

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, 2020

OR

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: 000-23329

**Charles & Colvard, Ltd.**

(Exact name of registrant as specified in its charter)

North Carolina

(State or other jurisdiction of incorporation or organization)

56-1928817

(I.R.S. Employer Identification No.)

170 Southport Drive

Morrisville, North Carolina

(Address of principal executive offices)

27560

(Zip Code)

(919) 468-0399

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, no par value per share	CTHR	The Nasdaq Stock Market LLC

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 every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of January 29, 2021, there were 29,202,785 shares of the registrant's common stock, no par value per share, outstanding.

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**CHARLES & COLVARD, LTD.**

**FORM 10-Q**  
**For the Quarterly Period Ended December 31, 2020**

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

**CHARLES & COLVARD, LTD.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	December 31, 2020 (unaudited)	June 30, 2020
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 16,690,105	\$ 13,993,032
Restricted cash	182,958	624,202
Accounts receivable, net	3,059,842	670,718
Inventory, net	12,072,929	7,443,257
Prepaid expenses and other assets	1,342,956	1,177,860
Total current assets	<u>33,348,790</u>	<u>23,909,069</u>
Long-term assets:		
Inventory, net	16,593,187	23,190,702
Property and equipment, net	975,989	999,061
Intangible assets, net	193,388	170,151
Operating lease right-of-use assets	366,083	584,143
Other assets	42,330	51,461
Total long-term assets	<u>18,170,977</u>	<u>24,995,518</u>
<b>TOTAL ASSETS</b>	<u>\$ 51,519,767</u>	<u>\$ 48,904,587</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,932,576	\$ 3,748,235
Operating lease liabilities	527,761	622,493
Current maturity of long-term debt	579,000	193,000
Accrued expenses and other liabilities	1,946,283	1,922,332
Total current liabilities	<u>5,985,620</u>	<u>6,486,060</u>
Long-term liabilities:		
Long-term debt, net	386,000	772,000
Noncurrent operating lease liabilities	-	203,003
Accrued income taxes	8,935	7,947
Total long-term liabilities	<u>394,935</u>	<u>982,950</u>
Total liabilities	<u>6,380,555</u>	<u>7,469,010</u>
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Common stock, no par value; 50,000,000 shares authorized; 29,092,326 and 28,949,410 shares issued and outstanding at December 31, 2020 and June 30, 2020, respectively	54,520,189	54,342,864
Additional paid-in capital	26,013,132	25,880,165
Accumulated deficit	(35,394,109)	(38,787,452)
Total shareholders' equity	<u>45,139,212</u>	<u>41,435,577</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u>\$ 51,519,767</u>	<u>\$ 48,904,587</u>

See Notes to Condensed Consolidated Financial Statements.

**CHARLES & COLVARD, LTD.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(unaudited)**

	<b>Three Months Ended December 31,</b>		<b>Six Months Ended December 31,</b>	
	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
Net sales	\$ 12,146,790	\$ 10,659,090	\$ 20,073,083	\$ 18,267,511
Costs and expenses:				
Cost of goods sold	6,167,708	5,530,514	10,363,763	9,407,138
Sales and marketing	2,480,571	3,160,965	4,128,503	5,390,556
General and administrative	977,528	1,203,686	2,185,564	2,553,187
Total costs and expenses	<u>9,625,807</u>	<u>9,895,165</u>	<u>16,677,830</u>	<u>17,350,881</u>
Income from operations	2,520,983	763,925	3,395,253	916,630
Other income (expense):				
Interest income	1,126	45,379	4,586	106,758
Interest expense	(2,466)	(277)	(4,905)	(419)
Loss on foreign currency exchange	(72)	(314)	(603)	(853)
Total other (expense) income, net	<u>(1,412)</u>	<u>44,788</u>	<u>(922)</u>	<u>105,486</u>
Income before income taxes	2,519,571	808,713	3,394,331	1,022,116
Income tax (expense) benefit	(494)	5,337	(988)	(747)
Net income	<u>\$ 2,519,077</u>	<u>\$ 814,050</u>	<u>\$ 3,393,343</u>	<u>\$ 1,021,369</u>
Net income per common share:				
Basic	\$ 0.09	\$ 0.03	\$ 0.12	\$ 0.04
Diluted	0.09	0.03	0.12	0.03
Weighted average number of shares used in computing net income per common share:				
Basic	28,804,265	28,656,910	28,795,424	28,610,299
Diluted	29,262,702	29,246,571	28,980,009	29,199,876

See Notes to Condensed Consolidated Financial Statements.

**CHARLES & COLVARD, LTD.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**(unaudited)**

	<b>Six Months Ended December 31, 2020</b>				
	<b>Common Stock</b>		<b>Additional Paid-in Capital</b>	<b>Accumulated Deficit</b>	<b>Total Shareholders' Equity</b>
	<b>Number of Shares</b>	<b>Amount</b>			
Balance at June 30, 2020	28,949,410	\$ 54,342,864	\$ 25,880,165	\$ (38,787,452)	\$ 41,435,577
Stock-based compensation	-	-	107,355	-	107,355
Issuance of restricted stock	178,750	-	-	-	-
Retirement of restricted stock	(162,500)	-	-	-	-
Net income	-	-	-	874,266	874,266
Balance at September 30, 2020	28,965,660	\$ 54,342,864	\$ 25,987,520	\$ (37,913,186)	\$ 42,417,198
Stock-based compensation	-	-	87,938	-	87,938
Stock option exercises	126,666	177,325	(62,326)	-	114,999
Net income	-	-	-	2,519,077	2,519,077
Balance at December 31, 2020	<u>29,092,326</u>	<u>\$ 54,520,189</u>	<u>\$ 26,013,132</u>	<u>\$ (35,394,109)</u>	<u>\$ 45,139,212</u>

  

	<b>Six Months Ended December 31, 2019</b>				
	<b>Common Stock</b>		<b>Additional Paid-in Capital</b>	<b>Accumulated Deficit</b>	<b>Total Shareholders' Equity</b>
	<b>Number of Shares</b>	<b>Amount</b>			
Balance at June 30, 2019	28,027,569	\$ 54,342,864	\$ 24,488,147	\$ (32,625,369)	\$ 46,205,642
Issuance of common stock, net of offering costs	630,500	-	932,480	-	932,480
Stock-based compensation	-	-	212,380	-	212,380
Issuance of restricted stock	325,000	-	-	-	-
Retirement of restricted stock	(1,159)	-	-	-	-
Net income	-	-	-	207,319	207,319
Balance at September 30, 2019	28,981,910	\$ 54,342,864	\$ 25,633,007	\$ (32,418,050)	\$ 47,557,821
Stock-based compensation	-	-	146,725	-	146,725
Net income	-	-	-	814,050	814,050
Balance at December 31, 2019	<u>28,981,910</u>	<u>\$ 54,342,864</u>	<u>\$ 25,779,732</u>	<u>\$ (31,604,000)</u>	<u>\$ 48,518,596</u>

See Notes to Condensed Consolidated Financial Statements.

**CHARLES & COLVARD, LTD.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(unaudited)**

	Six Months Ended December	
	31,	
	2020	2019
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 3,393,343	\$ 1,021,369
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	271,061	234,303
Stock-based compensation	195,293	359,105
Provision for (Recovery of) uncollectible accounts	5,514	(10,000)
Provision for sales returns	662,000	299,000
Inventory write-off	105,000	149,000
Provision for accounts receivable discounts	9,581	39,706
Changes in operating assets and liabilities:		
Accounts receivable	(3,066,219)	(1,454,318)
Inventory	1,862,843	(2,207,214)
Prepaid expenses and other assets, net	62,095	(196,764)
Accounts payable	(815,659)	1,403,677
Accrued income taxes	988	747
Accrued expenses and other liabilities	(273,784)	123,752
Net cash provided by (used in) operating activities	<u>2,412,056</u>	<u>(237,637)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(244,688)	(319,728)
Payments for intangible assets	(26,538)	(36,797)
Net cash used in investing activities	<u>(271,226)</u>	<u>(356,525)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of common stock, net of offering costs	-	932,480
Stock option exercises	114,999	-
Net cash provided by financing activities	<u>114,999</u>	<u>932,480</u>
NET INCREASE IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH	2,255,829	338,318
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, BEGINNING OF PERIOD	14,617,234	13,006,545
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, END OF PERIOD	<u>\$ 16,873,063</u>	<u>\$ 13,344,863</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	\$ -	\$ 277
Cash paid during the period for income taxes	\$ 8,961	\$ 2,050

See Notes to Condensed Consolidated Financial Statements.

**CHARLES & COLVARD, LTD.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**1. DESCRIPTION OF BUSINESS**

Charles & Colvard, Ltd. (the “Company”), a North Carolina corporation, was founded in 1995. The Company manufactures, markets, and distributes *Charles & Colvard Created Moissanite*® (hereinafter referred to as moissanite or moissanite jewels) and finished jewelry featuring moissanite, including *Forever One*™, our premium moissanite gemstone brand, for sale in the worldwide fine jewelry market. The Company also markets and distributes *Caydia*™ lab grown diamonds and finished jewelry featuring lab grown diamonds for sale in the worldwide fine jewelry market. Moissanite, also known by its chemical name silicon carbide (“SiC”), is a rare mineral first discovered in a meteorite crater. Because naturally occurring SiC crystals are too small for commercial use, larger crystals must be grown in a laboratory. Lab grown diamonds are also grown using technology that replicates the natural diamond growing process. The only differentiation between that of a lab grown diamond and a mined diamond is its origin. The result is a man-made diamond that is chemically, physically, and optically the same as those grown beneath the earth’s surface. The Company sells loose moissanite jewels, loose lab grown diamonds, and finished jewelry featuring both moissanite and lab grown diamonds at wholesale prices to distributors, manufacturers, retailers, and designers, including some of the largest distributors and jewelry manufacturers in the world. The Company’s finished jewelry and loose moissanite jewels and lab grown diamonds that are mounted into fine jewelry by other manufacturers are sold at retail outlets and via the Internet. The Company sells at retail prices to end-consumers through its wholly owned operating subsidiary, charlesandcolvard.com, LLC, third-party online marketplaces, drop-ship, and other pure-play, exclusively e-commerce outlets.

**2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Presentation and Principles of Consolidation*** – The accompanying unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information. However, certain information or footnote disclosures normally included in complete financial statements prepared in accordance with U.S. GAAP have been condensed, or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). In the opinion of the Company’s management, the unaudited condensed consolidated financial statements in this Quarterly Report on Form 10-Q include all normal and recurring adjustments necessary for the fair statement of the results for the interim periods presented. The results for the three and six months ended December 31, 2020 are not necessarily indicative of the results to be expected for the fiscal year ending June 30, 2021.

The condensed consolidated financial statements as of and for the three and six months ended December 31, 2020 and 2019 included in this Quarterly Report on Form 10-Q are unaudited. The balance sheet as of June 30, 2020 is derived from the audited financial statements as of that date. The accompanying statements should be read in conjunction with the audited financial statements and related notes contained in Item 8 of the Company’s Annual Report on Form 10-K (the “2020 Annual Report”) for the fiscal year ended June 30, 2020 filed with the SEC on September 4, 2020.

The accompanying condensed consolidated financial statements as of and for the three and six months ended December 31, 2020 and 2019, and as of the fiscal year ended June 30, 2020, include the accounts of the Company and its wholly owned subsidiaries charlesandcolvard.com, LLC; Charles & Colvard Direct, LLC; and Charles & Colvard (HK) Ltd., the Company’s Hong Kong subsidiary, which was entered into dormancy as of September 30, 2020 following its re-activation in December 2017. Charles & Colvard Direct, LLC, had no operating activity during the six-month periods ended December 31, 2020 or 2019. Charles & Colvard (HK) Ltd. previously became dormant in the second quarter of 2009 and has had no operating activity since 2008. All intercompany accounts have been eliminated.

***Significant Accounting Policies*** – In the opinion of the Company’s management, except as discussed below, the Company’s significant accounting policies used for the three and six months ended December 31, 2020, are consistent with those used for the fiscal year ended June 30, 2020. Accordingly, please refer to Note 2 to the Consolidated Financial Statements in the 2020 Annual Report for the Company’s significant accounting policies.



**Reclassifications** – Certain amounts in the Company’s condensed consolidated financial statements for the six months ended December 31, 2019 have been reclassified to conform to current presentation related to certain customer credit balances that were reclassified from accounts payable to accrued expenses and other liabilities in the amount of approximately \$48,000. These reclassifications had no impact on the Company’s condensed consolidated financial position or condensed consolidated results of operations as of or for the periods ended December 31, 2020 and 2019.

**Use of Estimates** – The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. As future events and their effects, including the impact of the COVID-19 pandemic and the related responses, cannot be fully determined with precision, actual results of operations, cash flow, and financial position could differ significantly from estimates. The most significant estimates impacting the Company’s condensed consolidated financial statements relate to valuation and classification of inventories, accounts receivable reserves, deferred tax assets, and revenue recognition. Changes in estimates are reflected in the condensed consolidated financial statements in the period in which the change in estimate occurs.

**Cash and Cash Equivalents** – All highly liquid investments with an original maturity of three months or less from the date of purchase are considered to be cash equivalents.

**Restricted Cash** – In accordance with cash management process requirements relating to the Company’s asset-based revolving credit facility from White Oak Commercial Finance, LLC (“White Oak”), there are access and usage restrictions on certain cash deposit balances for periods of up to two business days during which time such deposits are held by White Oak for the benefit of the Company. During the period these cash deposits are held by White Oak, such amounts are classified as restricted cash for reporting purposes on the Company’s condensed consolidated balance sheets. In the event that the Company has an outstanding balance on its revolving credit facility from White Oak, restricted cash balances held by White Oak would be applied to reduce such outstanding amounts.

The Company has full access to its cash balances without restriction following the period of time such cash is held by White Oak. For additional information regarding the Company’s asset-based revolving credit facility, see Note 10, “Debt.”

The reconciliation of cash, cash equivalents, and restricted cash, as presented on the Condensed Consolidated Statements of Cash Flows, consists of the following as of the dates presented:

	December 31, 2020	June 30, 2020
Cash and cash equivalents	\$ 16,690,105	\$ 13,993,032
Restricted cash	182,958	624,202
Total cash, cash equivalents, and restricted cash	<u>\$ 16,873,063</u>	<u>\$ 14,617,234</u>

**Recently Adopted/Issued Accounting Pronouncements** – Effective July 1, 2020, the Company adopted the new accounting standard related to the measurement and disclosure of credit losses on financial instruments. The new guidance includes a current expected credit loss (“CECL”) model that requires an entity to estimate credit losses expected over the life of an exposure or pool of exposures based on historical information, current conditions, and supportable forecasts at the time the asset is recognized and is measured at each reporting period. The new guidance principally aligns the Company’s accounting for its trade accounts receivable with the economics of extending credit and improves its financial reporting by requiring timelier recording of related credit losses.

The adoption of the new accounting standard did not have a material impact on the Company’s financial position or results of operations and the Company did not record a cumulative-effect adjustment to retained earnings. The Company amended its allowance for credit losses policy, as set forth below, for the implementation of the new accounting standard.

The Company records an allowance for credit losses, which includes a provision for expected losses based on historical write-offs, adjusted for current conditions as deemed necessary, and a specific reserve for accounts deemed at risk. The allowance is the Company’s estimate for accounts receivable as of the balance sheet date that ultimately will not be collected. Any changes in the allowance are reflected in the results of operations in the period in which the change occurs. The Company writes-off accounts receivable when it becomes probable, based upon customer facts and circumstances, that such amounts will not be collected.

Effective July 1, 2020, the Company also adopted the new accounting standard in connection with accounting for implementation costs incurred in a cloud computing arrangement that is a service contract. The new standard provides guidance to determine the accounting for fees paid in connection with a cloud computing arrangement that may include a software license. The adoption of this new accounting standard did not have a material impact on the Company's financial position or results of operations.

In December 2019, the FASB issued guidance on simplifying the accounting for income taxes that is intended to reduce the complexity while maintaining or improving the usefulness of tax disclosure information in financial statements. The new guidance is effective for fiscal years beginning after December 15, 2020. The Company does not expect the impact of the new guidance to have a material impact to the Company's financial statements.

In March 2020, as amended in January 2021, in response to concerns about structural risks of interbank offered rates ("IBORs"), and, particularly, the risk of cessation of the London Interbank Offered Rate ("LIBOR"), the FASB issued new guidance to ease the burden in accounting for or recognizing the effects of referenced interest rate reform on financial reporting. The new guidance is effective as of March 12, 2020 through December 31, 2022. As described in more detail in Note 10, "Debt", borrowings under the Company's line of credit are based on a rate equal to the one-month LIBOR. As of December 31, 2020, the Company had not borrowed against its line of credit, and therefore, is not subject to recognizing or disclosing any effect of referenced rate reform as of its quarterly period ended December 31, 2020.

### **3. SEGMENT INFORMATION AND GEOGRAPHIC DATA**

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making operating decisions and assessing performance as the source of the Company's operating and reportable segments.

The Company manages its business through two operating and reportable segments based on its distribution channels to sell its product lines, loose jewels and finished jewelry: its "Online Channels" segment, which consists of e-commerce outlets including charlesandcolvard.com, third-party online marketplaces, drop-ship retail, and other pure-play, exclusively e-commerce outlets; and its "Traditional" segment, which consists of wholesale and retail customers. The accounting policies of the Online Channels segment and Traditional segment are the same as those described in Note 2, "Basis of Presentation and Significant Accounting Policies" of this Quarterly Report on Form 10-Q and in the Notes to the Consolidated Financial Statements in the 2020 Annual Report.

The Company evaluates the financial performance of its segments based on net sales; product line gross profit, or the excess of product line sales over product line cost of goods sold; and operating income. The Company's product line cost of goods sold is defined as product cost of goods sold, excluding non-capitalized expenses from the Company's manufacturing and production control departments, comprising personnel costs, depreciation, leases, utilities, and corporate overhead allocations; freight out; inventory write-downs; and other inventory adjustments, comprising costs of quality issues, and damaged goods.

The Company allocates certain general and administrative expenses between its Online Channels segment and its Traditional segment based on net sales and number of employees to arrive at segment operating income. Unallocated expenses remain in its Traditional segment.

Summary financial information by reportable segment for the periods presented is as follows:

	<b>Three Months Ended December 31, 2020</b>		
	<b>Online Channels</b>	<b>Traditional</b>	<b>Total</b>
Net sales			
Finished jewelry	\$ 6,588,338	\$ 1,676,859	\$ 8,265,197
Loose jewels	997,939	2,883,654	3,881,593
Total	<u>\$ 7,586,277</u>	<u>\$ 4,560,513</u>	<u>\$ 12,146,790</u>
Product line cost of goods sold			
Finished jewelry	\$ 2,863,733	\$ 1,138,413	\$ 4,002,146
Loose jewels	388,426	1,417,177	1,805,603
Total	<u>\$ 3,252,159</u>	<u>\$ 2,555,590</u>	<u>\$ 5,807,749</u>
Product line gross profit			
Finished jewelry	\$ 3,724,605	\$ 538,446	\$ 4,263,051
Loose jewels	609,513	1,466,477	2,075,990
Total	<u>\$ 4,334,118</u>	<u>\$ 2,004,923</u>	<u>\$ 6,339,041</u>
Operating income	\$ 1,494,448	\$ 1,026,535	\$ 2,520,983
Depreciation and amortization	\$ 59,221	\$ 79,384	\$ 138,605
Capital expenditures	\$ 90,852	\$ 52,350	\$ 143,202
	<b>Three Months Ended December 31, 2019</b>		
	<b>Online Channels</b>	<b>Traditional</b>	<b>Total</b>
Net sales			
Finished jewelry	\$ 5,144,320	\$ 1,294,027	\$ 6,438,347
Loose jewels	940,434	3,280,309	4,220,743
Total	<u>\$ 6,084,754</u>	<u>\$ 4,574,336</u>	<u>\$ 10,659,090</u>
Product line cost of goods sold			
Finished jewelry	\$ 2,239,750	\$ 724,364	\$ 2,964,114
Loose jewels	405,869	1,675,785	2,081,654
Total	<u>\$ 2,645,619</u>	<u>\$ 2,400,149</u>	<u>\$ 5,045,768</u>
Product line gross profit			
Finished jewelry	\$ 2,904,570	\$ 569,663	\$ 3,474,233
Loose jewels	534,565	1,604,524	2,139,089
Total	<u>\$ 3,439,135</u>	<u>\$ 2,174,187</u>	<u>\$ 5,613,322</u>
Operating income	\$ 349,762	\$ 414,163	\$ 763,925
Depreciation and amortization	\$ 32,773	\$ 76,892	\$ 109,665
Capital expenditures	\$ 137,200	\$ 71,211	\$ 208,411

	<b>Six Months Ended December 31, 2020</b>		
	<b>Online Channels</b>	<b>Traditional</b>	<b>Total</b>
<b>Net sales</b>			
Finished jewelry	\$ 10,211,799	\$ 2,388,735	\$ 12,600,534
Loose jewels	1,839,772	5,632,777	7,472,549
<b>Total</b>	<b>\$ 12,051,571</b>	<b>\$ 8,021,512</b>	<b>\$ 20,073,083</b>
<b>Product line cost of goods sold</b>			
Finished jewelry	\$ 4,197,115	\$ 1,559,320	\$ 5,756,435
Loose jewels	701,115	2,848,410	3,549,525
<b>Total</b>	<b>\$ 4,898,230</b>	<b>\$ 4,407,730</b>	<b>\$ 9,305,960</b>
<b>Product line gross profit</b>			
Finished jewelry	\$ 6,014,684	\$ 829,415	\$ 6,844,099
Loose jewels	1,138,657	2,784,367	3,923,024
<b>Total</b>	<b>\$ 7,153,341</b>	<b>\$ 3,613,782</b>	<b>\$ 10,767,123</b>
Operating income	\$ 2,269,113	\$ 1,126,140	\$ 3,395,253
Depreciation and amortization	\$ 113,573	\$ 157,488	\$ 271,061
Capital expenditures	\$ 150,129	\$ 94,559	\$ 244,688

	<b>Six Months Ended December 31, 2019</b>		
	<b>Online Channels</b>	<b>Traditional</b>	<b>Total</b>
<b>Net sales</b>			
Finished jewelry	\$ 8,121,667	\$ 2,174,675	\$ 10,296,342
Loose jewels	1,668,716	6,302,453	7,971,169
<b>Total</b>	<b>\$ 9,790,383</b>	<b>\$ 8,477,128</b>	<b>\$ 18,267,511</b>
<b>Product line cost of goods sold</b>			
Finished jewelry	\$ 3,452,623	\$ 1,214,401	\$ 4,667,024
Loose jewels	671,063	3,210,043	3,881,106
<b>Total</b>	<b>\$ 4,123,686</b>	<b>\$ 4,424,444</b>	<b>\$ 8,548,130</b>
<b>Product line gross profit</b>			
Finished jewelry	\$ 4,669,044	\$ 960,274	\$ 5,629,318
Loose jewels	997,653	3,092,410	4,090,063
<b>Total</b>	<b>\$ 5,666,697</b>	<b>\$ 4,052,684</b>	<b>\$ 9,719,381</b>
Operating income	\$ 395,427	\$ 521,203	\$ 916,630
Depreciation and amortization	\$ 82,023	\$ 152,280	\$ 234,303
Capital expenditures	\$ 210,925	\$ 108,803	\$ 319,728

The Company does not allocate any assets to the reportable segments, and, therefore, no asset information is reported to the chief operating decision maker or disclosed in the financial information for each segment.

