost. The Company reserves for the no-cost product as a cost of sales, which may affect the Company's gross margin. Effective January 1, 2015, the Company has reduced the unit price to the major public sector purchasers to reflect the 5 percent no-cost product instead of awarding no-cost product.

RESULTS OF OPERATIONS

THREE MONTHS ENDED DECEMBER 31, 2014 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2013

The Company generated net revenues of \$6,659,206 and net income of \$804,917, or \$0.03 per diluted share, for the three months ended December 31, 2014, compared to net revenues of \$6,690,195 and net income of \$1,464,603, or \$0.05 per diluted share, for the three months ended December 31, 2013.

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Net revenues decreased \$30,989 on a 3 percent increase in unit sales for the three months ended December 31, 2014, compared with the same period last year. The FC2 average sales price per unit decreased 3.1 percent compared with the same period last year due to changes in sales mix.

Cost of sales decreased \$172,168, or 6 percent, to \$2,839,533 in the three months ended December 31, 2014 from \$3,011,701 for the same period last year.

Gross profit increased \$141,179, or 4 percent, to \$3,819,673 for the three months ended December 31, 2014 from \$3,678,494 for the three months ended December 31, 2013. Gross profit margin for the three months ended December 31, 2014 was 57 percent of net revenues versus 55 percent of net revenues for the same period last year. The increase reflects slightly higher material costs, which were more than offset by the favorable impact of currency exchange rates upon material purchases.

Significant quarter-to-quarter variations in the Company's results have historically resulted from the timing and shipment of large orders rather than from any fundamental changes in the business or the underlying demand for female condoms.

Operating expenses increased \$270,966, or 13 percent, to \$2,365,824 for the three months ended December 31, 2014 from \$2,094,858 in the prior year period, primarily due to an increase in sales, marketing, training and education expenses. The majority of the increased spending relates to payments to our Brazilian distributor for ongoing programming related to the 2012 tender and for marketing and management fees for the 2014 tender. Higher sales and marketing expenses also reflect the addition of an Executive Vice President of Sales and Marketing to the Company's management team. Any other headcount added to the sales and marketing team is a redeployment of training and education resources.

Operating income for the three months ended December 31, 2014, was \$1,453,849 versus operating income of \$1,583,636 in the first quarter of fiscal year 2014, a decrease of \$129,787, or 8 percent. The decrease was primarily due to higher operating expenses partially offset by improved gross margins.

Interest and other income, net, for the three months ended December 31, 2014 was \$652, an increase of \$2,384 from the same period in fiscal year 2013, when interest and other expense, net, was \$1,732. The Company recorded a foreign currency transaction gain of \$20,846 in the most recent quarter, compared with a foreign currency transaction loss of \$18,426 for the same period last year.

Income tax expense for the three months ended December 31, 2014 was \$670,430, an increase of \$571,555 from the same period in fiscal year 2014, when income tax expense was \$98,875. The increase was primarily due to the Company no longer recognizing an income tax benefit associated with reducing the Company's valuation allowance on its deferred tax assets related to net operating loss carryforwards. During the period ended December 31, 2013, the valuation allowance on the Company's deferred tax assets was fully reversed and as a result the Company does not expect to recognize such tax benefits to any significant extent in its consolidated statements of income for periods after December 31, 2013. However the Company's net operating loss carryforwards will be utilized to reduce cash payments for income taxes based on the statutory rate in effect at the time of such utilization. Actual income taxes paid are reflected on the Company's consolidated statements of cash flows.

The Company's net income decreased \$659,686, or 45 percent, to \$804,917 in the three months ended December 31, 2014 from net income of \$1,464,603 in the same period of the prior year, as a result of significantly higher income tax expense and the other factors discussed above. Net income was 12 percent and 22 percent of net revenues for the three months ended December 31, 2014 and 2013, respectively.

Reliance on a Single Product

At this time, the Company currently derives all of its revenues from FC2, its only current product. While management believes the global potential for FC2 is significant, the ultimate level of consumer demand around the world is not yet known.

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Distribution Network

The Company's strategy is to develop a global distribution network for FC2 by entering into partnership arrangements with financially secure companies with appropriate marketing expertise. This strategy has resulted in distribution in 144 countries, including numerous in-country distributions in the public health sector, particularly in Africa and Latin America. The Company has also entered into several partnership agreements for the commercialization of FC2 in consumer sector markets around the world. However, the Company is dependent on country governments, global donors, as well as U.S. municipal and state public health departments to continue AIDS/HIV/STI prevention and family planning programs that include FC2 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 FC2 within its contractual territory. Failure by the Company's partners to successfully market and distribute FC2 or failure of donors and/or 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 and family planning 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 FC2 are essentially available from either multiple sources or multiple locations within a source.

Global Market and Foreign Currency Risks

The Company manufactures FC2 in a leased facility located in Malaysia. Although a material portion of the Company's future sales are likely to be in foreign markets, FC2 sales are denominated in U.S. dollars only. Manufacturing costs are subject to normal currency risks associated with changes in the exchange rate of the Malaysian ringgit relative to the United States dollar.

The Company's distributors are subject to exchange rate risk as their orders are denominated in U.S. dollars and they generally sell to their customers in the local country currency. If currency fluctuations have a material impact on a distributor it may ask the Company for pricing concessions or other financial accommodations.