A reconciliation of the Company's product line cost of goods sold to cost of goods sold as reported in the condensed consolidated financial statements is as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2020	2019	2020	2019
Product line cost of goods sold	\$ 5,807,749	\$ 5,045,768	\$ 9,305,960	\$ 8,548,130
Non-capitalized manufacturing and production control expenses	395,237	427,643	724,641	817,519
Freight out	316,542	141,233	491,881	272,352
Inventory write-off	25,000	126,000	105,000	149,000
Other inventory adjustments	(376,820)	(210,130)	(263,719)	(379,863)
Cost of goods sold	<u>\$ 6,167,708</u>	<u>\$ 5,530,514</u>	<u>\$ 10,363,763</u>	<u>\$ 9,407,138</u>

The Company recognizes sales by geographic area based on the country in which the customer is based. Sales to international end consumers made through the Company's transactional website, charlesandcolvard.com, are included in international sales for financial reporting purposes. A portion of the Company's Traditional segment sales made to international wholesale distributors represents products sold internationally that may be re-imported to U.S. retailers.

The following presents net sales by geographic area:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2020	2019	2020	2019
Net sales				
United States	\$ 11,388,680	\$ 9,643,311	\$ 18,888,399	\$ 16,407,187
International	758,110	1,015,779	1,184,684	1,860,324
Total	<u>\$ 12,146,790</u>	<u>\$ 10,659,090</u>	<u>\$ 20,073,083</u>	<u>\$ 18,267,511</u>

#### 4. FAIR VALUE MEASUREMENTS

Under U.S. GAAP, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. U.S. GAAP also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are obtained from independent sources and can be validated by a third party, whereas unobservable inputs reflect assumptions regarding what a third party would use in pricing an asset or liability. The fair value hierarchy consists of three levels based on the reliability of inputs, as follows:

- Level 1.* Quoted prices in active markets for identical assets and liabilities;
- Level 2.* Inputs other than Level 1 quoted prices that are directly or indirectly observable; and
- Level 3.* Unobservable inputs that are not corroborated by market data.

The Company evaluates assets and liabilities subject to fair value measurements on a recurring and non-recurring basis to determine the appropriate level to classify them for each reporting period. This determination requires significant judgments to be made by management of the Company. The financial instruments identified as subject to fair value measurements on a recurring basis are cash and cash equivalents, trade accounts receivable, and trade accounts payable. All financial instruments are reflected in the consolidated balance sheets at carrying value, which approximates fair value due to the short-term nature of these financial instruments.

Assets that are measured at fair value on a non-recurring basis include property and equipment, leasehold improvements, and intangible assets comprising patents, license rights, and trademarks. These items are recognized at fair value when they are considered to be impaired. For the six months ended December 31, 2020 and 2019, no impairment was recorded.

**5. INVENTORIES**

The Company's total inventories, net of reserves, consisted of the following as of the dates presented:

	<b>December 31, 2020</b>	<b>June 30, 2020</b>
Finished jewelry:		
Raw materials	\$ 1,095,023	\$ 821,536
Work-in-process	925,022	602,390
Finished goods	7,019,742	6,019,985
Finished goods on consignment	1,964,458	2,297,907
Total finished jewelry	<u>\$ 11,004,245</u>	<u>\$ 9,741,818</u>
Loose jewels:		
Raw materials	\$ 2,056,183	\$ 3,526,399
Work-in-process	9,673,337	10,453,586
Finished goods	5,659,166	6,619,487
Finished goods on consignment	167,781	204,635
Total loose jewels	<u>17,556,467</u>	<u>20,804,107</u>
Total supplies inventory	105,404	88,034
Total inventory	<u>\$ 28,666,116</u>	<u>\$ 30,633,959</u>

As of the dates presented, the Company's total inventories, net of reserves, are classified as follows:

	<b>December 31, 2020</b>	<b>June 30, 2020</b>
Short-term portion	\$ 12,072,929	\$ 7,443,257
Long-term portion	16,593,187	23,190,702
Total	<u>\$ 28,666,116</u>	<u>\$ 30,633,959</u>

The Company's work-in-process inventories include raw SiC crystals on which processing costs, such as labor and sawing, have been incurred; and components, such as metal castings and finished good moissanite jewels, that have been issued to jobs in the manufacture of finished jewelry. The Company's moissanite jewel manufacturing process involves the production of intermediary shapes, called "preforms," that vary depending upon the expected size and shape of the finished jewel. To maximize manufacturing efficiencies, preforms may be made in advance of current finished inventory needs but remain in work-in-process inventories. As of December 31, 2020 and June 30, 2020, work-in-process inventories issued to active production jobs approximated \$1.61 million and \$1.34 million, respectively.

The Company's moissanite and lab grown diamond jewels do not degrade in quality over time and inventory generally consists of the shapes and sizes most commonly used in the jewelry industry. In addition, the majority of jewel inventory is not mounted in finished jewelry settings and is therefore not subject to fashion trends, and product obsolescence is closely monitored and reviewed by management as of and for each financial reporting period.

The Company manufactures finished jewelry featuring moissanite and lab grown diamonds. Relative to loose moissanite jewels and lab grown diamonds, finished jewelry is more fashion-oriented and subject to styling trends that could render certain designs obsolete over time. The majority of the Company's finished jewelry featuring moissanite and lab grown diamonds is held in inventory for resale and largely consists of such core designs as stud earrings, solitaire and three-stone rings, pendants, and bracelets that tend not to be subject to significant obsolescence risk due to their classic styling. In addition, the Company generally holds smaller quantities of designer-inspired and trend moissanite fashion jewelry that is available for resale through retail companies and through its Online Channels segment. The Company also carries a limited amount of inventory as part of its sample line that is used in the selling process to its customers.

The Company's continuing operating subsidiaries carry no net inventories, and inventory is transferred without intercompany markup from the parent entity as product line cost of goods sold when sold to the end consumer.

The Company's inventories are stated at the lower of cost or net realizable value on an average cost basis. Each accounting period the Company evaluates the valuation and classification of inventories including the need for potential adjustments to inventory-related reserves, which also include significant estimates by management. Changes to the Company's inventory reserves and allowances are accounted for in the current accounting period in which a change in such reserves and allowances is observed and deemed appropriate, including changes in management's estimates used in the process to determine such reserves and valuation allowances.

## 6. RETURNS ASSET AND REFUND LIABILITIES

In connection with its revenue recognition accounting policy, the Company provides for a returns asset account and a refund liabilities account to record the effects of its estimated product returns and sales returns allowance. The Company's returns asset and refund liabilities are updated at the end of each financial reporting period and the effect of such changes are accounted for in the period in which such changes occur.

The Company estimates anticipated product returns in the form of a refund liability based on historical return percentages and current period sales levels. The Company also accrues a related returns asset for goods expected to be returned in salable condition, less any expected costs to recover such goods, including return shipping costs that the Company may incur. As of December 31, 2020 and June 30, 2020, the Company's refund liabilities balances were \$1.37 million and \$704,000, respectively, and are included as allowances for sales returns within accounts receivable, net, in the accompanying condensed consolidated balance sheets. As of December 31, 2020 and June 30, 2020, the Company's returns asset balances were \$578,000 and \$289,000, respectively, and are included within prepaid expenses and other assets in the accompanying condensed consolidated balance sheets.

## 7. ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued expenses and other liabilities, current, consist of the following as of the dates presented:

	December 31, 2020	June 30, 2020
Deferred revenue	\$ 619,677	\$ 794,740
Accrued compensation and related benefits	508,008	395,006
Accrued sales tax	497,609	295,651
Accrued severance	128,269	338,355
Accrued cooperative advertising	192,719	89,517
Other	1	9,063
Total accrued expenses and other liabilities	<u>\$ 1,946,283</u>	<u>\$ 1,922,332</u>

## 8. INCOME TAXES

The Company recognized an income tax net expense of approximately \$500 and an income tax net benefit of approximately \$5,000, respectively, related to estimated taxes, penalties, and interest associated with uncertain tax positions for the three months ended December 31, 2020 and 2019, and an income tax net expense of approximately \$1,000 and \$1,000, respectively, also related to estimated taxes, penalties, and interest associated with uncertain tax positions for the six months ended December 31, 2020 and 2019.

As of each reporting date, the Company's management considers new evidence, both positive and negative, that could impact its view with regard to future realization of deferred tax assets. As of December 31, 2020 and June 30, 2020, management determined that sufficient negative evidence continued to exist to conclude it was uncertain that the Company would have sufficient future taxable income to utilize its deferred tax assets. Therefore, the Company continued to maintain a full valuation allowance against its deferred tax assets as of December 31, 2020 and June 30, 2020.

**9. COMMITMENTS AND CONTINGENCIES*****Lease Arrangements***

On December 9, 2013, the Company entered into a Lease Agreement, as amended on December 23, 2013 and April 15, 2014 (the "Lease Agreement"), for its corporate headquarters, which occupies approximately 36,350 square feet of office, storage, and light manufacturing space and is classified as an operating lease for financial reporting purposes. The expiration date of the base term of the Lease Agreement in effect as of December 31, 2020 is October 31, 2021 and the terms of the Lease Agreement contain no early termination provisions. Provided there is no outstanding uncured event of default under this Lease Agreement, the Company has two options to extend the lease term for a period of five years under each option. The Company's option to extend the term of the Lease Agreement must be exercised in writing on or before 270 days prior to expiration of the then-current term. If the options are exercised, the monthly minimum rent for each of the extended terms will be adjusted to the then prevailing fair market rate.

The Company took possession of the leased property on May 23, 2014, once certain improvements to the leased space were completed and did not have access to the property before this date. These improvements and other lease related incentives offered by the landlord totaled approximately \$623,000, of which approximately \$393,000 was unamortized as of July 1, 2019, the effective date upon which the Company adopted the current lease accounting standard.

The Company has no other material operating leases and is not party to leases that would qualify for classification as a finance lease, variable lease or short-term lease.

As of December 31, 2020, the Company's balance sheet classifications of its leases are as follows:

Operating Leases:	
Noncurrent operating lease ROU assets	\$ 366,083
Current operating lease liabilities	\$ 527,761
Noncurrent operating lease liabilities	-
Total operating lease liabilities	\$ 527,761

The Company's total operating lease cost was approximately \$128,000 and \$117,000 for the three months ended December 31, 2020 and 2019, respectively. The Company's total operating lease cost was approximately \$260,000 and \$235,000 for the six months ended December 31, 2020 and 2019, respectively.

As of December 31, 2020, the Company's estimated incremental borrowing rate used and assumed discount rate with respect to operating leases was 7.14% and the remaining operating lease term was 0.83 years.

As of December 31, 2020, the Company's remaining future payments under operating leases for each fiscal year ending June 30 are as follows:

2021	\$ 322,234
2022	219,723
Total lease payments	541,957
Less: imputed interest	(14,196)
Present value of lease payments	527,761
Less: current lease obligations	527,761
Total long-term lease obligations	\$ -

The Company makes cash payments for amounts included in the measurement of its lease liabilities. During the three months ended December 31, 2020 and 2019, cash paid for operating leases was approximately \$170,000 and \$164,000, respectively. During the six months ended December 31, 2020 and 2019, cash paid for operating leases was approximately \$340,000 and \$328,000, respectively. Except for the ROU assets recorded upon adoption of the current lease accounting standard as of July 1, 2019, the Company has no new ROU assets obtained in exchange for new operating lease liabilities.



See Note 14, “Subsequent Event”, for details in connection with the Third Amendment (the “Lease Amendment”) to the Company’s Lease Agreement that was executed on January 29, 2021. The Lease Amendment includes, among other things, an extension of the base term of the lease to October 31, 2026; changes to the monthly minimum rent, including a specified rent abatement, during the extension period of the base term of the lease; an allowance by the landlord to reimburse the Company for certain direct costs incurred by the Company for improvements to the leased real property; and under certain conditions, an option to extend the term of the Lease Agreement beyond October 31, 2026 for one additional five-year period.

### ***Purchase Commitments***

On December 12, 2014, the Company entered into an exclusive supply agreement (the “Supply Agreement”) with Cree, Inc. (“Cree”). Under the Supply Agreement, subject to certain terms and conditions, the Company agreed to exclusively purchase from Cree, and Cree agreed to exclusively supply, 100% of the Company’s required SiC materials in quarterly installments that must equal or exceed a set minimum order quantity. The initial term of the Supply Agreement was scheduled to expire on June 24, 2018, unless extended by the parties.

Effective June 22, 2018, the Supply Agreement was amended to extend the expiration date to June 25, 2023. The Supply Agreement was also amended to (i) provide the Company with one option, subject to certain conditions, to unilaterally extend the term of the Supply Agreement for an additional two-year period following expiration of the initial term; (ii) establish a process by which Cree may begin producing alternate SiC material based on the Company’s specifications that will give the Company the flexibility to use the materials in a broader variety of its products; and (iii) permit the Company to purchase certain amounts of SiC materials from third parties under limited conditions.

Effective June 30, 2020, the Supply Agreement was further amended to extend the expiration date to June 29, 2025, which may be extended again by mutual agreement of the parties. The Supply Agreement was also amended to, among other things, (i) spread the Company’s total purchase commitment under the Supply Agreement in the amount of approximately \$52.95 million over the term of the Supply Agreement, as amended; (ii) establish a process by which Cree has agreed to accept purchase orders in excess of the agreed-upon minimum purchase commitment, subject to certain conditions; and (iii) permit the Company to purchase revised amounts of SiC materials from third parties under limited conditions.

The Company’s total purchase commitment under the Supply Agreement, as amended, until June 2025 is approximately \$52.95 million, of which approximately \$35.57 remains to be purchased as of December 31, 2020. Over the life of the Supply Agreement, as amended, the Company’s future minimum annual purchase commitments of SiC crystals range from approximately \$4 million to \$10 million each year.

During the six months ended December 31, 2020, the Company purchased approximately \$1.03 million of SiC crystals from Cree pursuant to the terms of the Supply Agreement, as amended. During the six months ended December 31, 2019, the Company purchased approximately \$4.98 million of SiC crystals from Cree.

### ***COVID-19 Update***

The global outbreak of the coronavirus disease 2019, or COVID-19, was declared a pandemic by the World Health Organization and a national emergency by the U.S. Government in March 2020 and has since negatively affected the U.S. and global economies, disrupted global supply chains, resulted in significant travel and transport restrictions, including mandated closures and orders to “shelter-in-place” and quarantine restrictions, and created significant disruption of the financial markets. Certain countries and jurisdictions, including some geographic areas of the U.S., have begun to return to significantly more stringent social, business, and travel-related restrictions due to the dramatic increase in new and variant strains of COVID-19 cases. Even in the absence of legal restrictions, businesses and individuals may voluntarily continue to limit in-person interactions and practice social distancing, and such behaviors may continue beyond the formal end of the pandemic. The level and nature of the disruption caused by COVID-19 is unpredictable, may be cyclical and long-lasting and may vary from location to location. The Company’s management has taken measures to protect the health and safety of the Company’s employees, work with the Company’s customers and suppliers to minimize disruptions, reduce the Company’s expenses, and support its community in addressing the challenges posed by this ongoing COVID-19 pandemic. The pandemic continues to present unprecedented business challenges and the Company has experienced impacts on its business related to the COVID-19 pandemic, primarily in increased coronavirus-related costs, delays in supplier deliveries, impacts of travel restrictions, access to some customer locations, the effects to net revenue related to reduced demand and store closures, and the impacts of remote work and adjusted work schedules.

The impact of the COVID-19 pandemic on the global and domestic economy is currently not fully known. The Company's operations have, to date, been operating under applicable governmental orders that have restricted activities in an effort to prevent further outbreak of COVID-19. As such, the Company is conducting business with certain modifications, including having non-operational personnel working remotely where applicable; limiting site access to necessary employees and critical third parties; enhancing the cleaning and disinfection of equipment and common areas, including engaging third-party specialists to disinfect personal workspaces; and issuing a quarantine policy regarding employees with COVID-19 symptoms or potential exposure, among other things. The Company's management continues to actively monitor the situation and may take further actions that alter the Company's business operations including any that may be required by federal, state or local authorities or that management determines are in the best interests of the Company's employees, customers, suppliers, vendors, communities and other stakeholders.

Despite these challenges, the Company's efforts, especially with regard to product fulfillment and supply chain management, helped to partially mitigate the disruptions caused by the COVID-19 pandemic on the Company's operations in the second quarter of its fiscal year ending June 30, 2021, or Fiscal 2021. However, the ultimate impact of the COVID-19 pandemic on the Company's operations and financial performance in Fiscal 2021, and future periods, including management's ability to execute its business plan and strategic initiatives in the expected timeframe, remains uncertain and will depend on future developments, including the duration and spread of the coronavirus disease and related actions taken by the U.S. Government, state and local government officials, and international governments to prevent and manage disease spread, including the global roll-out of COVID-19 vaccines, all of which are uncertain and cannot be predicted. The long-term impacts of the COVID-19 pandemic on global consumer buying behaviors, which impacts demand for our products and services, are also difficult to predict.

The Company also intends to take advantage of COVID-19 related tax credits for required paid leave provided by the Company. These eligible tax credits are determined by qualified emergency paid sick and expanded family and medical leave wages pursuant to the Families First Coronavirus Response Act ("FFCRA"). Under FFCRA, the Company has provided employees with paid federal sick and expanded family and medical leave benefits for which it may be reimbursed by the government through payroll tax credits. Qualifying wages for tax credit purposes under FFCRA are those paid to an employee who takes leave under FFCRA for a qualifying reason, up to the applicable per diem and aggregate payment caps. Applicable tax credits also extend to the employer's share of amounts paid or incurred to maintain a group health plan.

The Consolidated Appropriations Act, 2021 (the "Act"), which is the latest federal stimulus relief bill for the COVID-19 pandemic, was signed into law on December 27, 2020. Notably, this legislation provides that employers who received a PPP loan may also qualify for the Employee Retention Credit (the "ERC"), once certain shutdown-related gross receipts decline eligibility hurdles are met. Previously, pursuant to the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), taxpayers that received a PPP loan were not eligible for the ERC and this change is retroactive to March 27, 2020. While the Company has had minimal and partial short-term shutdowns related to the COVID-19 pandemic such that it has not utilized this aid, if future shutdowns are mandated and more extensive, the Company may be eligible to claim the ERC.

Finally, as permitted by the NC COVID-19 Relief Act, the Company expects to receive a tax credit towards its contributions to the North Carolina Unemployment Insurance Fund.

## 10. DEBT

### ***Paycheck Protection Program Loan***

The Company received a loan pursuant to the Paycheck Protection Program under the CARES Act, as administered by the U.S. Small Business Administration (the "SBA"). The loan in the principal amount of \$965,000 (the "PPP Loan") was disbursed by Newtek Small Business Finance, LLC, (the "Lender"), a nationally licensed lender under the SBA, on June 18, 2020 pursuant to a promissory note issued by the Company (the "Promissory Note") on June 15, 2020. The Company accounted for the Promissory Note as debt within the accompanying consolidated financial statements.

The Promissory Note matures June 18, 2022 and may be extended with the consent of the Lender under the provisions of the CARES Act. The Promissory Note bears interest at a fixed rate of 1% per annum. Pursuant to the terms of the Promissory Note, monthly principal and interest payments in the amount of approximately \$41,000 will commence on April 1, 2021. For financial reporting purposes, as of December 31, 2020, the classification of the current maturity of long-term debt assumes there will be no principal forgiveness, as allowed under certain conditions by the agreement, and principal repayment for the full outstanding principal amount of the PPP Loan is assumed to be spread in equal monthly installments over the period from April 1, 2021 through the maturity date of the Promissory Note.

As of the dates presented, the Company's total long-term debt is classified as follows:

	<b>December 31, 2020</b>	<b>June 30, 2020</b>
Current maturity of long-term debt	\$ 579,000	\$ 193,000
Long-term debt, net	386,000	772,000
Total long-term debt	<u>\$ 965,000</u>	<u>\$ 965,000</u>

### ***Line of Credit***

On July 13, 2018, the Company and its wholly-owned subsidiary, charlesandcolvard.com, LLC (collectively, the "Borrowers"), obtained a \$5.00 million asset-based revolving credit facility (the "White Oak Credit Facility") from White Oak. The White Oak Credit Facility may be used for general corporate and working capital purposes, including permitted acquisitions. The White Oak Credit Facility, which matures on July 13, 2021, is guaranteed by Charles & Colvard Direct, LLC, a wholly-owned subsidiary of the Company. Under the terms of the White Oak Credit Facility, the Borrowers must maintain at least \$500,000 in excess availability at all times. The White Oak Credit Facility contains no other financial covenants.

Advances under the White Oak Credit Facility may be either revolving or non-revolving. During the first year of the term of the White Oak Credit Facility, revolving advances accrued interest at a rate equal to one-month LIBOR (reset monthly, and subject to a 1.25% floor) plus 3.75%, and non-revolving advances accrued interest at such LIBOR rate plus 4.75%. Thereafter, the interest margins will reduce upon the Company's achievement of a specified fixed charge coverage ratio. However, advances are in all cases subject to a minimum interest rate of 5.50%. Interest is calculated on an actual/360 basis and payable monthly in arrears. Principal outstanding during an event of default accrues interest at a rate 2% in excess of the rate otherwise applicable.

As of December 31, 2020, the Company had not borrowed against the White Oak Credit Facility.

## **11. SHAREHOLDERS' EQUITY AND STOCK-BASED COMPENSATION**

### ***Shelf Registration Statement***

The Company has an effective shelf registration statement on Form S-3 on file with the U.S. Securities and Exchange Commission (the "SEC") which allows it to periodically offer and sell, individually or in any combination, shares of common stock, shares of preferred stock, warrants to purchase shares of common stock or preferred stock, and units consisting of any combination of the foregoing types of securities, up to a total of \$25.00 million, of which approximately \$13.99 million remains available after giving effect to the Company's June 2019 public offering, including the impact of the partial exercise of the underwriters' over-allotment option. However, the Company may offer and sell no more than one-third of its public float (which is the aggregate market value of the Company's outstanding common stock held by non-affiliates) in any 12-month period. The Company's ability to issue equity securities under its effective shelf registration statement is subject to market conditions, which are in turn, subject to, among other things, the disruption and volatility caused by the COVID-19 pandemic.

### ***Dividends***

The Company has paid no cash dividends during the current fiscal year through December 31, 2020.

## Stock-Based Compensation

The following table summarizes the components of the Company's stock-based compensation included in net income for the periods presented:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2020	2019	2020	2019
Employee stock options	\$ 50,176	\$ 48,189	\$ 141,216	\$ 112,064
Restricted stock awards	37,762	98,536	54,077	247,041
Totals	\$ 87,938	\$ 146,725	\$ 195,293	\$ 359,105

No stock-based compensation was capitalized as a cost of inventory during the three and six months ended December 31, 2020 and 2019.

## Stock Options

The following is a summary of the stock option activity for the six months ended December 31, 2020:

	Shares	Weighted Average Exercise Price
Outstanding, June 30, 2020	2,809,095	\$ 1.19
Granted	358,033	\$ 0.93
Exercised	(126,666)	\$ 0.91
Expired	(56,000)	\$ 1.90
Outstanding, December 31, 2020	2,984,462	\$ 1.16

The total fair value of stock options that vested during the six months ended December 31, 2020 was approximately \$613,000.

The following table summarizes information about stock options outstanding at December 31, 2020:

Options Outstanding			Options Exercisable			Options Vested or Expected to Vest		
Balance as of 12/31/2020	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of 12/31/2020	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of 12/31/2020	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
2,984,462	6.03	\$ 1.16	2,423,679	5.23	\$ 1.22	2,900,315	5.94	\$ 1.16

As of December 31, 2020, the unrecognized stock-based compensation expense related to unvested stock options was approximately \$230,000, which is expected to be recognized over a weighted average period of approximately 18 months.

The aggregate intrinsic value of stock options outstanding, exercisable, and vested or expected to vest at December 31, 2020 was approximately \$805,000. This amount is before applicable income taxes and represents the closing market price of the Company's common stock at December 31, 2020 less the grant price, multiplied by the number of stock options that had a grant price that is less than the closing market price. This amount represents the amount that would have been received by the optionees had these stock options been exercised on that date. The aggregate intrinsic value of stock options exercised during the six months ended December 31, 2020, was approximately \$48,000. No stock options were exercised during the six months ended December 31, 2019.

## Restricted Stock

The following is a summary of the restricted stock activity for the six months ended December 31, 2020:

	Shares	Weighted Average Grant Date Fair Value
Unvested, June 30, 2020	162,500	\$ 1.57
Granted	178,750	\$ 0.72
Canceled	(162,500)	\$ 1.57
Unvested, December 31, 2020	<u>178,750</u>	<u>\$ 0.72</u>

The unvested restricted shares as of December 31, 2020 are all performance-based restricted shares that are scheduled to vest, subject to achievement of the underlying performance goals, in July 2021. As of December 31, 2020, the estimated unrecognized stock-based compensation expense related to unvested restricted shares subject to achievement of performance goals was approximately \$74,000, all of which is expected to be recognized over a weighted average period of approximately seven months.

## 12. NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the periods. Diluted net income per common share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the periods. Common equivalent shares consist of stock options and unvested restricted shares that are computed using the treasury stock method. Anti-dilutive stock awards consist of stock options that would have been anti-dilutive in the application of the treasury stock method.

The following table reconciles the differences between the basic and diluted net income per share presentations:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2020	2019	2020	2019
Numerator:				
Net income	\$ 2,519,077	\$ 814,050	\$ 3,393,343	\$ 1,021,369
Denominator:				
Weighted average common shares outstanding:				
Basic	28,804,265	28,656,910	28,795,424	28,610,299
Effect of dilutive securities	458,437	589,661	184,585	589,577
Diluted	<u>29,262,702</u>	<u>29,246,571</u>	<u>28,980,009</u>	<u>29,199,876</u>
Net income per common share:				
Basic	\$ 0.09	\$ 0.03	\$ 0.12	\$ 0.04
Diluted	\$ 0.09	\$ 0.03	\$ 0.12	\$ 0.03

For the three and six months ended December 31, 2020 stock options to purchase approximately 2.53 million and 2.80 million shares, respectively, and for each of the three and six months ended December 31, 2019, stock options to purchase approximately 2.13 million shares were excluded from the computation of diluted net income per common share for each period presented herein. These shares are excluded from the computations of diluted net income per common share because the exercise price of the stock options for each of the periods presented was greater than the average market price of the common shares or the effect of inclusion of such amounts would be anti-dilutive to net income per common share. Approximately 179,000 and 325,000 shares of unvested restricted stock are excluded from the computation of diluted net income per common share as of December 31, 2020 and 2019, respectively, because the shares are performance-based and the underlying conditions have not been met as of the periods presented.

### 13. MAJOR CUSTOMERS AND CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents, and restricted cash and trade accounts receivable. At times, cash balances may exceed the Federal Deposit Insurance Corporation (“FDIC”) insurable limits of \$250,000 per depositor at each financial institution. The Company has never experienced any losses related to these balances. Non-interest-bearing amounts on deposit in excess of FDIC insurable limits at December 31, 2020 and June 30, 2020 approximated \$5.71 million and \$2.01 million, respectively. Interest-bearing amounts on deposit in excess of FDIC insurable limits at December 31, 2020 and June 30, 2020 approximated \$10.64 million and \$11.64 million, respectively.

Trade receivables potentially subject the Company to credit risk. Payment terms on trade receivables for the Company’s Traditional segment customers are generally between 30 and 90 days, though it may offer extended terms with specific customers and on significant orders from time to time. The Company extends credit to its customers based upon a number of factors, including an evaluation of the customer’s financial condition and credit history that is verified through trade association reference services, the customer’s payment history with the Company, the customer’s reputation in the trade, and/or an evaluation of the Company’s opportunity to introduce its moissanite jewels or finished jewelry featuring moissanite to new or expanded markets. Collateral is not generally required from customers. The need for an allowance for doubtful accounts is determined based upon factors surrounding the credit risk of specific customers, historical trends, and other information.

For additional information regarding the Company’s measurement and disclosure of credit losses on financial assets, including trade accounts receivable, see Note 4, “Fair Value Measurements.”

At times, a portion of the Company’s accounts receivable will be due from customers that have individual balances of 10% or more of the Company’s total gross accounts receivable. The following is a summary of customers that represent 10% or more of total gross accounts receivable as of the dates presented:

	<u>December 31, 2020</u>	<u>June 30, 2020</u>
Customer A	26%	26%
Customer B	17%	*%
Customer C	** %	14%
Customer D	** %	13%

\* Customer B did not have individual balances that represented 10% or more of total gross accounts receivable as of June 30, 2020.

\*\* Customer C and Customer D did not have individual balances that represented 10% or more of total gross accounts receivable as of December 31, 2020.

A significant portion of sales is derived from certain customer relationships. The following is a summary of customers that represent 10% or more of total net sales for the periods presented:

	<u>Three Months Ended December 31,</u>		<u>Six Months Ended December 31,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
Customer A	14%	13%	12%	13%
Customer C	*%	13%	10%	13%

\* Customer C did not have net sales that represented 10% or more of total net sales for the three months ended December 31, 2020.

**14. SUBSEQUENT EVENT**

Effective January 29, 2021, the Company entered into a third amendment (the “Lease Amendment”) to the Company’s Lease Agreement. The Lease Amendment, among other things, (i) extends the base term of the Lease Agreement from November 1, 2021 through October 31, 2026 (the “Extension Period”); (ii) sets forth the minimum monthly rents, including a specified rent abatement, during the Extension Period; (iii) provides for an allowance by the landlord to reimburse the Company for certain direct costs incurred for improvements to the leased real property; and (iv) provided there is no outstanding uncured event of default under the Lease Agreement, gives the Company the option to extend the term of the Lease Agreement beyond October 31, 2026 for one additional five-year period, in each case in accordance with the terms and subject to the conditions set forth therein. During the Extension Period, the Company’s minimum monthly rent payments range from approximately \$71,000 to \$79,000 each month.

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

*This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Statements expressing expectations regarding our future and projections relating to products, sales, revenues, and earnings are typical of such statements and are made under the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, statements about our plans, objectives, representations, and contentions and are not historical facts and typically are identified by use of terms such as "may," "will," "should," "could," "expect," "plan," "anticipate," "believe," "estimate," "predict," "continue," and similar words, although some forward-looking statements are expressed differently.*

*All forward-looking statements are subject to the risks and uncertainties inherent in predicting the future. You should be aware that although the forward-looking statements included herein represent management's current judgment and expectations, our actual results may differ materially from those projected, stated, or implied in these forward-looking statements as a result of many factors including, but not limited to, the following:*

- 1. Our business, financial condition and results of operations could continue to be adversely affected by an ongoing COVID-19 pandemic and related global economic conditions;*
- 2. Our future financial performance depends upon increased consumer acceptance, growth of sales of our products, and operational execution of our strategic initiatives;*
- 3. The execution of our business plans could significantly impact our liquidity;*
- 4. Our business and our results of operations could be materially adversely affected as a result of general and economic conditions;*
- 5. The financial difficulties or insolvency of one or more of our major customers or their lack of willingness and ability to market our products could adversely affect results;*
- 6. We face intense competition in the worldwide gemstone and jewelry industry;*
- 7. We are subject to certain risks due to our international operations, distribution channels and vendors;*
- 8. Our business and our results of operations could be materially adversely affected as a result of our inability to fulfill orders on a timely basis;*
- 9. We are currently dependent on a limited number of distributor and retail partners in our Traditional segment for the sale of our products;*
- 10. We rely on assumptions, estimates, and data to calculate certain of our key metrics and real or perceived inaccuracies in such metrics may harm our reputation and negatively affect our business;*
- 11. We may experience quality control challenges from time to time that can result in lost revenue and harm to our brands and reputation;*
- 12. Seasonality of our business may adversely affect our net sales and operating income;*
- 13. Our operations could be disrupted by natural disasters;*
- 14. Our loan, pursuant to the Paycheck Protection Program, or the PPP Loan, under the Coronavirus Aid, Relief, and Economic Security Act, or the CARES Act, as administered by the U.S. Small Business Administration, or the SBA, may not be forgiven or may subject us to challenges and investigations regarding qualification for the loan;*
- 15. We may not be able to adequately protect our intellectual property, which could harm the value of our products and brands and adversely affect our business;*
- 16. Negative or inaccurate information on social media could adversely impact our brand and reputation;*
- 17. Sales of moissanite and lab grown diamond jewelry could be dependent upon the pricing of precious metals, which is beyond our control;*
- 18. Our current customers may potentially perceive us as a competitor in the finished jewelry business;*
- 19. Our failure to maintain compliance with The Nasdaq Stock Market's continued listing requirements could result in the delisting of our common stock;*
- 20. We depend on an exclusive supply agreement, or the Supply Agreement, with Cree, Inc., or Cree, for substantially all of our silicon carbide, or SiC, crystals, the raw materials we use to produce moissanite jewels; if our supply of high-quality SiC crystals is interrupted, our business may be materially harmed;*
- 21. If the e-commerce opportunity changes dramatically or if e-commerce technology or providers change their models, our results of operations may be adversely affected;*
- 22. A failure of our information technology infrastructure or a failure to protect confidential information of our customers and our network against security breaches could adversely impact our business and operations;*
- 23. If we fail to evaluate, implement, and integrate strategic acquisition or disposition opportunities successfully, our business may suffer;*
- 24. Governmental regulation and oversight might adversely impact our operations; and*
- 25. Some anti-takeover provisions of our charter documents may delay or prevent a takeover of our company.*



*Forward-looking statements speak only as of the date they are made. We undertake no obligation to update or revise such statements to reflect new circumstances or unanticipated events as they occur except as required by the federal securities laws, and you are urged to review and consider disclosures that we make in the reports that we file with the Securities and Exchange Commission, or SEC, that discuss other factors relevant to our business.*

The following discussion is designed to provide a better understanding of our unaudited condensed consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance, and a summary of our operating results. This information should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q, and the consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended June 30, 2020, or the 2020 Annual Report. Historical results and percentage relationships related to any amounts in the condensed consolidated financial statements are not necessarily indicative of trends in operating results for future periods.

## **Overview**

### **Our Mission**

At Charles & Colvard, Ltd., our mission is to redefine the definition of real within the jewelry industry and for consumers everywhere. We believe fine jewelry can be accessible, beautiful, and conscientious.

### **About Charles & Colvard**

Charles & Colvard, Ltd., a North Carolina corporation founded in 1995 (which may be referred to as Charles & Colvard, we, us, or our) is a globally recognized lab created gemstone company specializing in fine jewelry. We manufacture, market, and distribute *Charles & Colvard Created Moissanite*<sup>®</sup> (which we refer to as moissanite or moissanite jewels) and on September 14, 2020, we announced our expansion into the lab grown diamond market with the launch of *Caydia*<sup>™</sup>, an exclusive brand of premium lab grown diamonds. We offer gemstones and finished jewelry featuring our proprietary moissanite jewels and premium lab grown diamonds for sale in the worldwide fine jewelry market. Charles & Colvard is the original source of created moissanite, and in 2015, we debuted *Forever One*<sup>™</sup>, our premium moissanite gemstone brand. As an e-commerce and multi-channel destination for fine jewelry featuring lab grown gemstones, we believe that the addition of lab grown diamonds is a natural progression for the Charles & Colvard brand.

One of our unique differentiators, moissanite – *The World's Most Brilliant Gem*<sup>®</sup> – is core to our ambition to create a movement around environmentally and socially responsible fine jewelry. We believe that we are leading the way in delivering the premium moissanite brand through technological advances in gemstone manufacturing, cutting, polishing, and setting. By coupling what we believe to be unprecedented moissanite jewels with responsibly sourced precious metals, we are delivering a uniquely positioned product line for the conscientious consumer. Our *Caydia*<sup>™</sup> lab grown diamonds are hand selected by our Gemological Institute of America, or GIA, certified gemologists to meet Charles & Colvard's uncompromising standards and validated by independent third-party experts. Our *Caydia*<sup>™</sup> lab grown diamonds are available currently in E, F, and G color grades (based on the GIA's color grading scale) with a minimum clarity in accordance with the GIA's VS1 clarity classification along with excellent cut, polish, and symmetry. All of our *Caydia*<sup>™</sup> lab grown diamonds are set with responsibly sourced precious metals.

Our strategy is to build a globally revered brand of lab created gemstones and finished jewelry that appeal to a wide consumer audience. We believe this strategy leverages our advantages of being the original and leading worldwide source of *Charles & Colvard Created Moissanite*<sup>®</sup> and offering a curated assortment of jewelry featuring *Caydia*<sup>™</sup> lab grown diamonds, which we believe offers an ideal combination of quality and value. We believe a direct relationship with consumers is important to this strategy, which entails delivering tailored educational content, engaging in dialogue with our audience, and positioning our brand to meet the demands of today's discerning consumer.

## COVID-19 Update

The global outbreak of the coronavirus disease 2019, or COVID-19, was declared a pandemic by the World Health Organization and a national emergency by the U.S. Government in March 2020 and has negatively affected the U.S. and global economies, disrupted global supply chains, resulted in significant travel and transport restrictions, including mandated closures and orders to “shelter-in-place” and quarantine restrictions, and created significant disruption of the financial markets. Certain countries and jurisdictions, including some geographic areas of the U.S., have begun to return to significantly more stringent social, business, and travel-related restrictions due to the dramatic increase in new and variant strains of COVID-19 cases. Even in the absence of legal restrictions, businesses and individuals may voluntarily continue to limit in-person interactions and practice social distancing, and such behaviors may continue beyond the formal end of the pandemic. The level and nature of the disruption caused by COVID-19 is unpredictable, may be cyclical and long-lasting and may vary from location to location. We have taken measures to protect the health and safety of our employees, work with our customers and suppliers to minimize disruptions, reduce our expenses, and support our community in addressing the challenges posed by this ongoing COVID-19 pandemic. The pandemic continues to present unprecedented business challenges, and we have experienced impacts on our business related to the COVID-19 pandemic, primarily in increased coronavirus-related costs, delays in supplier deliveries, impacts of travel restrictions, access to some customer locations, the effects to net revenue related to reduced demand and store closures, and the impacts of remote work and adjusted work schedules.

The impact of the COVID-19 pandemic on the global and domestic economy is currently not fully known. Our operations have, to date, been operating under applicable governmental orders that have restricted activities in an effort to prevent further outbreak of COVID-19. As such, we are conducting business with certain modifications, including having non-operational personnel working remotely where applicable; limiting site access to necessary employees and critical third parties; enhancing the cleaning and disinfection of equipment and common areas, including engaging third-party specialists to disinfect personal workspaces; and issuing a quarantine policy regarding employees with COVID-19 symptoms or potential exposure, among other things. We continue to actively monitor the situation and may take further actions that alter our business operations including any that may be required by federal, state or local authorities or that we determine are in the best interests of our employees, customers, suppliers, vendors, communities and other stakeholders.

Despite these challenges, our efforts, especially with regard to product fulfillment and supply chain management, helped to partially mitigate the disruptions caused by the COVID-19 pandemic on our operations in the second quarter of our fiscal year ending June 30, 2021, or Fiscal 2021. In addition, strong net sales performance in our Online Channels segment during the calendar year-end 2020 holiday season and an overall reduction in costs and operating expenses resulting from cost-savings initiatives implemented by us have helped to offset the adverse impacts of the COVID-19 pandemic on our financial results in our second fiscal quarter. However, the ultimate impact of the COVID-19 pandemic on our operations and financial performance in Fiscal 2021 and future periods, including our ability to execute our business plan and strategic initiatives in the expected timeframe, remains uncertain and will depend on future developments, including the duration and recent increased spread of the coronavirus disease and related actions taken by the U.S. Government, state and local government officials, and international governments to prevent and manage disease spread, including the global roll-out of COVID-19 vaccines, all of which are uncertain and cannot be predicted. The long-term impacts of the COVID-19 pandemic on global consumer buying behaviors, which impacts demand for our products and services, are also difficult to predict.

For additional risks to the Company related to the COVID-19 pandemic, see “Part II, Item 1A. Risk Factors”, contained in our 2020 Annual Report.

## Fiscal 2021 Financial Trends

Currently, our financial outlook for Fiscal 2021 is subject to various risks and uncertainties and is based on assumptions that we believe in good faith are reasonable, but which may be materially different from actual results. The full extent of the impact of the COVID-19 pandemic on our operational and financial performance remains uncertain and continues to depend on many factors outside of our control, including, without limitation: the timing, extent, trajectory and duration of the pandemic particularly in light of the recent dramatic increases in new and variant strains of COVID-19 cases in the U.S. to the extent such outbreak would impact the local geographic region in which our business principally operates; the development and availability of effective treatments and the long-term effects of the recently implemented global vaccine rollout; the imposition of protective public safety measures; and the impact of the pandemic on the global economy and demand for consumer products. We expect the COVID-19 pandemic will continue to have an adverse impact on our business, results of operations, financial condition, and liquidity during Fiscal 2021. Due to the potentially significant impact on our operations of the COVID-19 pandemic, including governmental responses to prevent further outbreak of COVID-19, current period results are not necessarily indicative of expected performance for other interim periods or our full Fiscal 2021. We expect the COVID-19 pandemic will continue to have an adverse impact on our business, results of operations, financial condition, and liquidity during Fiscal 2021.

As we manage through these challenging times, our strategic focus for Fiscal 2021 remains centered on the expansion of Charles & Colvard's brand on a global scale and to continue increasing the size of our business through top-line disciplined growth by leveraging existing resources. We believe that lab-created gemstones, including our premier moissanite products, *Forever One*<sup>™</sup> and *Moissanite by Charles & Colvard*<sup>®</sup> and our lab grown diamond product line, *Caydia*<sup>™</sup>, are now being embraced by worldwide markets. We also believe that our ability to elevate our own lab-created gemstones - including both moissanite jewels and lab grown diamonds - and the Charles & Colvard brand directly with consumers is key to our future success and ability to continue fueling our growth. We intend to elevate the Charles & Colvard name by making it synonymous with quality, value, and price. Notwithstanding the global challenges we face in Fiscal 2021, we plan to execute on our key strategies with an ongoing commitment to spending judiciously and generating sustainable earnings improvement.

We discuss our key strategies for Fiscal 2021 in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations", contained in our 2020 Annual Report.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which we prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses and related disclosures of contingent assets and liabilities. "Critical accounting policies and estimates" are defined as those most important to the financial statement presentation and that require the most difficult, subjective, or complex judgments. We base our estimates on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Under different assumptions and/or conditions, including the impact of the COVID-19 pandemic and the related responses, those actual results of operations may materially differ. We have disclosed our critical accounting policies and estimates in our 2020 Annual Report, and that disclosure should be read in conjunction with this Quarterly Report on Form 10-Q. Except as set forth below, there have been no significant changes in our critical accounting policies and estimates during the first six months of Fiscal 2021.

For a discussion regarding our adoption of the new accounting standard related to the measurement and disclosure of credit losses on financial instruments, see Note 2 to our condensed consolidated financial statements in Item 1, "Financial Statements", of this Quarterly Report on Form 10-Q.

## Results of Operations

The following table sets forth certain consolidated statements of operations data for the three and six months ended December 31, 2020 and 2019:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2020	2019	2020	2019
Net sales	\$ 12,146,790	\$ 10,659,090	\$ 20,073,083	\$ 18,267,511
Costs and expenses:				
Cost of goods sold	6,167,708	5,530,514	10,363,763	9,407,138
Sales and marketing	2,480,571	3,160,965	4,128,503	5,390,556
General and administrative	977,528	1,203,686	2,185,564	2,553,187
Total costs and expenses	9,625,807	9,895,165	16,677,830	17,350,881
Income from operations	2,520,983	763,925	3,395,253	916,630
Other income (expense):				
Interest income	1,126	45,379	4,586	106,758
Interest expense	(2,466)	(277)	(4,905)	(419)
Loss on foreign currency exchange	(72)	(314)	(603)	(853)
Total other (expense) income, net	(1,412)	44,788	(922)	105,486
Income before income taxes	2,519,571	808,713	3,394,331	1,022,116
Income tax (expense) benefit	(494)	5,337	(988)	(747)
Net income	\$ 2,519,077	\$ 814,050	\$ 3,393,343	\$ 1,021,369

## Consolidated Net Sales

Consolidated net sales for the three and six months ended December 31, 2020 and 2019 comprise the following:

	Three Months Ended December 31,		Change		Six Months Ended December 31,		Change	
	2020	2019	Dollars	Percent	2020	2019	Dollars	Percent
	Finished jewelry	\$ 8,265,197	\$ 6,438,347	\$ 1,826,850	28%	\$ 12,600,534	\$ 10,296,342	\$ 2,304,192
Loose jewels	3,881,593	4,220,743	(339,150)	-8%	7,472,549	7,971,169	(498,620)	-6%
Total consolidated net sales	\$ 12,146,790	\$ 10,659,090	\$ 1,487,700	14%	\$ 20,073,083	\$ 18,267,511	\$ 1,805,572	10%

Consolidated net sales were \$12.15 million for the three months ended December 31, 2020 compared to \$10.66 million for the three months ended December 31, 2019, an increase of approximately \$1.49 million, or 14%. Consolidated net sales were \$20.07 million for the six months ended December 31, 2020 compared to \$18.27 million for the six months ended December 31, 2019, an increase of approximately \$1.81 million, or 10%. The increase in consolidated net sales for the three and six months ended December 31, 2020 was due primarily to strong calendar year-end holiday sales and increased consumer awareness and strong demand for our moissanite jewels, lab grown diamonds, and finished jewelry featuring both moissanite and lab grown diamonds. These increases resulted in higher finished jewelry product net sales during the three and six months ended December 31, 2020 in our Online Channels segment and Traditional segment. The increases in our Online Channels segment net sales in the three and six months ended December 31, 2020 were partially offset by lower net sales in our Traditional segment driven by lower loose jewels sales and decreased international sales during the three and six months ended December 31, 2020.

Sales of finished jewelry represented 68% and 63% of total consolidated net sales for the three and six months ended December 31, 2020, respectively, compared to 60% and 56%, respectively, of total consolidated net sales for the corresponding periods of the prior year. For the three months ended December 31, 2020, finished jewelry sales were \$8.27 million compared to \$6.44 million for the corresponding period of the prior year, an increase of approximately \$1.83 million, or 28%. For the six months ended December 31, 2020, finished jewelry sales were \$12.60 million compared to \$10.30 million for the corresponding period of the prior fiscal year, an increase of approximately \$2.30 million, or 22%. The increase in finished jewelry sales for the three- and six-month periods ended December 31, 2020 was due primarily to higher finished jewelry sales of *Forever One™* and *Moissanite by Charles & Colvard®* in our Online Channels segment as well as in our Traditional segment.