Government Regulation

FC2 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 current "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

The Company's operations used cash flow of \$1.2 million in the three months ended December 31, 2014, which included a negative impact of changes in operating assets and liabilities of \$(2.9) million, compared with providing cash flow of \$1.2 million in the three months ended December 31, 2013, which included a negative impact of changes in operating assets and liabilities of \$(0.6) million. At December 31, 2014 accounts receivable and inventory increased \$2.9 million and \$0.5 million, respectively, from September 30, 2014. These increases are a result of orders received under the awarded Brazil 2014 tender.

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Accounts receivable increased from \$2.9 million at September 30, 2014 to \$5.8 million at December 31, 2014. The Company's 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 impacted 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 62 days. Over the past five years, the Company's bad debt expense has been less than 0.04 percent of product sales.

Beginning February 16, 2010, through May 7, 2014, the Company paid 18 quarterly cash dividends. The first 9 were paid at a quarterly rate per share of \$0.05 through February 9, 2012, 4 were paid at a quarterly rate per share of \$0.06 from May 9, 2012 through February 6, 2013, and 5 were paid at a quarterly rate per share of \$0.07 from May 8, 2013 through May 7, 2014. A cumulative total of \$29.4 million has been paid since the programs initiation. The Company paid cash dividends of \$2.0 million during the three months ended December 31, 2013. On July 14, 2014, the Company announced that its Board of Directors has elected to suspend the payment of quarterly cash dividends in order to devote operating cash flows towards strategic growth initiatives.

At December 31, 2014, the Company had working capital of \$11.0 million and stockholders' equity of \$29.3 million compared to working capital of \$9.7 million and stockholders' equity of \$28.1 million as of December 31, 2013.

The Company believes its current cash position is adequate to fund operations of the Company in the next 12 months, although no assurances can be made that such cash will be adequate. If the Company needs additional cash, it may sell equity securities to raise additional capital and may borrow funds under its Heartland Bank credit facility.

On August 1, 2014, the Company entered into an amendment to the Second Amended and Restated Loan Agreement (as amended, the "Loan Agreement") with Heartland Bank to extend the term of the Company's revolving line of credit to August 1, 2015. The credit facility consists of a single revolving note for up to \$2 million with Heartland Bank, with borrowings limited to a borrowing base determined based on 70 percent to 80 percent of eligible accounts receivable plus 50 percent of eligible inventory. Significant restrictive covenants in the Loan Agreement include prohibitions on any merger, consolidation or sale of all or a substantial portion of the Company's assets and limits on the payment of dividends or the repurchase of shares. The Loan Agreement does not contain any financial covenants that require compliance with ratios or amounts. Dividends and share repurchases are permitted as long as after giving effect to the dividend or share repurchase the Company has a ratio of total liabilities to total stockholders' equity of no more than 1:1. Borrowings on the revolving note bear interest at the national prime rate published by the Wall Street Journal (3.25 percent at December 31, 2014). The note is collateralized by substantially all of the assets of the Company. No amounts were outstanding under the revolving note at either December 31, 2014 or September 30, 2014.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's exposure to market risk is limited to fluctuations in raw material commodity prices, particularly the nitrile polymer used to manufacture FC2, and foreign currency exchange rate risk associated with the Company's foreign operations. The Company does not utilize financial instruments for trading purposes or to hedge risk and holds no derivative financial instruments which would expose it to significant market risk. Effective October 1, 2009, the Company's U.K. subsidiary and Malaysia subsidiary each adopted the U.S. dollar as its functional currency. The consistent use of the U.S. dollar as the functional currency across the Company reduces its foreign currency risk and stabilizes its operating results. The Company's distributors are subject to exchange rate risk as their orders are denominated in the U.S. dollars and they generally sell to their customers in the local country currency. If currency fluctuations have a material impact on a distributor it may ask the Company for pricing concessions or other financial accommodations. The Company currently has no significant exposure to interest rate risk. The Company has a line of credit with Heartland Bank, consisting of a revolving note for up to \$2 million with borrowings limited to a percentage of eligible accounts receivable and eligible inventory. Outstanding borrowings under the line of credit will incur interest at a rate equal to the national prime rate published by the Wall Street Journal. As the Company has had no outstanding borrowings in the last five years, it currently has no significant exposure to market risk for changes in interest rates. Should the Company incur future borrowings under its line of credit, it would be subject to interest rate risk related to such borrowings.

Item 4. 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.

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PART II. OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in Part I, Item 1A, "Risk Factors," of the Company's Form 10-K for the year ended September 30, 2014. Please refer to that section for disclosures regarding the risks and uncertainties relating to the Company's business.

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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)
- 4.1 Amended and Restated Articles of Incorporation (same as Exhibit 3.1).
- 4.2 Articles II, VII and XI of the Amended and Restated By-Laws (included in Exhibit 3.5).
- 10.1 First Amendment to Consulting Agreement, dated as of October 1, 2014, between the Company and Donna Felch.
- 10.2 Letter Agreement dated November 18, 2014 terminating Amended and Restated Change of Control Agreement of O.B. Parrish.
- 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)
- 101 The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2014, formatted in XBRL (Extensible Business Reporting Language): (1) the Unaudited Condensed Consolidated Balance Sheets, (2) the Unaudited Condensed Consolidated Statements of Income, (3) the Unaudited Condensed Consolidated Statements of Cash Flows and (4) the Notes to the Unaudited Condensed Consolidated Financial Statements.

- (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 March 31, 2003.
- (5) Incorporated by reference to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 22, 2013.

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(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.

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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: February 3, 2015

/s/ Karen King

Karen King, President and
Chief Executive Officer

DATE: February 3, 2015

/s/ Michele Greco

Michele Greco, Executive Vice President
and Chief Financial Officer