Sales of loose jewels represented 32% and 37% of total consolidated net sales for the three and six months ended December 31, 2020, respectively, compared to 40% and 44%, respectively, of total consolidated net sales for the corresponding periods of the prior fiscal year. For the three months ended December 31, 2020, loose jewel sales were \$3.88 million compared to \$4.22 million for the corresponding period of the prior year, a decrease of \$339,000, or 8%. For the six months ended December 31, 2020, loose jewel sales were \$7.47 million compared to \$7.97 million for the corresponding period of the prior fiscal year, a decrease of \$500,000, or 6%. The decrease in loose jewels sales for the three- and six-month periods ended December 31, 2020 was primarily due to lower levels of sales principally through the international distributor network in our Traditional segment.

U.S. net sales accounted for approximately 94% of total consolidated net sales for each of the three- and six-month periods ended December 31, 2020, compared to 90% of total consolidated net sales for each of the corresponding periods of the prior year. U.S. net sales increased to \$11.39 million, or 18%, during the three months ended December 31, 2020 from the corresponding period of the prior fiscal year. U.S. net sales increased to \$18.89 million, or 15%, during the six months ended December 31, 2020 from the corresponding period of the prior year. U.S. net sales increased during the three and six months ended December 31, 2020 primarily as a result of increased sales to U.S. customers in both our Online Channels segment and Traditional segment.

Our largest U.S. customer during the three and six months ended December 31, 2020 accounted for 14% and 12% of total consolidated net sales during each respective period. This same customer was also one of our two largest U.S. customers during the three and six months ended December 31, 2019 when this customer accounted for 13% of total consolidated net sales during each of the respective three- and six-month periods. Our second largest U.S. customer during the six months ended December 31, 2020 accounted for 10% of total consolidated net sales during the period then ended. This same customer was also one of our two largest U.S. customers during the three and six months ended December 31, 2019, when this customer accounted for 13% of total consolidated net sales during each of the respective three- and six-month periods. We expect that we will remain dependent on our ability, and that of our largest customers, to maintain and enhance retail programs. A change in or loss of any of these customer or retailer relationships could have a material adverse effect on our results of operations.

International net sales accounted for approximately 6% of total consolidated net sales for each of the three- and six-month periods ended December 31, 2020, respectively, compared to 10% of total consolidated net sales for each of the corresponding periods of the prior year. International net sales decreased 25% and 36% during the three and six months ended December 31, 2020, respectively, from the corresponding periods of the prior fiscal year principally as a result of lower demand in our international distributor market, which was partially offset by growth in our direct-to-consumer presence internationally reflecting solid direct-to-consumer sales from our Online Channels segment in international markets. In light of the effects of ongoing global economic conditions, we continue to evaluate these and other potential distributors in international markets to determine the best long-term partners. As a result, and in light of the ongoing worldwide pandemic and international trade challenges, we expect our sales in these markets to continue to fluctuate significantly each reporting period.

We did not have an international customer account for 10% or more of total consolidated sales during the three and six months ended December 31, 2020 or 2019. A portion of our international consolidated sales represents jewels sold internationally that may be re-imported to U.S. retailers.

## Costs and Expenses

### Cost of Goods Sold

Cost of goods sold for the three and six months ended December 31, 2020 and 2019 are as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2020	2019			2020	2019		
Product line cost of goods sold:								
Finished jewelry	\$ 4,002,146	\$ 2,964,114	\$ 1,038,032	35%	\$ 5,756,435	\$ 4,667,024	\$ 1,089,411	23%
Loose jewels	1,805,603	2,081,654	(276,051)	-13%	3,549,525	3,881,106	(331,581)	-9%
Total product line cost of goods sold	5,807,749	5,045,768	761,981	15%	9,305,960	8,548,130	757,830	9%
Non-product line cost of goods sold	359,959	484,746	(124,787)	-26%	1,057,803	859,008	198,795	23%
Total cost of goods sold	\$ 6,167,708	\$ 5,530,514	\$ 637,194	12%	\$ 10,363,763	\$ 9,407,138	\$ 956,625	10%

Total cost of goods sold was \$6.17 million for the three months ended December 31, 2020 compared to \$5.53 million for the three months ended December 31, 2019, a net increase of approximately \$637,000, or 12%. Total cost of goods sold was \$10.36 million for the six months ended December 31, 2020 compared to \$9.41 million for the six months ended December 31, 2019, an increase of approximately \$957,000, or 10%. Product line cost of goods sold is defined as product cost of goods sold in each of our Online Channels segment and Traditional segment excluding non-capitalized expenses from our manufacturing and production control departments, comprising personnel costs, depreciation, rent, utilities, and corporate overhead allocations; freight out; inventory write-offs; and other inventory adjustments, comprising costs of quality issues, and damaged goods.

The increase in cost of goods sold for the three months ended December 31, 2020 compared to the same period in 2019 was primarily driven by increased sales of finished jewelry, which reflect higher material and labor costs, in both our Online Channels segment and Traditional segment as a result of strong demand during the calendar year-end 2020 holiday season. Our finished jewelry products cost more to produce due to higher material and labor costs when compared to the production of loose jewels.

The net decrease in non-product line cost of goods sold for the three months ended December 31, 2020, comprises a favorable \$167,000 change in other inventory adjustments principally relating to positive changes in production standard cost variances compared to the three months ended December 31, 2019. The net decrease in non-product line cost of goods sold was also related to an approximate \$101,000 change in inventory valuation adjustments primarily related to favorable changes in obsolescence reserves in the current period compared to those in the comparable prior year period as well as an approximate \$32,000 decrease in non-capitalized manufacturing and production control expenses principally due to the timing when work-in-process is received into inventory and overhead costs are allocated. These decreases in non-product line cost of goods sold were offset in part by an approximate \$175,000 increase in freight out from increased shipments resulting from Online Channels segment sales growth during the quarter ended December 31, 2020.

The increase in cost of goods sold for the six months ended December 31, 2020 compared to the same period in 2019 was also primarily driven by the increased finished jewelry sales in both our Online Channels segment and Traditional segment as a result of strong sales during the calendar year-end 2020 holiday season.

The net increase in non-product line cost of goods sold for the six months ended December 31, 2020, comprises an unfavorable \$116,000 change in other inventory adjustments principally related to adverse changes in production standard cost variances compared to the six months ended December 31, 2019. The net increase in non-product line cost of goods sold was also related to an approximate \$220,000 increase in freight out from increased shipments resulting from Online Channels segment sales growth during the six months ended December 31, 2020. These increases in non-product line cost of goods sold were offset in part by an approximate \$93,000 decrease in non-capitalized manufacturing and production control expenses principally due to the timing when work-in-process is received into inventory and overhead costs are allocated as well as an approximate \$44,000 change in inventory valuation allowances primarily related to favorable changes in obsolescence reserves in the six months ended December 31, 2020, compared to those in the comparable prior year period.

For additional disclosure relating to non-product line cost of goods sold, see Note 3 to our condensed consolidated financial statements in Item 1, “Financial Statements”, of this Quarterly Report on Form 10-Q.

### Sales and Marketing

Sales and marketing expenses for the three and six months ended December 31, 2020 and 2019 are as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2020	2019			2020	2019		
Sales and marketing	\$ 2,480,571	\$ 3,160,965	\$ (680,394)	-22%	\$ 4,128,503	\$ 5,390,556	\$ (1,262,053)	-23%

Sales and marketing expenses were \$2.48 million for the three months ended December 31, 2020 compared to \$3.16 million for the three months ended December 31, 2019, a decrease of approximately \$680,000, or 22%. Sales and marketing expenses were \$4.13 million for the six months ended December 31, 2020 compared to \$5.39 million for the six months ended December 31, 2019, a decrease of approximately \$1.26 million, or 23%.

The decrease in sales and marketing expenses for the three months ended December 31, 2020 compared to the same period in 2019 was primarily due to a \$418,000 decrease in compensation-related expenses; a \$321,000 decrease in advertising and digital marketing expenses; a \$14,000 decrease in travel expenses as a result of COVID-19 cost-control measures; and a \$6,000 decrease in software-related costs compared with those incurred in the prior year associated with upgraded operating system maintenance agreements. These decreases were partially offset by a \$51,000 increase in general office-related expenses primarily due to increased credit card transaction fees associated with a higher level of online sales; a \$26,000 increase in depreciation and amortization principally associated with the capitalization of costs relating to information technology-related upgrades; and a \$2,000 increase in professional services principally comprising non-recurring consulting information technology services.

Compensation expenses for the three months ended December 31, 2020 compared to the same period in 2019 decreased primarily due to a \$337,000 decrease in salaries, commissions, and related employee benefits in the aggregate; a \$67,000 decrease in bonus expense; and a \$14,000 decrease in employee stock-based compensation expense. All three of these compensation-related expense decreases reflect our June 2020 management reorganization and workforce reduction.

The decrease in advertising and digital marketing expenses for the three months ended December 31, 2020 compared to the same period in 2019 comprises a \$148,000 decrease in Internet marketing; a \$98,000 decrease in outside agency fees; a \$55,000 decrease in cooperative advertising; and a \$20,000 decrease in promotion-related expenses.

The decrease in sales and marketing expenses for the six months ended December 31, 2020 compared to the same period in 2019 was primarily due to an \$819,000 decrease in compensation-related expenses; a \$457,000 decrease in advertising and digital marketing expenses; a \$56,000 decrease in professional services fees principally comprising non-recurring consulting services for cybersecurity and merchandising imaging in the prior year period; and a \$21,000 decrease in travel expenses as a result of COVID-19 cost-control measures. These decreases were partially offset by a \$49,000 increase in general office-related expenses, which are principally related to higher credit card transaction fees from increased online sales levels; a \$30,000 increase in depreciation and amortization expense relating to capitalized costs associated with information technology-related upgrades; and a \$12,000 increase in software-related costs principally in connection with maintenance agreements as well as other software-related agreements.

Compensation expenses for the six months ended December 31, 2020 compared to the same period in 2019 decreased primarily as a result of a \$655,000 decrease in salaries, commissions, and related employee benefits in the aggregate; a \$114,000 decrease in bonus expense; and a \$52,000 decrease in employee stock-based compensation expense. All three of these compensation-related expense decreases reflect our June 2020 management reorganization and workforce reduction. These decreases were partially offset by a \$2,000 increase in employee-related severance costs.

The decrease in advertising and digital marketing expenses for the six months ended December 31, 2020 compared to the same period in 2019 comprises a \$190,000 decrease in Internet marketing; a \$174,000 decrease in cooperative advertising; an \$88,000 decrease in outside agency fees; and an \$8,000 decrease in print media expenses. These decreases were partially offset by a \$3,000 increase in promotion-related expenses.

### General and Administrative

General and administrative expenses for the three and six months ended December 31, 2020 and 2019 are as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,				December 31,			
	2020	2019	Dollars	Percent	2020	2019	Dollars	Percent
General and administrative	\$ 977,528	\$ 1,203,686	\$ (226,158)	-19%	\$ 2,185,564	\$ 2,553,187	\$ (367,623)	-14%

General and administrative expenses were \$978,000 for the three months ended December 31, 2020 compared to \$1.20 million for the three months ended December 31, 2019, a decrease of approximately \$226,000, or 19%. General and administrative expenses were \$2.19 million for the six months ended December 31, 2020 compared to \$2.55 million for the six months ended December 31, 2019, a decrease of approximately \$368,000, or 14%.

The decrease in general and administrative expenses for the three months ended December 31, 2020 compared to the same period in 2019 was primarily due to a \$118,000 decrease in professional services; an \$83,000 decrease in compensation expenses; and a \$45,000 decrease in bad debt expense associated with our allowance for doubtful accounts reserve policy. These decreases were partially offset by a \$7,000 increase in insurance expenses, principally related to higher renewal premiums; a \$3,000 increase in depreciation and amortization expense; a \$2,000 increase in equipment-related rental expense; a \$2,000 increase in business taxes and licenses; and a \$6,000 net increase in miscellaneous other general and administrative expenses.

Professional services fees decreased for the three months ended December 31, 2020 compared to the same period in 2019 primarily due to a \$73,000 decrease in legal fees resulting from non-recurring non-capitalized fees incurred in connection with our underwritten public offering and corporate governance matters in the prior year; a \$30,000 decrease in investor relations fees; a \$12,000 decrease in accounting services also principally related to non-recurring fees associated with our underwritten public offering in the prior year; and a \$3,000 decrease in consulting and other professional services.

Compensation expenses decreased for the three months ended December 31, 2020 compared to the same period in 2019 principally due to a \$39,000 decrease in salaries and related employee benefits in the aggregate; a \$22,000 decrease in bonus expense; and a \$22,000 decrease in employee stock-based compensation expense. All three of these compensation-related expense decreases reflect our June 2020 management reorganization and workforce reduction.

The decrease in general and administrative expenses for the six months ended December 31, 2020 compared to the same period in 2019 was primarily due to a \$247,000 decrease in professional services; a \$197,000 decrease in compensation expenses; and a \$9,000 decrease in Board retainer fees as a result of the resignation of a former Director in September 2019. These decreases were partially offset by a \$24,000 increase in insurance expenses principally related to higher renewal premiums; a \$16,000 increase in bad debt expense associated with our allowance for doubtful accounts reserve policy; a \$14,000 increase in software-related costs principally in connection with maintenance agreements as well as other software-related agreements; an \$8,000 increase in travel-related expenses; a \$7,000 increase in bank charges as a result of transaction fees associated with increased online transactions; a \$6,000 increase in business taxes and licenses; a \$4,000 increase in equipment-related rental expense; a \$4,000 increase in depreciation and amortization expense; and a \$2,000 net increase in miscellaneous other general and administrative expenses.

Professional services fees decreased for the six months ended December 31, 2020 compared to the same period in 2019 primarily due to a \$159,000 decrease in legal fees resulting from non-recurring non-capitalized fees incurred in connection with our underwritten public offering and corporate governance matters in the prior year; a \$45,000 decrease in accounting services also principally related to non-recurring fees associated with our underwritten public offering in the prior year; a \$33,000 decrease in investor relations fees; and a \$10,000 decrease in consulting and other professional services.



Compensation expenses decreased for the six months ended December 31, 2020 compared to the same period in 2019 principally due to a \$93,000 decrease in salaries and related employee benefits in the aggregate; a \$55,000 decrease in employee stock-based compensation expense; and a \$49,000 decrease in bonus expense. All three of these compensation-related expense decreases reflect our June 2020 management reorganization and workforce reduction.

### Interest Income

Interest income for the three and six months ended December 31, 2020 and 2019 is as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2020	2019			2020	2019		
Interest income	\$ 1,126	\$ 45,379	\$ (44,253)	-98%	\$ 4,586	\$ 106,758	\$ (102,172)	-96%

In June 2019, we completed an underwritten public offering of 6,250,000 shares of our common stock, which together with the partial exercise of the underwriters' over-allotment option for an additional 630,500 shares in July 2019, resulted in net proceeds of approximately \$9.99 million. The net proceeds from this offering, along with excess operating cash, are deposited into and maintained in an interest-bearing account with a federally insured commercial bank. Accordingly, during the three and six months ended December 31, 2020 and 2019, we earned interest from cash on deposit in this interest-bearing account. The decrease in earned interest reflects adverse changes in interest rate fluctuations during the first half of Fiscal 2021 compared with the first half of Fiscal 2020.

### Interest Expense

Interest expense for the three and six months ended December 31, 2020 and 2019 is as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2020	2019			2020	2019		
Interest expense	\$ 2,466	\$ 277	\$ 2,189	790%	\$ 4,905	\$ 419	\$ 4,486	1,071%

On June 18, 2020, we received the proceeds from our Paycheck Protection Program Loan, or the PPP Loan, pursuant to the Paycheck Protection Program under the Coronavirus Aid, Relief, and Economic Security Act, or the CARES Act, as administered by the U.S. Small Business Administration, or SBA. The PPP Loan in the principal amount of \$965,000 was disbursed by Newtek Small Business Finance, LLC, or the Lender, pursuant to a promissory note, or the Promissory Note, dated June 15, 2020. We accounted for the Promissory Note as debt within the accompanying consolidated financial statements. Accordingly, during the three and six months ended December 31, 2020, we incurred interest on the Promissory Note. We had no debt during the comparable periods in the prior fiscal year.

### Loss on Foreign Currency Exchange

Losses on foreign currency exchange related to foreign sales transacted in functional currencies other than the U.S. dollar for the three and six months ended December 31, 2020 and 2019 are as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2020	2019			2020	2019		
Loss on foreign currency exchange	\$ 72	\$ 314	\$ (242)	-77%	\$ 603	\$ 853	\$ (250)	-29%

During the three and six months ended December 31, 2020 and 2019, we had international sales transactions denominated in currencies other than the U.S. dollar that resulted in foreign currency exchange net losses. The decrease in these losses reflects the lower level of international sales during the three and six months ended December 31, 2020 compared with the same periods in the prior year.

## **Provision for Income Taxes**

We recognized income tax net expense of \$500 and income tax net benefit of approximately \$5,000 for the three-month periods ended December 31, 2020 and 2019, respectively. We recognized income tax net expense of approximately \$1,000 and \$1,000 for the six-month periods ended December 31, 2020 and 2019, respectively. Income tax provisions in these periods primarily relate to estimated taxes, penalties, and interest associated with uncertain tax positions.

As of each reporting date, management considers new evidence, both positive and negative, that could impact its view with regard to future realization of deferred tax assets. Beginning in 2014, management determined that negative evidence outweighed positive evidence and established a full valuation allowance against our deferred tax assets. We maintained a full valuation allowance against our deferred taxes as of December 31, 2020 and June 30, 2020.

## **Liquidity and Capital Resources**

The impact of the COVID-19 pandemic on the global and domestic economy is currently not fully known. With the dramatic increase in new and variant strains of COVID-19 infection levels around the world, many geographical regions, including some parts of the U.S., are reimposing tighter social and business restrictions in an effort to prevent further outbreak of COVID-19. Accordingly, the world continues to adapt to the ongoing COVID-19 pandemic and its adverse effects on global economics and business operations. The impact of the COVID-19 pandemic continues to place unprecedented pressures on global and U.S. businesses including our own. The ongoing spread of the coronavirus disease continues to lead to business disruption and volatility in the global capital markets, which, depending on future developments, including the success of the global vaccine efforts to control the spread of the underlying virus, could further adversely impact our capital resources and liquidity in the future. We remain increasingly focused on the COVID-19 pandemic and are continually evaluating its potential effect on our business and liquidity and capital resources.

### ***Capital Structure and Long-Term Debt***

As disclosed above, on June 18, 2020, we received the proceeds from our PPP Loan, pursuant to the CARES Act, as administered by the SBA. The PPP Loan in the principal amount of \$965,000 was disbursed by the Lender pursuant to the Promissory Note, dated June 15, 2020.

Under the CARES Act and the Promissory Note, loan forgiveness is available, subject to certain conditions, for the sum of documented payroll costs, covered rent payments, and covered utilities during the 24-week period beginning on the date of first disbursement of the PPP Loan. For purposes of the CARES Act, payroll costs exclude cash compensation of an individual employee in excess of \$100,000, prorated annually. Not more than 40% of the forgiven amount can be attributable to non-payroll costs. Although we currently believe that our use of the PPP Loan will meet the conditions for forgiveness for a portion of the PPP Loan, we cannot assure our future adherence to the forgiveness criteria and that the PPP Loan will be forgiven, in whole or in part.

The CARES Act provides that existing AMT credit carryforwards are now eligible for acceleration and refundable AMT credits are to be completely refunded to companies for taxable years beginning in 2019, or by election, taxable years beginning in 2018. Accordingly, we elected to have the AMT tax completely refunded and filed a refund claim for the remaining AMT tax credit. The full amount of the remaining balance of our AMT credit refund in the amount of approximately \$272,000 was refunded by the Internal Revenue Service in October 2020.

We also intend to take advantage of COVID-19 related tax credits for required paid leave provided by us. These eligible tax credits are determined by qualified emergency paid sick and expanded family and medical leave wages pursuant to the Families First Coronavirus Response Act, or FFCRA. Under FFCRA, we have provided employees with paid federal sick and expanded family and medical leave benefits for which we may be reimbursed by the government through payroll tax credits. Qualifying wages for tax credit purposes under FFCRA are those paid to an employee who takes leave under FFCRA for a qualifying reason, up to the applicable per diem and aggregate payment caps. Applicable tax credits also extend to the employer's share of amounts paid or incurred to maintain a group health plan.

The Consolidated Appropriations Act, 2021, or the Act, which is the latest federal stimulus relief bill for the COVID-19 pandemic, was signed into law on December 27, 2020. Notably, this legislation provides that employers who received a PPP loan may also qualify for the Employee Retention Credit, or ERC, once certain shutdown-related gross receipts decline eligibility hurdles are met. Previously, pursuant to the CARES Act, taxpayers that received a PPP loan were not eligible for the ERC and this change is retroactive to March 27, 2020. While we have had minimal short-term shutdowns related to the COVID-19 pandemic such that we have not utilized this aid, if future shutdowns are mandated and more extensive, we may be eligible to claim the ERC.

Finally, as permitted by the NC COVID-19 Relief Act, we will receive a tax credit towards our contributions to the North Carolina Unemployment Insurance Fund, which will also serve to further enhance future cash flow.

As a component of our liquidity and capital structure, we have an effective shelf registration statement on Form S-3 on file with the SEC which allows us to periodically offer and sell, individually or in any combination, shares of common stock, shares of preferred stock, warrants to purchase shares of common stock or preferred stock, and units consisting of any combination of the foregoing types of securities, up to a total of \$25.00 million, of which approximately \$13.99 million remains available after giving effect to our June 2019 public offering, including the impact of the partial exercise of the underwriters' over-allotment option, described below. However, we may offer and sell no more than one-third of our public float (which is the aggregate market value of our outstanding common stock held by non-affiliates) in any 12-month period. Our ability to issue equity securities under the shelf registration statement is subject to market conditions, which are in turn, subject to the disruption and volatility being caused by the ongoing COVID-19 pandemic. Any capital raise is not assured and may not be at terms that would be acceptable to us.

### ***Financing Activities***

In June 2019, we completed an underwritten public offering of 6,250,000 newly issued shares of common stock, at a price to the public of \$1.60 per share, pursuant to our effective shelf registration statement on Form S-3. Net proceeds from the offering were approximately \$9.06 million, net of the underwriting discount and fees and expenses. Pursuant to the terms of the underwriting agreement entered into in connection with this offering, the underwriters were granted a 30-day option to buy up to an additional 937,500 shares of our common stock to cover over-allotments. Pursuant to the partial exercise of the underwriters' over-allotment option, in July 2019, we issued an additional 630,500 shares of our common stock at a price of \$1.60 per share for net proceeds of approximately \$932,000, net of the underwriting discount and fees and expenses of approximately \$77,000. After giving effect to the partial exercise of the over-allotment option, we sold an aggregate of 6,880,500 shares of our common stock at a price of \$1.60 per share with total gross proceeds of approximately \$11.01 million, before deducting the underwriting discount and fees and expenses of approximately \$1.02 million. Early during Fiscal 2020, we began using the aggregate net proceeds of approximately \$9.99 million from the offering for marketing and for general corporate and working capital purposes. However, in response to the COVID-19 pandemic and its impact on consumer confidence and spending, management drastically reduced related advertising and digital marketing expenditures in mid-March 2020. We will continue to monitor and adjust our advertising and digital marketing and professional services expenditure levels to correspond to the e-commerce market disruption and volatility being caused by the ongoing COVID-19 pandemic. However, we plan to maintain these reduced advertising and digital marketing expenditure levels for the foreseeable future.

As discussed above, on June 18, 2020 we received a PPP Loan in the principal amount of \$965,000 from the Lender pursuant to a Promissory Note dated June 15, 2020. The Promissory Note matures June 18, 2022 and may be extended with the consent of the Lender under the provisions of the CARES Act. The Promissory Note bears interest at a fixed rate of 1% per annum. Pursuant to the terms of the Promissory Note, monthly principal and interest payments in the amount of approximately \$41,000 will commence on April 1, 2021. For financial reporting purposes as of December 31, 2020, the classification of the current maturity of this long-term debt assumes there will be no principal forgiveness and principal repayment for the full outstanding principal amount of the PPP Loan will be spread in equal monthly installments over the period from April 1, 2021 through the maturity date of the Promissory Note.

We did not provide any collateral or guarantees for the PPP Loan, nor did we pay any facility charge to obtain the PPP Loan. The Promissory Note provides for customary events of default, including, among others, those relating to failure to make payment and breaches of representations. We may prepay the principal of the PPP Loan at any time without incurring any prepayment charges.

## ***Operating Activities and Cash Flows***

We require cash to fund our operating expenses and working capital requirements, including outlays for capital expenditures. As of December 31, 2020, our principal sources of liquidity were cash, cash equivalents and restricted cash totaling \$16.87 million, trade accounts receivable of \$3.06 million, and net current inventory of \$12.07 million, as compared to cash and cash equivalents totaling \$14.62 million, trade accounts receivable of \$671,000, and net current inventory of \$7.44 million as of June 30, 2020. As described more fully herein, we also have long-term debt in the amount of \$965,000, of which \$579,000 is classified as its current maturity as of December 31, 2020, and access to a \$5.00 million asset-based revolving credit facility with White Oak, or the White Oak Credit Facility.

During the six months ended December 31, 2020, our working capital increased by approximately \$9.94 million to \$27.36 million from \$17.42 million at June 30, 2020. As described more fully below, the increase in working capital at December 31, 2020 is primarily attributable to an increase in our allocation of inventory from long-term to short-term, an increase in our accounts receivable, an increase in our cash, cash equivalents, and restricted cash resulting from cash provided by our operations, a decrease in our accounts payable, an increase in our prepaid expenses and other assets, and a decrease in our short-term operating lease liabilities. These factors were offset partially by an increase in the current maturity of our long-term debt and an increase in our accrued expenses and other liabilities.

During the six months ended December 31, 2020, approximately \$2.41 million of cash was provided by our operations. The primary drivers of our cash flows from operations were the favorable effect of net income in the amount of \$3.39 million; a decrease in inventory of \$1.86 million; a decrease in prepaid expenses and other assets of \$62,000; and an increase in accrued income taxes in the amount of \$1,000. In addition, the net effect of non-cash items included in net income totaling \$1.25 million also favorably impacted net cash provided by operating activities during the six months ended December 31, 2020. These factors were offset partially by an increase in accounts receivable of \$3.07 million; a decrease in accounts payable of \$816,000; and a decrease in accrued expenses and other liabilities of \$274,000.

Accounts receivable increased principally due to the increased level of sales during the six months ended December 31, 2020 as compared with the sales during the period leading up to June 30, 2020. As a result of the COVID-19 pandemic, we offered extended Traditional segment customer payment terms beyond 90 days to certain credit-worthy customers during the first half of Fiscal 2021 and second half of Fiscal 2020. Because of the ongoing impact of the pandemic on the global economy, the extension of these terms may not immediately increase liquidity as a result of ongoing current-period sales, which we expect to continue to be pressured due to the effects of the ongoing COVID-19 pandemic. In addition, we believe our competitors and other vendors in the wholesale jewelry industry have expanded their use of extended payment terms and, in aggregate, we believe that, through our use of extended payment terms, we provide a competitive response in our market during the current global economic environment. We believe that we are unable to estimate the impact of these actions on our net sales, but we believe that if we ceased providing extended payment terms, we would be at a competitive disadvantage for some Traditional segment customers in the marketplace during this economic period and that our net sales and profits would likely be adversely impacted.

We manufactured approximately \$6.36 million in finished jewelry and \$3.76 million in loose jewels, which includes the cost of the loose jewels and the purchase of precious metals and labor in connection with jewelry production, during the six months ended December 31, 2020. We expect our purchases of precious metals and labor to increase as we increase our finished jewelry business. In addition, the price of gold has increased significantly over the past decade, and more significantly over the last 12 months, resulting in higher retail price points for gold jewelry. Because the market price of gold and other precious metals is beyond our control, the upward price trends could continue and have a negative impact on our operating cash flow as we manufacture finished jewelry.

Historically, our raw material inventories of SiC crystals had been purchased under exclusive supply agreements with a limited number of suppliers. Because the supply agreements restricted the sale of these crystals exclusively to us, the suppliers negotiated minimum purchase commitments with us that, when combined with reduced sales levels during prior periods in which the purchase commitments were in effect, have resulted in levels of inventories that are higher than we might otherwise maintain. As of December 31, 2020 and June 30, 2020, \$16.59 million and \$23.19 million, respectively, of our inventories were classified as long-term assets. Loose jewel sales and finished jewelry that we manufacture will utilize both the finished goods loose jewels currently on-hand and, as we deplete certain shapes and sizes, our on-hand raw material SiC crystals of \$2.06 million and new raw material that we purchase pursuant to the Supply Agreement.

Our more detailed description of our inventories is included in Note 5 to our condensed consolidated financial statements in Part I, Item 1, “Financial Statements”, of this Quarterly Report on Form 10-Q.

As of December 31, 2020, we had approximately \$309 of remaining federal income tax credits that expire in 2021 and can be carried forward to offset future income taxes. As of December 31, 2020, we also had a federal tax net operating loss carryforward of approximately \$23.72 million expiring between 2022 and 2037, which can be used to offset against future federal taxable income; North Carolina tax net operating loss carryforwards of approximately \$20.12 million expiring between 2023 and 2033; and various other state tax net operating loss carryforwards expiring between 2021 and 2040, which can be used to offset against future state taxable income.

### ***Contractual Commitment***

On December 12, 2014, we entered into the Supply Agreement with Cree. Under the Supply Agreement, subject to certain terms and conditions, we agreed to exclusively purchase from Cree, and Cree agreed to exclusively supply, 100% of our required SiC materials in quarterly installments that must equal or exceed a set minimum order quantity. The initial term of the Supply Agreement was scheduled to expire on June 24, 2018, unless extended by the parties. Effective June 22, 2018, the Supply Agreement was amended to extend the expiration date to June 25, 2023. The Supply Agreement, as amended, also provides for the exclusive production of our premium moissanite product, Forever One™ and provided us with one option, subject to certain conditions, to unilaterally extend the term of the Supply Agreement for an additional two-year period following the expiration of the initial term. In addition, the amendment to the Supply Agreement established a process by which Cree may begin producing alternate SiC material based on our specifications that will give us the flexibility to use the materials in a broader variety of our products, as well as to permit us to purchase certain amounts of SiC materials from third parties under limited conditions. On August 26, 2020, the Supply Agreement was further amended, effective June 30, 2020, to extend the expiration date to June 29, 2025, which may be further extended by mutual agreement of the parties. The Supply Agreement was also amended to, among other things, (i) spread our total purchase commitment under the Supply Agreement in the amount of approximately \$52.95 million over the term of the Supply Agreement, as amended; (ii) establish a process by which Cree has agreed to accept purchase orders in excess of the agreed-upon minimum purchase commitment, subject to certain conditions; and (iii) permit us to purchase revised amounts of SiC materials from third parties under limited conditions. Our total purchase commitment under the Supply Agreement, as amended, until June 2025 is approximately \$52.95 million, of which approximately \$35.57 million remains to be purchased as of December 31, 2020.

During the six months ended December 31, 2020, we purchased approximately \$1.03 million of SiC crystals from Cree pursuant to the terms of the Supply Agreement, as amended. Going forward, we expect to use existing cash and cash equivalents and access to other working capital resources, including but not limited to the issuance of equity securities, together with future cash expected to be provided by operating activities and, if necessary, our White Oak Credit Facility, to finance our purchase commitment under the Supply Agreement, as amended.

### ***Line of Credit***

On July 13, 2018, we and our wholly-owned subsidiary, charlesandcolvard.com, LLC, collectively referred to as the Borrowers, obtained the \$5.00 million asset-based revolving White Oak Credit Facility. The White Oak Credit Facility may be used for general corporate and working capital purposes, including permitted acquisitions. The White Oak Credit Facility, which matures on July 13, 2021, is guaranteed by Charles & Colvard Direct, LLC, another of our wholly-owned subsidiaries. Under the terms of the White Oak Credit Facility, the Borrowers must maintain at least \$500,000 in excess borrowing availability at all times. The White Oak Credit Facility contains no other financial covenants.

Advances under the White Oak Credit Facility may be either revolving or non-revolving. During the first year of the term of the White Oak Credit Facility, revolving advances accrued interest at a rate equal to one-month LIBOR (reset monthly, and subject to a 1.25% floor) plus 3.75%, and non-revolving advances accrued interest at such LIBOR rate plus 4.75%. Thereafter, the interest margins will reduce upon our achievement of a specified fixed charge coverage ratio. However, advances are in all cases subject to a minimum interest rate of 5.50%. Interest is calculated on an actual/360 basis and payable monthly in arrears. Principal outstanding during an event of default accrues interest at a rate 2% in excess of the rate otherwise applicable.

As of December 31, 2020, we had not borrowed against the White Oak Credit Facility. As a result of our diminished borrowing base as of December 31, 2020, which is tied to our accounts receivable, our ability to draw down funds from the White Oak Credit Facility may from time to time be restricted.

## **Liquidity and Capital Trends**

We believe that our existing cash and cash equivalents and access to other working capital resources, including but not limited to the access to federal government economic relief programs pursuant to the CARES Act, including our existing PPP Loan and the available conditional forgiveness of the PPP Loan in whole or in part, access to available federal and state tax-related considerations, the issuance of equity securities, and future cash expected to be provided by operating activities combined will be sufficient to meet our working capital and capital expenditure needs over the next twelve months.

Our future capital requirements and the adequacy of available funds will depend on many factors, including the ongoing spread of COVID-19 that could lead to further disruption and volatility in the global capital markets as well as its impact on our rate of sales growth; the expansion of our sales and marketing activities; the timing and extent of raw materials and labor purchases in connection with loose jewel production to support our moissanite jewels and lab grown diamonds business and precious metals and labor purchases in connection with jewelry production to support our finished jewelry business; the timing of capital expenditures; and the risk factors described in more detail in “Risk Factors” in Part II, Item 1A of this Quarterly Report on Form 10-Q, in Part II, Item 1A of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2020, and in Part I, Item 1A of our 2020 Annual Report on Form 10-K. Currently, we have the White Oak Credit Facility through its expiration on July 13, 2021, that we believe would mitigate these risks to our cash and liquidity position. Also, we may make investments in, or acquisitions of, complementary businesses, which could also require us to seek additional equity or debt financing.

As of December 31, 2020, we had not borrowed against the White Oak Credit Facility.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Not applicable.

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective at the reasonable assurance level.

#### **Changes in Internal Control Over Financial Reporting**

We routinely review our internal control over financial reporting and from time to time make changes intended to enhance the effectiveness of our internal control over financial reporting. We will continue to evaluate the effectiveness of our disclosure controls and procedures and internal control over financial reporting on an ongoing basis and will take action as appropriate. During the three months ended December 31, 2020, we made no changes to our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, that we believe materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

There are no material pending legal proceedings to which we are a party or to which any of our property is subject.

### Item 1A. Risk Factors

We discuss in our Annual Report on Form 10-K for the fiscal year ended June 30, 2020 and our Quarterly Report on Form 10-Q for the quarter September 30, 2020 various risks that may materially affect our business. There have been no material changes to such risks.

### Item 5. Other Information

On January 29, 2021, we entered into a third amendment, or Lease Amendment, to our lease agreement, or Lease Agreement, with SBP Office Owner, L.P., successor-in-interest to Southport Business Park Limited Partnership, relating to space leased by us for our corporate headquarters at 170 Southport Drive, Morrisville, North Carolina 27560. The Lease Amendment, among other things, (i) extends the base term of the Lease Agreement from November 1, 2021 through October 31, 2026, or the Extension Period; (ii) sets forth the minimum monthly rents, including a specified rent abatement, during the Extension Period; (iii) provides for an allowance by the landlord to reimburse us for certain direct costs we incur for improvements to the leased real property; and (iv) provided there is no outstanding uncured event of default under the Lease Agreement, gives us the option to extend the term of the Lease Agreement beyond October 31, 2026 for one additional five-year period, in each case on the terms and subject to the conditions set forth therein. During the Extension Period, our minimum monthly rent payments range from approximately \$71,000 to \$79,000 each month.

The foregoing is only a summary description of the terms of the Lease Amendment, does not purport to be complete and is qualified in its entirety by reference to the Lease Amendment, which is filed as Exhibit 10.5 to this Quarterly Report on Form 10-Q and incorporated herein by reference.

**Item 6. Exhibits**

The following exhibits are being filed herewith and are numbered in accordance with Item 601 of Regulation S-K:

<u>Exhibit No.</u>	<u>Description</u>
<a href="#">10.1</a>	Letter Agreement, effective March 22, 2010, between Charles & Colvard, Ltd. and Cree.**
<a href="#">10.2</a>	Amendment to Letter Agreement, effective February 8, 2013, between Charles & Colvard, Ltd. and Cree, Inc.**
<a href="#">10.3</a>	Second Amendment to Letter Agreement, effective September 5, 2013, between Charles & Colvard, Ltd. and Cree, Inc.**
<a href="#">10.4</a>	Exclusive Supply Agreement, effective as of December 12, 2014 by and between Charles & Colvard, Ltd. and Cree, Inc., and, solely for purposes of Section 6(c) of the Exclusive Supply Agreement, Charles & Colvard Direct, LLC, and Moissanite.com, LLC**
<a href="#">10.5</a>	Third Amendment to Lease Agreement, dated January [00], 2021, between Charles & Colvard, Ltd. and SBP Office Owner, L.P., successor to Southport Business Park Limited Partnership
<a href="#">31.1</a>	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<a href="#">31.2</a>	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<a href="#">32.1</a>	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
<a href="#">32.2</a>	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from Charles & Colvard, Ltd.'s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2020 formatted in XBRL (eXtensible Business Reporting Language) and furnished electronically herewith: (i) Condensed Consolidated Balance Sheets; (ii) Condensed Consolidated Statements of Operations; (iii) Condensed Consolidated Statements of Changes in Shareholders' Equity; (iv) Condensed Consolidated Statements of Cash Flow; and (v) Notes to Condensed Consolidated Financial Statements.
**	Asterisks located within the exhibit denote information which has been redacted pursuant to Item 601(b)(10)(iv) of Regulation S-K because it is both not material and would cause in all likelihood competitive harm to us if publicly disclosed.



## 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.

### **CHARLES & COLVARD, LTD.**

February 4, 2021

By: /s/ Don O'Connell  
Don O'Connell  
President and Chief Executive Officer

February 4, 2021

By: /s/ Clint J. Pete  
Clint J. Pete  
Chief Financial Officer  
(Principal Financial Officer and Chief Accounting Officer)

March 22, 2010

Randy N. McCullough  
CEO  
Charles & Colvard, Ltd.  
300 Perimeter Park, Suite A  
Morrisville, North Carolina 27560

Stephen D. Kelley  
Chief Operating Officer  
Cree, Inc.  
4600 Silicon Drive  
Durham, North Carolina 27703

This letter, when signed on behalf of Charles & Colvard, Ltd. (“C&C”) and Cree, Inc. (“Cree”), will serve as an agreement between C&C and Cree, effective as of the date first set forth above (the “Agreement”), to amend the parties' letter agreement dated November 12, 2007 (which was effective on and after December 25, 2007 and previously amended by the letter dated September 18, 2008) (the “Letter Agreement”) and to document such other mutual agreements as set forth herein. Except as expressly provided herein, the supply and purchase of SiC Materials will be governed by the terms and conditions of the parties' Amended and Restated Exclusive Supply Agreement dated June 6, 1997 (the “Supply Agreement”, as amended). Capitalized terms used herein which are not defined herein but are defined in the Supply Agreement shall have the meanings specified in the Supply Agreement.

1. Cree and C&C agree that C&C is obligated to purchase [\*\*\*] kilograms of SiC production crystals previously manufactured by Cree for C&C pursuant the Letter Agreement at a price of \$[\*\*\*] per gram for grade 10 and \$[\*\*\*] per gram for grade 20. This material was previously graded and approved by C&C as “usable material” in accordance with the applicable specifications (Reference: Attachment A).
  2. Notwithstanding any contrary language in the Letter Agreement, Cree and C&C agree that on or before March 31, 2010, and each calendar month thereafter, C&C will purchase at least [\*\*\*] kilograms of this previously manufactured SiC production crystals until the full amount (i.e., [\*\*\*] kilograms) of the material identified in Paragraph 1 has been purchased by C&C.
  3. Notwithstanding any contrary language in the Supply Agreement, the following new provisions shall apply to purchase orders for SiC Materials (other than those orders contemplated by Paragraph 2 above) placed on or after the date of this Agreement (each a “New Order”):
    - (a) Lead time for each New Order shall be [\*\*\*] months. For example, for delivery of newly manufactured SiC Materials in [\*\*\*], a New Order must be placed by C&C in [\*\*\*]. When [\*\*\*], Cree will advise C&C of any reduction in the applicable lead time for subsequent orders; and
    - (b) The minimum order quantity for each New Order placed by C&C in accordance with the terms defined by the Supply Agreement shall be [\*\*\*] kilograms.
  4. **Planning:** On or before the first day of each calendar quarter during the Term of this Agreement, starting with the calendar quarter beginning on October 1, 2010, C&C will submit to Cree via facsimile or e-mail a rolling forecast of its projected requirements for SiC Materials to be purchased from Cree during the next four (4) calendar quarters in a format to be agreed upon by the parties. Although such forecasts are for planning purposes only and do not represent a commitment by C&C to purchase or Cree to sell any SiC Materials, C&C will endeavor to submit timely and accurate forecasts to ensure that Cree has the most current information available to anticipate and plan its production schedule.
  5. When the rolling forecast first indicates that newly manufactured SiC Materials are needed by C&C in [\*\*\*] months, Cree and C&C will begin proactive discussions on the specifications and prices that will be applicable to such materials, including any necessary changes in the crystal diameter and grading process due to interim changes in Cree's manufacturing process. Consistent with past practices, the parties shall agree in writing on prices, quarterly quantities, and any necessary modifications to the specifications prior to the resumption of New Orders; provided however, this provision does not alter the rights and duties of the parties under the Supply Agreement.
-

6. To the parties' knowledge, as of the effective date of this Agreement there are no existing defaults under the Supply Agreement nor events which have occurred that, with the giving of notice or the passing of time, will become a default under the Supply Agreement.
7. The contents of this Agreement shall be considered "Confidential Information" of each party subject to the provisions of Section 5 of the Supply Agreement.

ACKNOWLEDGED AND AGREED:

CHARLES & COLVARD, LTD.

CREE, INC.

By: /s/ Randy N. McCullough  
Randy N. McCullough  
Chief Executive Officer

By: /s/ John T. Kurtzweil  
John T. Kurtzweil  
Chief Financial Officer

Date: March 24, 2010

Date: March 23, 2010

Cree, Inc. and Charles and Colvard, Ltd. Proprietary

## ATTACHMENT A

### Specification of usable material as referenced in paragraph 1 above.

The quantity of "usable material" of crystals delivered to C&C pursuant to the Letter Agreement will be determined according to the following:

- A. Material will be graded according to the specifications defined below.
- B. Grams of usable material will be calculated on a crystal-by-crystal basis according to the following equation: (usable mm) as a percent of total length of the crystal in mm multiplied by the actual weight of the crystal in grams. "Usable mm" means millimeters of usable material as defined in Attachment A.
- C. Crystals shipped to C&C must contain at least [\*\*\*] grams of usable material for the 2" crystals, [\*\*\*] grams for 2.25" crystals, [\*\*\*] grams for 2.40" crystals or [\*\*\*] grams for 3" crystals. This usable area must be contiguous. Crystal diameter to be shipped will be 2", 2.25", 2.40" or 3", as determined by Cree.

**COLOR:** Usable material is calculated as "light gray" or "very light gray". Specifically tone/color number 20 and 10 as used in the C&C boule-grading screen will be considered acceptable tone and color material. (Note: Grade 10 is preferred. Grade 20 material will be valued at \$[\*\*\*] per-gram.)

### **DEFECTS:**

Material volume of acceptable color will be reduced by the percentage of the defects listed in the table below. C&C shall set the acceptable standards for the quality of both the color and defects of all material purchased pursuant to the Letter Agreement. Unless otherwise mutually agreed by the parties in writing, however, the grading of the material by both Cree and C&C will adhere to those standards and methods identified in Notes 1 & 2 below, applied on a consistent basis in the same manner as applied during September, October and November of calendar 2003. Should C&C deem such standards and methods or new defects unacceptable, it can request changes to its volume commitment or the methods, standards or list of price reducing defects, with such changes to be effective sixty (60) days after giving Cree notice of the changes. Cree may request changes to its pricing and/or volume commitment. If the parties do not agree in writing on the changes to be made, before the effective date of the requested changes, either party can terminate the Letter Agreement upon notice and, in that event, the Supply Agreement will govern the parties' obligations thereafter.

ID	D-Type	
1	[***]	Reduce
2	[***]	Reduce
3	[***]	Reduce
4	[***]	No reduction
5	[***]	Reduce
6	[***]	Reduce
7	[***]	No reduction
8	[***]	Reduce
9	[***]	Reduce

### **Notes**

- 1 CH0257R 17.4mm tone/color 20 (lightest 20), new gray boules that are lighter than this will grade as 10, CE0269R 9.5mm tone/color 30 (lightest 30), new gray boules that are lighter than this will grade as 20
- 2 Micropipe grading will be performed according to the Cree document identified as the CCG – 948 Rev C, Dense Fine Pipe Grading procedure (Revision 8/17/06). The area determined according to this procedure multiplied by 1.2, ("20% adder"), defines the area of non-usable material for micropipes.

Cree, Inc. and Charles and Colvard, Ltd. Proprietary

February 1, 2013

Via Email

Randy N. McCullough  
Chief Executive Officer  
Charles & Colvard, Ltd.  
300 Perimeter Park, Suite A  
Morrisville, North Carolina 27560

Dear Randy:

This document serves as an amendment to the Letter Agreement between the parties dated March 22, 2010 (“Letter Agreement”). Except as expressly set forth in the Letter Agreement, as modified herein, the supply and purchase of SiC Materials will be governed in all respects by the terms and conditions of the parties’ Amended and Restated Exclusive Supply Agreement dated June 6, 1997 (the “Supply Agreement,” as amended). Capitalized terms used herein that are not defined shall have the meanings specified in the Letter Agreement or the Supply Agreement, as the case may be.

Pursuant to C&C’s recent verbal request for the supply of newly-manufactured SiC Materials on an expedited basis (*that is*, earlier than the lead time prescribed under the Letter Agreement), Cree agrees to use its best efforts to satisfy such need for SiC Materials on the terms provided herein:

**1) Timeline for the Reestablishment of Manufacturing Capability, Production of Sample Material and Fulfillment of Initial New Order.**

- (a) By way of background, under the terms of the Letter Agreement, the parties agreed that a lead time of [\*\*\*\*] months for the fulfillment of each New Order for SiC Materials was reasonable, based upon the time required for Cree to reestablish its manufacturing capability. The parties further agreed that once [\*\*\*\*], the lead time required for subsequent orders could be reduced by Cree in its discretion.
  - (b) Notwithstanding the foregoing agreements and understandings, upon its receipt of an initial New Order consisting of SiC Materials requirements amounting to no less than \$4 million to be delivered by [\*\*\*\*], Cree will use best efforts to reestablish the necessary manufacturing capability and begin producing a limited quantity of sample material as soon as reasonably possible, with the goal of submitting such sample material to C&C for review within [\*\*\*\*] from the date of Cree’s receipt of such order.
  - (c) C&C acknowledges and agrees that in no event will Cree commence the mass manufacture of SiC Materials in fulfillment of the volume of SiC Materials required under the initial New Order until such sample material demonstrates to the reasonable satisfaction of the parties that such materials satisfy the specifications agreed to herein in all material respects. Upon receipt of the sample material, C&C will promptly verify whether the sample material meets the applicable specifications. Following confirmation from C&C, Cree will ramp up production and will commence weekly deliveries as SiC Materials meeting the specifications are produced until the total initial New Order quantity is produced and delivered. C&C agrees to accept such deliveries when made notwithstanding the due date set forth in the initial New Order. It is anticipated that with both parties acting reasonably, the requested volume of SiC Materials set forth under the initial New Order will be delivered no later than [\*\*\*\*].
-

- 2) **New Order Requirements.** In recognition of the redeployment of personnel and capital expenditure necessary to reestablish the manufacturing capability to fulfill the requirements under the initial New Order, C&C agrees to (a) issue a non-cancellable New Order for the supply of SiC Materials to be delivered in the [\*\*\*\*] quarter of [\*\*\*\*] upon delivery of \$[\*\*\*\*] of SiC Materials pursuant to the initial New Order; and (b) issue non-cancellable New Orders for SiC Materials for delivery in each consecutive calendar quarter thereafter during the remainder of the term of the Supply Agreement. The minimum order quantity for each New Order after the initial New Order shall be [\*\*\*\*] kilograms for delivery in the [\*\*\*\*] quarter of [\*\*\*\*], [\*\*\*\*] kilograms for delivery in the [\*\*\*\*] quarter of [\*\*\*\*], [\*\*\*\*] kilograms for delivery in [\*\*\*\*] quarter of [\*\*\*\*], and [\*\*\*\*] kilograms for delivery in the [\*\*\*\*] quarters of [\*\*\*\*] and for each quarter shall request weekly delivery in nearly equal quantities per week.
- 3) **Specifications.** Notwithstanding anything to the contrary in the Supply Agreement, Cree agrees to provide C&C with crystals of a quality and grade that is similar in all materials respects with the requirements set forth under Attachment A of the Letter Agreement. The parties acknowledge and agree that any changes to the foregoing specifications must be mutually agreed upon by the parties in writing and could impact Cree's manufacturing process, leading to changes in the price or delivery of SiC Materials hereunder.
- 4) **Price.** \$[\*\*\*\*]/gram for grade 10; \$[\*\*\*\*]/gram for grade 20. The parties agree that the foregoing pricing shall be subject to change from time to time based upon improvements made by Cree to the specifications of the SiC Materials.
- 5) **Exclusivity.** Exclusivity shall remain in effect as provided in the Supply Agreement.

The contents of this amendment to the Letter Agreement shall be considered "Confidential Information" of each party subject to the provisions of Section 5 of the Supply Agreement. No amendment or modification of this amendment shall be effective unless reduced to writing and executed by an officer of each party hereto.

If the foregoing terms and conditions meet with your approval, please execute this document where indicated below and return a signed copy to my attention via fax at (919) [\*\*\*\*] or via email at [\*\*\*\*].

Regards,

/s/ David T. Emerson  
David T. Emerson  
Vice President – Chips and Materials

AGREED AND ACCEPTED BY:  
CHARLES & COLVARD, LTD.

By /s/ Randy N. McCullough  
Name Randy N. McCullough  
Title Chief Executive Officer  
Date 2/8/13

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[Cree, Inc. Letterhead]

September 5, 2013

Mr. Randy N. McCullough  
Chief Executive Officer  
Charles & Colvard, Ltd.  
300 Perimeter Park, Suite A  
Morrisville, North Carolina 27560

Dear Randy:

This document (the "Second Amendment") serves as an amendment to the letter agreement between Charles & Colvard, Ltd. ("C&C") and Cree, Inc. ("Cree") dated March 22, 2010 (the "2010 Agreement") and previously amended by the letter dated February 1, 2013 (the "First Amendment") (collectively, the "Letter Agreement"). Except as expressly set forth in the Letter Agreement, as modified herein, the supply and purchase of SiC Materials will be governed in all respects by the terms and conditions of the parties' Amended and Restated Exclusive Supply Agreement dated June 6, 1997 (the "Supply Agreement," as amended). Capitalized terms used herein which are not defined herein shall have the meanings specified in the Letter Agreement or the Supply Agreement, as the case may be.

1. Cree will supply SiC production crystals to C&C, and C&C will purchase SiC production crystals from Cree, according to the terms stated in the Letter Agreement, as modified herein.
2. Cree will provide 1.5" SiC production crystals for sale to C&C for \$\$[\*\*\*\*]/gram for Grade 10 and \$[\*\*\*\*]/gram for Grade 20. Cree may fulfill C&C's outstanding purchase orders [\*\*\*\*] as agreed. All delivered orders [\*\*\*\*] will be applied toward C&C's outstanding purchase orders [\*\*\*\*] and its New Order requirements in paragraph 2 of the First Amendment. The quantity of "usable material" in 1.5" crystals delivered to C&C pursuant to the Letter Agreement will be graded according to the specifications in Attachment A of the 2010 Agreement.

The contents of this Second Amendment will be considered "Confidential Information" of each party subject to the provisions of Section 5 of the Supply Agreement. No amendment or modification of this Second Amendment or the Letter Agreement shall be effective unless reduced to writing and executed by an authorized representative of each party hereto. Except as modified by this Second Amendment, the Letter Agreement and the Supply Agreement shall remain in full force and effect in accordance with their terms and conditions.

If the foregoing terms and conditions meet with your approval, please execute this Second Amendment where indicated below and return a signed copy to my attention via fax at (919) [\*\*\*\*] or via email at [\*\*\*\*].

Regards,

/s/ David T. Emerson  
David T. Emerson  
Vice President – Chips and Materials

AGREED AND ACCEPTED BY:  
CHARLES & COLVARD, LTD.

By: /s/ Randy N. McCullough  
Randy N. McCullough, CEO

## **EXCLUSIVE SUPPLY AGREEMENT**

**This Exclusive Supply Agreement** (“Agreement”) dated as of December 12, 2014 (the “Effective Date”), is entered into by and between CHARLES & COLVARD, LTD., a North Carolina corporation, with its principal place of business at 170 Southport Drive, Morrisville, North Carolina 27560 (“C&C”), CREE, INC., a North Carolina corporation, with its principal place of business located at 4600 Silicon Dr., Durham, North Carolina 27703 (“Cree”), and, solely for purposes of Section 6(c), Charles & Colvard Direct, LLC (“C&C Direct”) and Moissanite.com, LLC (“Moissanite”; C&C, C&C Direct, and Moissanite may be referred to herein individually as an “Obligor” and collectively as “Obligors”). C&C and Cree may be referred to hereinafter individually as “Party” and collectively as “Parties”.

**WHEREAS**, Cree is in the business of developing, manufacturing and selling silicon carbide (SiC) substrates and materials for various electronic applications; and

**WHEREAS**, C&C develops, manufactures and markets gemstones fabricated from SiC material and desires to purchase such material from Cree; and

**WHEREAS**, C&C and Cree previously entered into an Amended and Restated Exclusive Supply Agreement dated June 6, 1997, as such has been previously amended (the “Expiring Agreement”). The Expiring Agreement will expire by its terms on July 14, 2015. Prior to expiration, the Parties desire to enter into this Agreement to supersede and replace the Expiring Agreement as of the Effective Date.

**NOW, THEREFORE**, the Parties, in consideration of the foregoing premises and the covenants and undertakings herein contained, mutually agree as follows:

### **1. SUBJECT OF THE AGREEMENT**

The subject of this Agreement is the procurement of [\*\*\*\*] SiC materials by C&C from Cree. The terms and conditions set forth in this Agreement apply to those [\*\*\*\*] SiC materials set forth on Exhibit A of this Agreement, as Exhibit A may be modified by the Parties from time to time (individually, a “Product,” and collectively, the “Products”). The specifications for each Product shall be as set forth or referenced in Exhibit A (the “Specifications”). Exhibit A shall be deemed modified if the Parties agree in writing on the terms and conditions regarding a new [\*\*\*\*] SiC Material to be supplied under this Agreement, including among other things the applicable Specifications and prices therefor. Upon execution by both Parties, this Agreement shall apply with respect to Products to be purchased under Purchase Orders (as defined below) with an issue date subsequent to the Effective Date of this Agreement, and previously issued orders will be subject to and governed by the Expiring Agreement. As used in this Agreement, “affiliate” of any particular party means any other person or entity controlling, controlled by or under common control with such party, where “control” means the possession, directly or indirectly, of the power to direct the management and policies of a person or entity whether through the ownership of voting securities, contracts, or otherwise.

### **2. TERM**

(a) The term of this Agreement shall begin on the Effective Date and expire on June 24, 2018 (the “Initial Term”), unless earlier terminated as provided herein or extended by mutual written agreement of the Parties or extended as provided in Paragraph 2(b). At least [\*\*\*\*] months prior to the expiration date of the Initial Term, the Parties will meet in person or by telephone to discuss a possible extension to the Term. However, subject to Paragraph 2(b) below, neither Party shall be obligated to agree to extend the Term.

(b) Subject to the conditions set forth in this Paragraph 2(b), C&C shall have one (1) option (the “Renewal Option”) to extend the term of this Agreement for an additional two (2)-year period (the “Renewal Term”). The period from the Effective Date until the expiration or termination of this Agreement in accordance with its terms shall be referred to as the “Term.” The Renewal Option shall be exercisable upon written notice (the “Option Notice”) given by C&C to Cree not later than [\*\*\*\*]. The right of C&C to exercise its Renewal Option is subject to the following conditions precedent:

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- (1) the Agreement shall be in effect at the time the Option Notice is received by Cree and on the last day of the Initial Term;
- (2) C&C shall not be in material default beyond any applicable grace or cure period under any provisions of this Agreement at the time the Option Notice is given and on the last day of the Initial Term, and C&C shall not have failed to timely cure any material default during the Initial Term (whether or not Cree sought to enforce any remedy or consequences against C&C for such default); and
- (3) C&C shall have timely paid all amounts due to Cree under this Agreement and any Sales Agreement created hereunder. C&C will not be considered in violation of this condition if no more than [\*\*\*\*] payments are past due during any [\*\*\*\*]-month period and such past due amounts are paid within [\*\*\*\*] days after written or verbal notice from Cree that the amounts are past due.

### **3. FORECAST**

On or before the [\*\*\*\*] during the Term of this Agreement, C&C will endeavor to provide to Cree a rolling planning forecast of its anticipated requirements for Products for the next [\*\*\*\*] calendar months (each a "Planning Forecast"). Cree will take Planning Forecast figures into consideration when planning the utilization of its manufacturing capabilities and will notify C&C as soon as reasonably practicable if Cree's capacity to accept orders for such forecasted quantities becomes constrained. The forecast quantities in the Planning Forecasts are for planning purposes only, and except as otherwise provided in this Agreement, C&C will not be committed to purchase these quantities, and Cree will not be committed to supply these quantities.

### **4. ORDER/DELIVERY**

(a) The terms and conditions of this Agreement will apply for all orders (each a "Purchase Order") for Products issued by C&C to Cree during the Term to the exclusion of any additional or different terms and conditions included or referenced in any order or confirmation documents issued by either Party (which additional or different terms and conditions are hereby rejected by the receiving Party). Unless otherwise agreed by the Parties, each Purchase Order will be for the [\*\*\*\*] in a Fiscal Quarter, shall request deliveries [\*\*\*\*] or upon such schedule as is mutually agreed upon by the Parties, and will be submitted to Cree no later than [\*\*\*\*] days prior to the [\*\*\*\*] of the Fiscal Quarter. As used in this Agreement, "Fiscal Year" (or "FY") refers to the fifty-two (52)-week period beginning on the day immediately following the last day of the preceding Fiscal Year (which date is publicly available from Cree's filings with the Securities and Exchange Commission) and ending on the last Sunday in June, and "Fiscal Quarter" refers to the thirteen (13)-week period beginning on the day immediately following the last day of the preceding Fiscal Quarter and ending on the thirteenth (13<sup>th</sup>) Sunday thereafter, where the first Fiscal Quarter of a Fiscal Year commences on the first day of such Fiscal Year. Every four or five years, Cree's Fiscal Year will include fifty-three (53) weeks in order for the period to end on the last Sunday in June. In such years, one Fiscal Quarter will have fourteen (14) weeks. If such a Fiscal Year falls within the Term of this Agreement, Cree will advise C&C in advance of the Fiscal Quarter that will include fourteen (14) weeks.

(b) Within [\*\*\*\*] days after the receipt of a Purchase Order, Cree will provide C&C written notice of acceptance (by issuance of a written order confirmation) if it can accept the Purchase Order as submitted. If Cree is unable to accept the Purchase Order as submitted, Cree will contact C&C and propose alternative quantities, sizes of Products, and/or delivery schedule. If C&C agrees with the alternative quantities, sizes of Products, and/or delivery schedule, it will issue a new Purchase Order reflecting such mutually-agreed upon terms for acceptance by Cree, and Cree will promptly accept such Purchase Order. No Purchase Order shall be deemed to be accepted unless and until Cree issues a written order confirmation. Once accepted by Cree, Purchase Orders shall be non-cancellable and non-reschedulable except as otherwise agreed to in writing by Cree or as provided in Paragraph 14 below.

(c) The terms that govern each accepted Purchase Order shall consist of (i) the Specifications for the Product(s) as in effect on the date of Cree's acceptance of the Purchase Order (with such changes, if any, as may be expressly agreed to in writing by C&C and Cree); (ii) the terms and conditions of this Agreement; (iii) only the following terms and conditions manually entered on the face of the accepted Purchase Order: Cree's part number(s), price, quantity ordered, and "ship to" and "bill to" instructions; and (iv) the delivery schedule confirmed by Cree or mutually agreed upon by the parties as provided in Section 4(b) above (collectively, a "Sales Agreement"). The documents listed in the previous sentence are listed in the order of precedence in the event of any conflict between them.

(d) C&C agrees that any delay in shipment or failure by Cree to ship or perform any part of this Agreement will not be grounds for C&C to terminate this Agreement or any Sales Agreement as provided in Paragraph 14(a) or, except as explicitly contemplated and permitted by this Agreement, to refuse to comply with any provisions herein or therein. Notwithstanding the foregoing, the following provisions will apply in the event that Cree cannot adhere to the previously scheduled delivery date for any quantity due to no reason reasonably and directly attributable to C&C and not due to a delay caused by an event of Force Majeure, as defined in Paragraph 22. If delivery of any Products will be delayed from the originally scheduled date for delivery, Cree will, as soon as reasonably possible, issue a rescheduling notice indicating the expected new delivery date(s). If Cree issues a rescheduling notice in accordance with the foregoing indicating that delivery of any Products will be delayed from the originally scheduled date for performance or any previously agreed upon rescheduled date for performance beyond the end of the then current Fiscal Quarter, (i) the Purchase Order for the Fiscal Quarter within which the original delivery date was to occur will be cancelled as to the delayed quantities, and (ii) C&C will reissue its Purchase Order for the next Fiscal Quarter to include the delayed quantities and the delayed quantities will be applied toward C&C's Minimum Purchase Commitment (as defined in Paragraph 9(a) below) as provided in Paragraph 9(c)(ii) below. Adjustment of C&C's Minimum Purchase Commitment as provided in Paragraph 9(c)(ii) below, and C&C's right to purchase Products from third parties as contemplated by Paragraph 7(a), will be C&C's sole and exclusive remedies for any delay in delivery attributed to Cree or for Cree's failure to ship the Products, or to otherwise perform an accepted Purchase Order, in a timely manner, provided that the foregoing shall not be construed to limit C&C's remedies, or Cree's liability, for any other breach of this Agreement by Cree.

## **5. SHIPPING/TITLE/ACCEPTANCE**

(a) Unless the Parties mutually agree in writing on a different shipping term, Products delivered by [\*\*\*\*] will be shipped [\*\*\*\*], and title and risk of loss to the Products will pass to C&C when [\*\*\*\*]. For any Products delivered [\*\*\*\*], the shipping terms will be [\*\*\*\*], and title and risk of loss to the Products will pass to C&C when [\*\*\*\*] point.

(b) All Products delivered hereunder will be deemed accepted by C&C (without waiving any rights under the warranty provided in Paragraph 10(a)) as conforming to this Agreement and the Specifications, and C&C will have no right to revoke any acceptance, unless written notice of the claimed nonconformity is received by Cree within [\*\*\*\*] days of delivery thereof. C&C's sole and exclusive remedy, and Cree's sole obligation, with respect to properly rejected Products will be to return the rejected Products for rework or replacement thereof and delivery of corresponding reworked or replacement Products conforming to the Specifications by Cree as soon as reasonably possible (and Cree shall perform such rework or replacement as soon as reasonably possible) or, if such rework or replacement is not possible within a commercially reasonable time, to receive a refund of the purchase price paid by C&C for the rejected Products (or if not yet paid for, Cree will reduce the amount owed by C&C under the relevant invoice by the amount of the purchase price invoiced for such rejected Products and [\*\*\*\*]). In order to claim the remedy in the foregoing sentence, C&C must request a return materials authorization (RMA) from Cree (which shall be provided by Cree promptly upon such request) and return the rejected Products to Cree, FOB Cree's manufacturing facility, within ten (10) business days after receipt of the RMA. Upon request, [\*\*\*\*] will be [\*\*\*\*] if C&C's rejection is appropriate (i.e., for Products not conforming to this Agreement and the Specifications).

## **6. PRICE/PAYMENT TERMS**

(a) Product prices shall be as set forth in Exhibit A and are subject to modification as otherwise provided in this Agreement. All applicable sales, use, excise or other taxes directly related to the sales of Products (other than taxes on Cree's net income) will be paid by C&C unless C&C provides Cree with appropriate tax exemption certificates. All reasonable, documented out-of-pocket shipping expenses incurred by Cree for independent transportation companies will be invoiced to and paid by C&C. All unit prices and price extensions are subject to correction for clerical or mathematical errors.

(b) Upon shipment of the Products, Cree will generate an invoice that will be promptly provided to C&C. Each shipment shall be considered a separate and independent transaction, and payment for each shipment shall be due accordingly. Unless otherwise agreed upon in writing, C&C shall pay Cree net [\*\*\*\*] days following the invoice date. Cree reserves the right to revoke or modify these credit terms if C&C's credit rating significantly declines or its payments to Cree are repeatedly overdue. All payments will be made in US dollars to a bank account designated by Cree, with each Party being responsible for any fees or charges incurred from its own bank.

(c) Any portion of any invoice not paid by the applicable due date therefor will accrue interest until paid at the rate of [\*\*\*\*] per month or, if less, the maximum rate permitted by law. Cree hereby reserves, and Obligors hereby grant to Cree, a security interest in all Collateral (as defined below) to secure any and all amounts due from C&C to Cree relating to the purchase of Products under this Agreement or any Sales Agreement created hereunder until all amounts due Cree therefor have been paid in full; provided that, except with respect to Cree Priority Collateral (as defined below), Cree agrees that its security interest in Collateral will be subordinate to Obligors' lender's security interest therein. Obligors agree upon Cree's request to sign appropriate financing statements evidencing Cree's security interest hereunder. Further, Obligors authorize Cree to execute and file a financing statement to perfect Cree's security interest hereunder in the Collateral. In the event of default in payment of any invoice, C&C agrees to pay Cree's reasonable, documented out-of-pocket expenses, including reasonable attorney's fees and expenses, incurred in enforcing payment thereof. The Parties acknowledge and agree that (x) with respect to any overdue unpaid amount under this Agreement, Cree may exercise its rights under its security interest in the Cree Priority Collateral beginning on the day following the day on which the unpaid amount was due, provided that, subject to and in accordance with the thirty (30)-day stand-by period set forth in Section 2.3(a) of the IC Agreement (defined below), Cree shall not take any remedial action against any Cree Priority Collateral (i.e., Cree shall not sell, lease, assign, transfer, remove or otherwise dispose of all or any portion of the Cree Priority Collateral) prior to the day following the expiration of such thirty (30)-day stand-by period and any of Obligors (or their lender) will be permitted to cure any late payment during that 30-day period, (y) neither Cree's exercise of such rights nor taking of any such remedial action shall itself be construed as a termination of this Agreement (under Section 14(a) or otherwise), and (z) Cree's rights with respect to Collateral are subject to that certain intercreditor agreement among Cree, C&C, and Wells Fargo Bank, National Association (the "IC Agreement"). For purposes of this Section 6(c):

(I) the capitalized terms "Accounts," "Deposit Accounts," and "Inventory" shall have the meanings ascribed to such terms in the Uniform Commercial Code as in effect in the State of Georgia;

(II) "Cree Priority Collateral" means all Collateral (as defined below) constituting (a) all raw SiC materials in boule form purchased by C&C from Cree from time to time and (b) SiC slabs created by cutting such raw materials purchased by C&C from Cree. For the avoidance of doubt, all finished goods Inventory of C&C, all Accounts, money and Deposit Accounts of C&C, all other proceeds of the items described in the foregoing clauses (a) and (b) (except proceeds arising from Cree's disposition of Cree Priority Collateral in accordance with the IC Agreement), and all assets of each of C&C Direct and Moissanite (except assets specifically described in the preceding sentence that are held by C&C Direct or Moissanite, and proceeds arising from Cree's disposition of such assets in accordance with the IC Agreement) shall not constitute Cree Priority Collateral; and

(III) "Collateral" means any and all of the assets now owned or hereafter acquired by any Obligor, together with all proceeds, products, accessions and additions with respect to each of the foregoing from time to time, including, without limitation, any insurance proceeds.

## **7. BUYER'S EXCLUSIVITY COMMITMENT**

(a) Subject to the terms and conditions in this Paragraph 7, C&C agrees to purchase from Cree in each Fiscal Quarter 100% of C&C's requirements for SiC materials for the production of gemstones. C&C shall not be in breach of this Paragraph 7(a) if purchases by C&C in a given Fiscal Quarter fall below such 100% due to Cree's failure to (i) deliver any Products within [\*\*\*\*] days after the originally scheduled date for delivery due to no reason reasonably and directly attributable to C&C, provided that in such case, C&C shall only be permitted to purchase quantities equal or approximately equal to the quantities delayed, or (ii) accept Purchase Orders requesting delivery of any amount in the Fiscal Quarter, provided that C&C's Purchase Orders do not request delivery during the Fiscal Quarter for an aggregate quantity of Products [\*\*\*\*] during the preceding Fiscal Quarter, [\*\*\*\*] a commercially reasonable [\*\*\*\*] not to exceed [\*\*\*\*] and that C&C complies with the balance of this Paragraph 7(a). If C&C places a Purchase Order for a quantity (up to the above-described [\*\*\*\*] limit) and delivery of the full order during the Fiscal Quarter is critical to C&C, C&C must advise Cree in writing at the time the Purchase Order is placed that C&C will need to purchase from another supplier if the full requirements cannot be met on the requested delivery schedule. If Cree is unable to accept such Purchase Order as requested by C&C within [\*\*\*\*] days after the receipt thereof, C&C and Cree will work together in good faith to try to determine a mutually acceptable delivery schedule for the quantities and types of Products required by C&C. If the parties are unable to reach agreement within [\*\*\*\*] business days, C&C may purchase any shortfall in its requirements for that Fiscal Quarter (i.e., the difference between the amount C&C requested to purchase and the amount Cree is able to supply) from a third party provided that it purchases during such Fiscal Quarter all of the Products Cree offered to supply to C&C that meet its requirements,

(b) C&C shall only be obligated to purchase from Cree under this Agreement, and Cree shall only be obligated to sell to C&C, SiC material [\*\*\*\*] following the Effective Date, from Cree. Should C&C require SiC material in [\*\*\*\*], C&C will extend to Cree a right of first refusal with respect to the development, manufacture and sale of such material as provided in this Paragraph 7(b). C&C agrees that it will not purchase such material from, or otherwise enter into any agreement for the development, manufacture or sale of such material with, any person or entity other than Cree except in compliance with this Paragraph 7(b). C&C will give Cree written notice referencing this Paragraph 7(b) setting out the terms of the proposed transaction and extending an offer to contract with Cree on such terms. If Cree does not accept such offer by written notice given within [\*\*\*\*] days after receipt of C&C's notice, C&C shall be free at any time within the next [\*\*\*\*] months after expiration of the [\*\*\*\*]-day period to conclude the transaction with any third party supplier, provided the [\*\*\*\*] thereof are not, taken as a whole, materially more favorable to the third party supplier than those described in C&C's notice to Cree. If Cree accepts any offer from C&C under this paragraph, then the terms described in such offer shall be binding on Cree and, in addition to such terms, all terms and provisions of this Agreement relating to the purchase of SiC material for the production of gemstones not inconsistent with such offer shall apply to the development, manufacture and sale of such material. The foregoing shall not be construed as an assignment or other transfer by Cree of any rights in any intellectual property.

(c) C&C's obligation to purchase 100% of its requirements for SiC materials from Cree is conditioned upon the Product prices offered by Cree [\*\*\*\*] as determined in this Paragraph 7(c). Should C&C [\*\*\*\*] of SiC materials, as reasonably demonstrated by C&C based upon [\*\*\*\*], C&C will extend to Cree a right of first refusal as provided in this Paragraph 7(c) [\*\*\*\*]. C&C agrees that, without limitation of C&C's rights under Paragraph 7(a) or 7(b), it will not purchase such material from, or otherwise enter into any agreement for the purchase of such material with, any person or entity other than Cree except in compliance with this Paragraph 7(c). C&C will give Cree written notice referencing this Paragraph 7(c) setting out the terms of the proposed transaction, providing [\*\*\*\*], and extending an offer [\*\*\*\*]. If Cree does not accept such offer by written notice given within [\*\*\*\*] days after receipt of C&C's notice, C&C shall be free at any time within the next [\*\*\*\*] months after expiration of the [\*\*\*\*]-day period to conclude the transaction with any third party supplier, provided [\*\*\*\*] thereof are not, taken as a whole, materially more favorable to the third party supplier than those described in C&C's notice to Cree. C&C understands and acknowledges that Cree's [\*\*\*\*] of SiC materials assumes C&C's [\*\*\*\*] provided in Exhibit A. If C&C relies on this Paragraph 7(c) to purchase [\*\*\*\*] of Product offered by Cree, Cree reserves the right to [\*\*\*\*] of Product purchased from Cree.

(d) Notwithstanding anything to the contrary, C&C shall be free, without breach or default of this Paragraph 7 or any other provision of this Agreement, to purchase [\*\*\*\*] of SiC materials from third parties in such amounts (collectively not to exceed in any Fiscal Quarter [\*\*\*\*] percent ([\*\*\*\*]%) of the Minimum Purchase Commitment applicable to that Fiscal Quarter) and in such [\*\*\*\*] as may reasonably be necessary to enable C&C to compare such SiC materials to Products supplied under this Agreement and/or evaluate such SiC materials' ability to be used in the manufacture of gemstones, for purposes related to C&C's evaluation of whether or not to exercise its rights under Paragraph 2(b), 7(a), 7(b), or 7(c) or pursue discussions or negotiations with a third party with respect to circumstances which may lead to the exercise of C&C's rights under Paragraph 7(a), 7(b) or 7(c) or otherwise related to a potential manufacturing or supply relationship with such third party that would not reasonably be anticipated to result in a breach of this Agreement by C&C (e.g., a relationship that would go into effect after expiration or termination of this Agreement). The foregoing sentence is not intended to waive or release any breach or default of this Paragraph 7 or any other provision of this Agreement that otherwise results from C&C entering into a manufacturing or supply relationship with such third party.

(e) C&C will give Cree written notice upon the purchase from anyone other than Cree any portion of its requirements of SiC material for the production of gemstones. Thereafter Cree shall have the right, [\*\*\*\*], to have an independent public accounting firm reasonably acceptable to C&C audit C&C's purchases of SiC material for the production of gemstones. The audit shall be conducted during normal business hours and upon reasonable prior notice. The accounting firm conducting the audit shall be required to enter into a mutually acceptable nondisclosure agreement with C&C under which such firm will be obligated not to disclose any information obtained during the course of the audit, except that it may disclose to Cree its analysis of whether C&C has complied with its obligations under this Paragraph 7. The audit right under this paragraph may be exercised not more than [\*\*\*\*] during any Fiscal Year of Cree and only with respect to Fiscal Quarters ended within [\*\*\*\*] preceding the request for an audit. C&C shall provide reasonable assistance to the public accounting firm including, but not limited to, providing a schedule of purchases, supporting analyses and any supporting source documentation reasonably required by the public accounting firm. The accounting firm will audit and report to Cree its analysis of whether C&C has complied with its obligations under this Paragraph 7, but will not divulge to Cree any proprietary or confidential information (including but not limited to supporting schedules and source documentation) disclosed during the audit process.

(f) Cree's sole and exclusive remedies for breach of this Paragraph 7 by C&C will be (i) to terminate the Parties' exclusivity obligations as provided in Paragraph 8(c) below or (ii) [\*\*\*\*] for the [\*\*\*\*] of Product purchased from Cree.

## **8. SELLER'S EXCLUSIVITY COMMITMENT**

(a) Subject to the terms and conditions in this Paragraph 8, and except as permitted in Paragraphs 8(c) and (d), Cree agrees that during the Term of this Agreement (i) it will not sell SiC material or crystals in any form to any customer other than C&C if Cree knows or has reason to believe that such customer intends to use such material for the purpose of fabricating, distributing or selling gemstones (or enabling third parties to engage in such activities), (ii) it will use commercially reasonable efforts to contractually prohibit purchasers of its SiC material or crystals of a thickness that reasonably could be used for gemstone manufacture from fabricating, distributing or selling gemstones using such material or selling such materials to third parties if such customer knows or has reason to believe such third party intends to use the material for such purpose, and (iii) Cree will use commercially reasonable efforts to enforce any such provisions.

(b) Cree's obligations in Paragraph 8(a) are conditioned upon: (i) C&C's compliance with its exclusivity commitment in Paragraph 7; (ii) notwithstanding C&C's compliance with its exclusivity commitment in Paragraph 7, C&C's satisfaction of its Minimum Purchase Commitment for each Fiscal Quarter (including any permissible cure period) as provided in and determined by Paragraph 9 below; and (iii) C&C's timely payment of amounts due to Cree under this Agreement and any Sales Agreement created hereunder. With respect to item (iii), C&C will not be considered in violation of that condition if no more than [\*\*\*\*] payments are past due during any [\*\*\*\*]-month period and such past due amounts are paid within [\*\*\*\*] days after written or verbal notice from Cree that the amounts are past due.

(c) If C&C fails to satisfy any condition in Paragraph 8(b), Cree, at its sole discretion, may terminate the Parties' respective exclusivity obligations by providing written notice of termination to C&C (the "Exclusivity Termination Notice"). Following issuance of the Exclusivity Termination Notice by Cree, C&C shall be free to buy SiC materials from third party suppliers and Cree shall be free to sell SiC material to others for use in the fabrication of gemstones. For avoidance of doubt, except for the cure periods expressly provided in Paragraph 8(b) above for late payments and in Paragraph 9(b) below for satisfaction of C&C's Minimum Purchase Commitment, Cree shall not be required to give C&C any cure period prior to issuing an Exclusivity Termination Notice terminating the exclusivity provisions in this Agreement. Except for the exclusivity provisions in Paragraphs 7 and 8, the remainder of this Agreement will continue in full force and effect following any Exclusivity Termination Notice provided by Cree.

(d) Notwithstanding anything to the contrary, Cree shall be free, without breach or default of this Paragraph 8 or any other provision of this Agreement, to sell [\*\*\*\*] of SiC materials to third parties in such amounts (collectively not to exceed in any Fiscal Quarter [\*\*\*\*] percent ([\*\*\*\*]%) of the Minimum Purchase Commitment applicable to that Fiscal Quarter) and in such [\*\*\*\*] as may reasonably be necessary to enable other potential customers to compare such SiC materials to materials they are buying from other sources and/or to evaluate Cree's SiC materials' ability to be used in the manufacture of gemstones, so that Cree is able to evaluate whether or not to exercise its rights under Paragraph 8(c) or 9 or pursue discussions or negotiations with a third party with respect to circumstances which may result from the exercise of Cree's rights under Paragraph 8(c) or 9 or otherwise related to a potential manufacturing or supply relationship with such third party that would not reasonably be anticipated to result in a breach of this Agreement by Cree (e.g., a relationship that would go into effect after expiration or termination of this Agreement). The foregoing sentence is not intended to waive or release any breach or default of this Paragraph 8 or any other provision of this Agreement that otherwise results from Cree entering into a manufacturing or supply relationship with such third party.

## **9. BUYER'S PURCHASE COMMITMENTS**

(a) Each Fiscal Quarter, C&C agrees to purchase Products from Cree in quantities at or above the Minimum Purchase Commitment amount for such Fiscal Quarter. Failure to do so will, except as contemplated below, be considered a breach of the Agreement. The "Minimum Purchase Commitment" for each Fiscal Quarter will be [\*\*\*\*] (i) at least [\*\*\*\*]% of C&C's requirements for SiC materials for the production of gemstones [\*\*\*\*] from Cree, excluding from such calculation any SiC materials purchased from third parties as expressly permitted in Paragraph 7(a) (but including any SiC materials purchased from third parties as expressly permitted in Paragraph 7(b) or 7(c)), or (ii) (A) [\*\*\*\*] kilograms in the [\*\*\*\*] Quarter of [\*\*\*\*]; (B) [\*\*\*\*] kilograms in the [\*\*\*\*] Quarter of [\*\*\*\*]; (C) [\*\*\*\*] kilograms in [\*\*\*\*] Quarter of [\*\*\*\*]; (D) [\*\*\*\*] kilograms in [\*\*\*\*] Quarter of [\*\*\*\*]; and (E) [\*\*\*\*] kilograms in [\*\*\*\*] Quarter of [\*\*\*\*]. If C&C exercises its Renewal Option or the parties otherwise agree to an extension of the Initial Term, no later than [\*\*\*\*], the Parties will begin good faith discussions seeking to mutually agree upon the Minimum Purchase Commitment amounts for the Fiscal Quarters of the Renewal Term (or other mutually agreed-upon extension of the Initial Term), but in no event will the Minimum Purchase Commitment for any Fiscal Quarter during the Renewal Term (or other mutually agreed-upon extension of the Initial Term) be less than [\*\*\*\*] kilograms. Notwithstanding any contrary language in the Agreement, if the Parties have not agreed in writing on the Minimum Purchase Commitment amounts by [\*\*\*\*], or such later date as may be mutually agreed upon in writing by the Parties, (x) C&C shall have the right, by written notice given to Cree within [\*\*\*\*] business days of [\*\*\*\*] or such later agreed-upon date (if any), to have the Minimum Purchase Commitment amount for each Fiscal Quarter of the Renewal Term equal [\*\*\*\*] kilograms for [\*\*\*\*] Quarter of [\*\*\*\*] and [\*\*\*\*] kilograms for [\*\*\*\*] Quarter of [\*\*\*\*] (in which case the Renewal Term shall be effective), and (y) if C&C does not provide such written notice under the preceding clause (x), either Party, in its sole discretion, may terminate this Agreement as of the end of the Initial Term by providing the other Party notice of such termination decision.

(b) To maintain Seller's exclusivity as provided in Paragraph 8 during the Term of this Agreement, C&C must, except to the extent otherwise provided herein, purchase Products from Cree in quantities at or above the applicable Minimum Purchase Commitment amount each Fiscal Quarter. If C&C fails to purchase Products from Cree in quantities at or above the applicable Minimum Purchase Commitment amount for a particular Fiscal Quarter, C&C will be permitted the opportunity to cure such shortfall by purchasing during the [\*\*\*\*] an amount equal to the sum of the purchase shortfall from [\*\*\*\*] and the Minimum Purchase Commitment for the new Fiscal Quarter. For example, if C&C only purchases [\*\*\*\*] kilograms of Product during the [\*\*\*\*] Quarter of [\*\*\*\*], C&C may cure its purchase shortfall by purchasing at least [\*\*\*\*] kilograms of Product during the [\*\*\*\*] Quarter of [\*\*\*\*], (The foregoing example assumes that [\*\*\*\*]% of C&C's requirements for SiC materials for the production of gemstones [\*\*\*\*] from Cree for both the [\*\*\*\*] of [\*\*\*\*] was less than [\*\*\*\*] kilograms.) If C&C fails to cure the purchase shortfall in [\*\*\*\*], Cree, at its sole discretion, may terminate the Parties' respective exclusivity obligations by providing an Exclusivity Termination Notice to C&C. If C&C fails to cure the purchase shortfall in the same manner by the [\*\*\*\*] in quantities at or above the applicable Minimum Purchase Commitment amount, Cree, at its sole discretion, may terminate this Agreement by providing written notice of termination to C&C. For avoidance of doubt, unless otherwise agreed in writing by Cree, in order to cure a purchase shortfall for any Fiscal Quarter, C&C must purchase the aggregate amount of any prior shortfalls and the Minimum Purchase Commitment for the then-current Fiscal Quarter (i.e., the cure shall not be effective unless and until C&C has satisfied all Minimum Purchase Commitments for completed Fiscal Quarters). It will be C&C's responsibility to track its compliance with the Minimum Purchase Commitments and to be aware of any opportunities to cure any purchase shortfalls. Cree will have no obligation to give C&C written notice of any purchase shortfall. Upon Cree's written request, C&C will inform Cree in writing if [\*\*\*\*]% of C&C's requirements for SiC materials for the production of gemstones [\*\*\*\*] from Cree during any Fiscal Quarter was greater than the fixed quantity for such Fiscal Quarter set forth in clause (ii) of the first sentence of Paragraph 9(a) above.

(c) The following rules will apply in determining whether C&C has met its Minimum Purchase Commitment in any Fiscal Quarter:

- (i) If C&C orders Products for delivery in a particular Fiscal Quarter and Cree proposes delivery of any of the requested quantities in a later Fiscal Quarter, as provided in Paragraph 4, and any quantity of any deferred Products is needed in order for C&C to meet its Minimum Purchase Commitment for the Fiscal Quarter in which such Products were originally requested by C&C to be shipped, the needed quantity of deferred Products will be [\*\*\*\*] in the Fiscal Quarter [\*\*\*\*] to be shipped (rather than in the Fiscal Quarter [\*\*\*\*]) solely for the purpose of determining whether the Minimum Purchase Commitment has been met, provided that C&C's orders do not request delivery during the Fiscal Quarter for an aggregate quantity of Products in excess of the quantity to be delivered during the preceding Fiscal Quarter, [\*\*\*\*] a commercially reasonable [\*\*\*\*] not to exceed [\*\*\*\*]; and
- (ii) If Products ordered by C&C are not shipped by Cree in the Fiscal Quarter for which they were originally confirmed to be shipped by Cree, as provided in Paragraph 4, and the quantity of any delayed Products is needed in order for C&C to meet its Minimum Purchase Commitment for the Fiscal Quarter in which such Products were originally confirmed by Cree to be shipped, the needed quantity of delayed Products will be [\*\*\*\*] in the Fiscal Quarter [\*\*\*\*] to be shipped (rather than in the Fiscal Quarter [\*\*\*\*]) solely for the purpose of determining whether the Minimum Purchase Commitment has been met, provided that shipment of such Products is not delayed to the Fiscal Quarter in which the delayed Products are later shipped due to any cause reasonably and directly attributable to C&C; and
- (iii) If C&C purchases more than its Minimum Purchase Commitment in any Fiscal Quarter, it may apply the excess toward its Minimum Purchase Commitment in the [\*\*\*\*], but only up to the amount needed to achieve the Minimum Purchase Commitment (i.e., application of the excess amount may not create a new excess).

## **10. LIMITED WARRANTY**

(a) Cree warrants to C&C that each Product shall conform strictly to and perform in accordance with the Specification for that Product (within the deviations specified in such Specifications, if any). All breach of warranty claims must be reported to Cree as soon as possible, but in any event not later than 90 days after shipment. If not so reported, such claims will be deemed waived. C&C must request a return materials authorization (RMA) from Cree and return the non-conforming Products to Cree, FOB Cree's manufacturing facility, within ten (10) days after receipt of the RMA, and Cree shall promptly provide an RMA upon C&C's request. Cree will have no liability under this warranty unless Cree is notified in writing promptly upon C&C's discovery of the defect and the alleged defective Products are returned to Cree as provided above. All breach of warranty claims are subject to verification by Cree, and both Parties must agree on the existence and extent of any claimed defect or failure to perform or, in the absence of such verification or agreement, the existence and extent of any claimed defect or failure to perform shall have been found to exist or occur pursuant to Paragraph 16(b). Cree's sole liability and obligation and C&C's sole and exclusive remedy under this warranty is limited to repair or replacement of items determined by Cree to be defective or, at Cree's sole option, refund of (or if not yet paid, reduce the amount owed by C&C under the relevant invoice by the amount of the purchase price invoiced for such defective Products [\*\*\*\*]) the purchase price charged by Cree for the defective Products. **ANY SCRAP MATERIAL OR NON-STANDARD PRODUCTS REQUESTED BY C&C AND SUPPLIED UNDER THIS AGREEMENT WILL BE SUPPLIED "AS IS" AND WITHOUT WARRANTY OF ANY KIND.**

(b) Cree's warranty will not apply to any defect or failure to perform resulting from misapplication, improper installation, improper operation, abuse, or contamination, whether internal or external, and Cree will have no liability of any kind for failures caused by services, materials and items not supplied by Cree. Remedies of C&C for any breach of warranty under Paragraph 10(a) are limited to those provided in Paragraph 10(a) to the exclusion of all other remedies, including, without limitation, loss of profits, production or revenue, business interruption or any consequential, incidental, special or punitive damages. No representation, warranty, affirmation or agreement of Cree varying or extending the foregoing warranty and limitation of remedy provisions may be relied upon unless it is in writing and signed by the President or a Vice President of Cree. C&C understands that, without limitation of the warranty provided in Paragraph 10(a), the Products may not conform to any model or sample shown to C&C.

(c) Each Party represents and warrants to the other that, as of the date hereof:

- i. it is duly organized and validly existing under the laws of its jurisdiction of organization, and has full corporate power and authority to enter into this Agreement and to carry out the provisions hereof
- ii. it is duly authorized to execute and deliver this Agreement and to perform its obligations hereunder, and the person or persons executing this Agreement on its behalf has been duly authorized to do so by all requisite corporate action;
- iii. this Agreement is legally binding upon it and enforceable in accordance with its terms. The execution, delivery and performance of this Agreement by it does not conflict with any agreement, instrument or understanding, oral or written, to which it is a party or by which it may be bound, nor violate any law or regulation of any governmental authority having jurisdiction over it;
- iv. it is aware of no action, suit or inquiry or investigation instituted by any governmental agency or other third party that questions or threatens the validity of this Agreement; and
- v. all necessary consents, approvals and authorizations of all governmental authorities and third parties required to be obtained by such Party to enter into this Agreement and to perform under and pursuant to this Agreement have been obtained (provided, however, that the foregoing shall not be construed as a representation or warranty concerning non-infringement of intellectual property rights of Third Parties).

(d) **THE FOREGOING WARRANTY PROVISIONS ARE EXCLUSIVE AND ARE GIVEN AND ACCEPTED IN LIEU OF ANY AND ALL OTHER WARRANTIES, WHETHER EXPRESS OR IMPLIED, INCLUDING WITHOUT LIMITATION ANY WARRANTY AGAINST INFRINGEMENT OR ANY IMPLIED WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE.** This Paragraph 10 (as limited by other applicable terms and conditions of this Agreement) shall survive with full force and effect after the termination or expiration of this Agreement with respect to Products that are included in a Sales Agreement prior to such termination or expiration.

## **11. INDEMNIFICATION**

(a) Subject to the limitations set out in this Agreement, Cree will defend C&C and its affiliates against any suit, action, or proceeding brought by any third party (a "Claim") against C&C or any affiliate thereof, and indemnify and hold harmless C&C and its affiliates against any damages, liabilities, expenses and/or losses, including reasonable legal expenses and attorneys' fees, based on or relating to such Claim (collectively, "Losses"), insofar as such Claim is based on an allegation that the Products sold pursuant to this Agreement, or their design or manufacture by Cree, infringe any United States [\*\*\*\*] patent issued as of the date of shipment [\*\*\*\*]. Cree will have no obligation to pay for C&C's separate legal counsel once Cree has assumed the defense of the Claim; however, C&C may continue to participate in the defense at its own expense through counsel of its own choosing. Cree will pay all Losses based on or relating to such a Claim, including but not limited to those finally awarded against C&C in any such suit, action, or proceeding or paid by way of settlement, but Cree shall have no liability whatsoever with respect to any settlement made by C&C without Cree's prior written consent, which consent shall not be unreasonably withheld. These obligations of Cree are subject to the conditions that Cree is promptly notified in writing of the Claim and given control of the defense and that C&C provides such information and assistance as Cree reasonably requests in connection therewith at Cree's expense, provided that if C&C fails to comply with any of the foregoing conditions, Cree will only be relieved of its obligations under this Paragraph 11(a) to the extent materially prejudiced by such failure. If the Products (or their design or manufacture) are held to infringe any patent issued as of the date of shipment, [\*\*\*\*], or if in the opinion of Cree such Products are likely to become the subject of such a claim of infringement, [\*\*\*\*], then Cree will, at its own expense, either procure a license to protect C&C against such claim without cost to C&C, replace such Products with Products not subject to such infringement, [\*\*\*\*], or require return of such Products, at Cree's expense, and refund the price paid by C&C to Cree for such Products. The foregoing states Cree's sole liability and C&C's sole and exclusive remedy for any Claim based upon or related to any alleged infringement of any patent or other intellectual property rights of a third party. Cree shall have no liability for any Claim of infringement or damages to the extent based on (I) C&C's or its affiliates' custom designs or, to the extent proposed by C&C following the Effective Date, not based on technical information provided by Cree, and differing from the Specifications, specifications, or technical information for any Products, (II) a combination of Products furnished under this Agreement with products, equipment, or materials not furnished hereunder (and not based solely on the Products, or their design or manufacture), or (III) any items made with Products furnished under this Agreement (except to the extent such items are solely comprised of Products and such Claims solely relate to Products as supplied by Cree or their design or manufacture by Cree). In no event may Cree compromise, settle, or enter into any voluntary disposition of any Claim subject to indemnification under this Paragraph 11(a) in any manner that admits material fault or wrongdoing on the part of C&C or any affiliate thereof or incurs liability on the part of C&C or any affiliate thereof that is not covered by Cree's defense, indemnification, or hold harmless obligations without the prior written consent of C&C

(b) Subject to the limitations set out in this Agreement, C&C will defend Cree and its affiliates against any Claim brought against Cree or any affiliate thereof, and indemnify and hold harmless Cree and its affiliates against any Loss, claiming infringement of a third party's patents, trademarks or other intellectual property rights to the extent arising out of any of the circumstances described in (I), (II) or (III) in Paragraph 11(a). C&C will have no obligation to pay for Cree's separate legal counsel once C&C has assumed the defense of the Claim; however, Cree may continue to participate in the defense at its own expense through counsel of its own choosing. C&C will pay all Losses based on or arising from such a Claim, including but not limited to those finally awarded against Cree in any such suit, action, or proceeding or paid by way of settlement, but C&C shall have no liability whatsoever with respect to any settlement made by Cree without C&C's prior written consent, which consent shall not be unreasonably withheld. These obligations of C&C are subject to the conditions that C&C is promptly notified in writing of the Claim and given control of the defense and that Cree provides such information and assistance as C&C reasonably requests in connection therewith, at C&C's expense, provided that if Cree fails to comply with any of the foregoing conditions, C&C will only be relieved of its obligations under this Paragraph 11(b) to the extent materially prejudiced by such failure. In no event may C&C compromise, settle, or enter into any voluntary disposition of any Claim subject to indemnification under this Paragraph 11(b) in any manner that admits material fault or wrongdoing on the part of Cree or incurs liability on the part of Cree that is not covered by C&C's defense, indemnification, or hold harmless obligations without the prior written consent of Cree.



## **12. INTELLECTUAL PROPERTY**

Other than those rights of Cree exhausted by the sale of Products hereunder, Cree does not convey any express or implied license under any patent, copyright, trademark or other proprietary rights owned or controlled by Cree, whether relating to the Products sold or any manufacturing process or other matter. Furthermore, nothing contained in this Agreement confers any right to use in advertising, publicity or other promotional activities any name, trade name, trademark or other designation of either Party (including contraction, abbreviation or simulation of any of the foregoing). If such use is desired, necessary or required, the Parties will enter into an appropriate customary agreement governing such use.

## **13. CONFIDENTIAL INFORMATION**

(a) The exchange of confidential information by the Parties and their affiliates during the Term shall be governed by the terms and conditions of the Non-Disclosure Agreement entered into by the Parties dated as of the Effective Date, as such agreement has been or may be amended (the "NDA"), the terms and conditions of which are incorporated as if fully set forth herein. Notwithstanding any contrary language in the NDA, (i) the NDA will remain in effect for the entire Term, and the NDA may not be terminated so long as this Agreement remains in effect, and (ii) the receiving Party shall not be liable for, and shall be entitled to engage in, (A) disclosure of Confidential Information (as defined in the NDA) to its external legal counsel in the event of a dispute concerning this Agreement, or (B) disclosure of non-technical, non-trade secret Confidential Information (including the terms of this Agreement) to its external auditors, consultants or other professional advisors who have a need to know such information in connection with [\*\*\*\*] (as such terms are defined in Paragraph [\*\*\*\*] below), provided that all such recipients are bound by professional or contractual obligations to maintain such information in confidence on substantially similar terms as found in this Agreement. For avoidance of doubt, a receiving Party's obligation to maintain information in confidence will survive expiration or termination of the NDA as provided in the NDA.

(b) Nothing in this Agreement is or shall be construed to require either Party to disclose proprietary or confidential information to the other. The Parties agree that the terms of this Agreement shall be treated as Confidential Information of each other subject to the NDA; provided, however, that either Party may, upon prior notice and after providing the other Party an opportunity to review the intended disclosure, make such public disclosures regarding this Agreement as, based on the advice of counsel for such Party, are required by applicable securities laws or regulations, other applicable law, or the rules of any securities exchange to which such Party is subject.

## **14. TERMINATION/EXPIRATION**

(a) This Agreement and/or any Sales Agreement may be terminated by mutual written agreement of the Parties. In addition, either Party may terminate this Agreement by written notice to the other Party upon the occurrence of one of the conditions below:

- (i) If the other Party materially breaches this Agreement and fails to cure that breach within [\*\*\*\*] days after receiving notice of the breach from the non-breaching Party; or
- (ii) If the other Party becomes insolvent, or any voluntary or involuntary petition for bankruptcy or for reorganization is filed by or against the other Party, or a receiver is appointed with respect to all or any substantial portion of the assets of the other Party, or a liquidation proceeding is commenced by or against the other Party; provided that, in the case of any involuntary petition or proceeding filed or commenced against a Party, the same is not dismissed within sixty (60) days.

If a Party elects to unilaterally terminate the Agreement for one of the foregoing reasons, that Party may concurrently terminate any Sales Agreement to the extent of Products not yet shipped. Further, either Party may terminate any Sales Agreement to the extent of Products not yet shipped (without terminating this Agreement) by giving written notice of termination to the other Party if the other Party commits a material breach of its obligations under the Sales Agreement and does not cure such breach within [\*\*\*\*] days after receipt of written notice of the breach from the non-breaching Party.

(b) In addition, either Party may terminate this Agreement and any Sales Agreements by written notice to the other Party in the event the other Party's performance is delayed by more than one hundred eighty (180) days due to an event of Force Majeure.

(c) Except as expressly provided otherwise in this Agreement, each Party will remain obligated to fully perform all Sales Agreements that are executory at the time of termination or expiration of this Agreement, and the applicable terms and conditions of this Agreement (including Exhibits) will survive with respect to the continued and full performance of such Sales Agreements. Further, expiration or termination will not affect (i) C&C's obligation to pay all amounts accrued or earned by Cree prior to expiration or termination after resolution of disputed amounts, if any, or (ii) any accrued obligations of Cree with respect to any amounts to be refunded, canceled, or credited for the benefit of C&C (and Cree shall, to the extent any amounts to be credited against amounts due Cree under this Agreement exceed the amounts due Cree under this Agreement, promptly pay C&C such excess following termination or expiration of this Agreement after resolution of disputed amounts, if any).

## **15. COMPLIANCE AND OTHER OBLIGATIONS OF THE PARTIES**

(a) Each Party agrees to comply with all laws, rules, orders, treaties, and regulations related to the production, manufacture, packaging, generation, processing, distribution, transport, treatment, storage, disposal, installation, sale, use, import, and export, and other handling of all Products, or products incorporating the Products, that are applicable to its activities in connection with or in furtherance of this Agreement, to the extent not inconsistent with United States law.

(b) Cree will not be obligated under this Agreement or any Sales Agreement to export, transfer or deliver any Products or related technical information to C&C if prohibited by applicable law or until all necessary governmental authorizations have been obtained. Cree will not be liable under this Agreement or any Sales Agreement for any expenses or damages resulting from failure to obtain or delays in obtaining any required government authorizations. C&C will comply fully with all export administration and control laws and regulations of the U.S. government as may be applicable to the export, re-export, resale or other disposition of any Products purchased from Cree.

(c) C&C agrees that it will not, without Cree's written consent, use any SiC material supplied by Cree as a seed for bulk crystal growth or for any purpose other than fabricating gemstones from such material. Growth of one or more silicon carbide or Group III-nitride epitaxial layers on a single substrate having an aggregate epitaxial thickness of less than 150 microns will not be considered bulk growth for purposes of this Agreement. C&C further agrees that it will not, without Cree's written consent, resell or otherwise transfer bulk SiC material supplied by Cree (including, without limitation, SiC materials in boule or slab form) to any third party other than [\*\*\*\*]. Notwithstanding the foregoing, any buyer or transferee of bulk SiC material must also [\*\*\*\*] and C&C must (i) not know or have reason to believe the buyer/transferee intends to use the SiC material as a seed for the bulk growth of SiC or for any purpose other than fabricating gemstones from such material, (ii) use commercially reasonable efforts to contractually prohibit the buyers/transferees from using the SiC material as a seed for the bulk growth of SiC or for any purpose other than fabricating gemstones from such material and from further transferring the bulk SiC material to another party, and (iii) use commercially reasonable efforts to enforce any such provisions.

(d) Each Party agrees that during the term of this Agreement, without the prior written consent of the other Party, it will not employ or otherwise engage the services (as a consultant or in any other capacity) of any individual who within [\*\*\*\*] year prior to being so engaged served as an employee of the other Party, or as a consultant to the other Party providing services, in the case of Cree, [\*\*\*\*] (including without limitation, [\*\*\*\*]), or, in the case of C&C, [\*\*\*\*].

(e) Neither Party shall issue any press release or otherwise make any public announcement concerning this Agreement without the prior consent of the other Party; provided, however, that nothing in this provision shall prevent a Party from making any disclosures that may be required by applicable securities regulations or law or applicable listing standards. Neither party shall use the name of the other Party in any advertising, marketing or similar material without the other Party's prior written consent.

## **16. GOVERNING LAW; DISPUTE RESOLUTION**

(a) This Agreement is governed by the laws of the State of North Carolina, without regard to its conflicts of laws provisions. The Parties expressly disclaim the application of the United Nations Convention on Contracts for the International Sale of Goods.

(b) All disputes arising out of or relating to this Agreement or any Sales Agreement, or any breach or alleged breach hereof or thereof, that cannot be settled amicably by the Parties will, upon written notice by either Party, be settled exclusively by arbitration to be held in (or within thirty (30) miles of) Durham, NC under the Commercial Arbitration Rules of the American Arbitration Association (the "Rules"), as such Rules may be modified by mutual agreement of the Parties as contemplated herein; provided, however, that a Party may seek provisional, injunctive, or equitable remedies, including but not limited to preliminary injunctive relief, from a court having jurisdiction, before, during or after the pendency of any arbitration proceeding, or join the other Party to existing litigation or any Claim brought by a third party. A single independent, neutral arbitrator selected by the Parties shall preside over the proceeding. If a single arbitrator cannot be agreed upon by the Parties within fifteen (15) days of a Party's notice triggering arbitration hereunder, a panel of three (3) arbitrators shall preside. This panel shall be comprised of one independent, neutral arbitrator selected by Cree, one independent, neutral arbitrator selected by C&C, and a third independent, neutral arbitrator selected by the two arbitrators appointed by the Parties; if either Party does not select an arbitrator in accordance with the foregoing within five (5) business days of the expiration of the above-referenced fifteen (15)-day period, such arbitrator shall be selected in accordance with the Rules. If elected by either Party by written notice to the other Party within five (5) business days of the notice initiating dispute resolution under this Paragraph 16(b), the Parties shall negotiate in good faith in an effort to mutually agree as to the rules and procedures which shall govern such proceeding. In the event the Parties cannot agree as to the rules and procedures which shall govern arbitration hereunder within thirty (30) days of such written election, the arbitrator(s) shall determine such governing rules and procedures. The arbitrator(s) shall have no right to award damages or provide remedies that are expressly excluded in this Agreement. The award shall be final and binding upon the Parties. Judgment upon the award may be entered in any court having jurisdiction thereof. The prevailing party in any suit or arbitration proceeding will be entitled to recover its reasonable and necessary attorney fees and other reasonable, documented out-of-pocket costs and expenses incurred in such proceeding.

(c) Except for actions to enforce a right under Paragraph 11, no action, regardless of form, arising under or relating to this Agreement or a Sales Agreement may be brought by either Party more than [\*\*\*\*] after the date the claim arises.

## 17. ASSIGNMENT

(a) Neither this Agreement nor any rights hereunder may be assigned or transferred, including without limitation by means of a merger, change of control, or similar transaction that results in a different party possessing, directly or indirectly, the power to direct the management and policies of such Party whether through the ownership of voting securities, contract(s), or otherwise, (collectively an "Assignment") by either Party without the other Party's prior written consent, which consent shall not be unreasonably withheld, provided that, notwithstanding the foregoing, (i) Cree shall be entitled, without C&C's prior written consent, to make an Assignment of this Agreement and its rights and obligations hereunder in connection with the transfer or sale of all or substantially all of Cree's assets or business relating to the performance of this Agreement, a merger transaction to which Cree is a party, a change of control of Cree, or a similar transaction, and (ii) C&C shall be entitled, without Cree's prior written consent, to make an Assignment of this Agreement and its rights and obligations hereunder to a Permitted C&C Assignee in connection with [\*\*\*\*]. Any attempted assignment in violation of this Paragraph 17(a) is void and shall constitute a material breach of this Agreement. A "Permitted C&C Assignee" shall mean any person or entity other than a person or entity that is a [\*\*\*\*]. "[\*\*\*\*]" shall mean any corporation, partnership, university, government agency or other entity or person that is conducting [\*\*\*\*]:

- (1) [\*\*\*\*];
- (2) [\*\*\*\*];
- (4) [\*\*\*\*];
- (5) [\*\*\*\*];
- (6) [\*\*\*\*];
- (7) [\*\*\*\*];
- (8) [\*\*\*\*]; and
- (9) [\*\*\*\*].

For purposes of the [\*\*\*\*] in (2) above, a corporation, partnership, university, government agency or other entity or person shall not be considered a [\*\*\*\*]. Notwithstanding the foregoing or any contrary language in this Agreement, (i) a corporation, partnership, or other entity or person shall [\*\*\*\*], and (ii) Cree shall be entitled to immediately terminate this Agreement, without notice or opportunity to cure, if subsequent to such permitted Assignment the Permitted C&C Assignee or its affiliate becomes engaged in a [\*\*\*\*].

(b) It will be a condition of any permitted assignment that the assignee will assume all obligations of its assignor under this Agreement or Sales Agreement, as applicable, arising following such assignment. Unless otherwise agreed by the Parties in writing, no assignment will relieve any Party of responsibility for the performance of its obligations hereunder. The terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective successors and permitted assigns of the Parties, and, notwithstanding any contrary language herein, the term "C&C" as used herein shall refer to any successor or permitted assignee of C&C, and the term "Cree" as used herein shall refer to any successor or permitted assignee of Cree.

## **18. LIMITATIONS ON LIABILITY**

**CREE'S AGGREGATE LIABILITY TO C&C IN DAMAGES OR OTHERWISE ARISING OUT OF THIS AGREEMENT OR ANY SALES AGREEMENT WITH RESPECT TO THE SALE OF ANY PARTICULAR PRODUCTS WILL IN NO EVENT EXCEED THE AMOUNT, IF ANY, RECEIVED BY CREE FOR THE PRODUCT(S) THAT ARE THE CAUSE OF SUCH DAMAGES. IF ANY REMEDY IS FOUND TO FAIL OF ITS ESSENTIAL PURPOSE OR IF CREE'S PRODUCTS ARE NOT THE CAUSE OF THE DAMAGES, CREE'S AGGREGATE LIABILITY IN DAMAGES OR OTHERWISE TO C&C WILL IN NO EVENT EXCEED \$[\*\*\*\*] USD. C&C'S AGGREGATE LIABILITY TO CREE ARISING OUT OF THIS AGREEMENT OR ANY SALES AGREEMENT WITH RESPECT TO THE PURCHASE OF ANY PARTICULAR PRODUCTS WILL IN NO EVENT EXCEED THE PURCHASE PRICE FOR SUCH PRODUCTS, PLUS OTHER AMOUNTS EXPRESSLY PROVIDED IN THIS AGREEMENT FOR TAXES, TRANSPORTATION COSTS, INTEREST, AND COLLECTION COSTS. IN NO EVENT SHALL EITHER PARTY HAVE LIABILITY IN CONNECTION WITH THIS AGREEMENT OR ANY SALES AGREEMENT FOR ANY CONSEQUENTIAL, INDIRECT, OR INCIDENTAL, SPECIAL, OR PUNITIVE DAMAGES (WHICH MAY INCLUDE LOST PROFITS, PRODUCTION, OR REVENUE, OR BUSINESS INTERRUPTION) ARISING OUT OF OR IN CONNECTION WITH THIS AGREEMENT, ANY SALES AGREEMENT OR THE MANUFACTURE, USE OR PERFORMANCE OF THE PRODUCTS, EVEN IF ADVISED OF THE POSSIBILITY OF SUCH DAMAGES; PROVIDED THAT THE FOREGOING SHALL IN NO WAY LIMIT C&C'S OBLIGATION TO PAY FOR PRODUCTS PURCHASED HEREUNDER IN ACCORDANCE WITH THE TERMS HEREOF. THE LIMITATIONS IN THIS PARAGRAPH 18 APPLY REGARDLESS OF WHETHER SUCH CLAIM IS BASED ON TORT, CONTRACT, WARRANTY, NEGLIGENCE, STRICT LIABILITY OR ANY OTHER THEORY, PROVIDED THAT, NOTWITHSTANDING ANYTHING TO THE CONTRARY, THE LIMITATIONS IN THIS PARAGRAPH 18 SHALL NOT IN ANY EVENT APPLY TO A PARTY'S OBLIGATION PURSUANT TO THE PROVISIONS IN PARAGRAPH 11 TO DEFEND THE OTHER PARTY AGAINST OR TO INDEMNIFY OR HOLD HARMLESS THE OTHER PARTY FOR AMOUNTS CLAIMED BY, OWED TO, OR RECOVERED BY A THIRD PARTY OR ANY BREACH OF PARAGRAPH 13, 15(c) or 17(a).**

## **19. ENTIRE AGREEMENT**

This Agreement, including the Exhibits (which are hereby incorporated herein), and the NDA contain the entire agreement between C&C and Cree with respect to subject matter of this Agreement and supersede all other prior written or oral agreements relating to the purchase and sale of Products, including without limitation the Expiring Agreement. Any additional or different terms stated on any other correspondence, document or form of either Party, including Purchase Orders, order confirmations and invoices, are material alterations of this contract and are expressly rejected. The terms of this Agreement cannot be modified unless done so in a writing signed by both Parties. A waiver by a Party of any breach or default by the other Party is not a waiver of any other breach or default, and no course of dealings between the Parties or trade usage will modify this Agreement. In addition to the provisions that expressly or by their nature contemplate performance or observance of obligations subsequent to any expiration or termination of this Agreement, the provisions regarding warranty, indemnification, intellectual property, confidential information, compliance, limitations of liability, and dispute resolution survive the termination of this Agreement. This Agreement and any amendment or modification hereto may be executed in counterparts with the same force and effect as if the Parties had executed one instrument, and each such counterpart will be deemed to constitute an original hereof. The Parties agree that the delivery of any executed copy of this Agreement or any amendment hereto by electronic portable document format (.pdf) or facsimile will be legal and binding and will have the same full force and effect as if an original executed copy of this Agreement or amendment had been delivered.

## **20. AUTHORITY**

Each Party represents that it has the right to enter into and perform its obligations under this Agreement and entering this Agreement will not breach any obligation it has to any third party.

## **21. SEVERABILITY**

If any provision of this Agreement is invalid, illegal, or unenforceable in any jurisdiction, for any reason, the invalidity, illegality, or unenforceability of that provision will not affect any other provision of this Agreement, and the invalid provision will be substituted with a valid provision that most closely approximates the intent and the economic effect of the invalid provision and that would be enforceable to the maximum extent permitted in the jurisdiction.

## **22. FORCE MAJEURE**

Neither Party will be in default or liable for any delay or failure to comply with its obligations under this Agreement or any Sales Agreement (other than an obligation to pay money) due to an event of Force Majeure. The affected Party will provide the other Party prompt notice of any such anticipated delay or failure of compliance; provided, however, that any such event of Force Majeure will not relieve the affected Party's obligations hereunder and such Party agrees to perform its obligations as soon as reasonably practicable after the conditions causing such delay or failure have subsided. As used in this Agreement, "Force Majeure" means a force beyond the fault or reasonable control of the affected Party, which may include, but shall not be limited to: any fire, flood, or other natural disaster; strikes or work stoppages; wars (declared or undeclared); acts of God; inability to procure or general shortage of labor, equipment, facilities, materials or supplies in the open market; acts, omissions or failure or refusal to act of any government agency or authority (de jure or de facto) acting in either its sovereign or contractual capacity; terrorists acts or acts of public enemies; epidemics or quarantine restrictions; freight embargoes; and public disorders or riots. For avoidance of doubt, a Party's lack of, or inability to procure, monies to fulfill its commitments and obligations under this Agreement shall not constitute an event of Force Majeure, and Force Majeure shall in no event apply to or excuse a Party's obligations to pay amounts due hereunder.

## **23. NOTICES**

All notices required under this Agreement will be in writing and sent by reputable national or international courier service, or by facsimile or electronic message (with a confirmation copy concurrently dispatched by prepaid post or courier service), to the address(es) of the respective Party as set forth below its signature hereto or to such other address as a Party may later specify by written notice so given. Notices will be effective upon receipt at the location of the specified address; provided that, notices will be effective on the date of receipt only if such day is a business day for the recipient and the notice was received before or during business hours on such day. If not, such notice will be effective on the recipient's next business day after the date of receipt.

[Signature page to follow.]

**IN WITNESS WHEREOF**, each of the parties has duly executed this Agreement effective as of the Effective Date, notwithstanding a later execution date.

**CREE, INC.**

By: /s/ David Emerson  
David Emerson  
Title: Vice President - Chips & Materials  
Date: 12/4/14

**Address for Notices**

Cree, Inc.  
4600 Silicon Drive  
Durham, North Carolina 27703  
Attn: David Emerson  
Email: [\*\*\*\*]  
Fax No.: 919-[\*\*\*\*]

With copy of any notices  
of a legal nature to:

Cree, Inc.  
Attn: General Counsel  
4600 Silicon Dr.  
Durham, North Carolina 27703  
Email: [\*\*\*\*]  
Fax No.: 919-[\*\*\*\*]

**CHARLES & COLVARD, LTD.**

By: /s/ Randy N. McCullough  
Randy N. McCullough  
Title: President and CEO  
Date: 12/12/14

**Address for Notices**

Charles & Colvard, Ltd.  
170 Southport Drive  
Morrisville, North Carolina 27560  
Attn: Randy N. McCullough  
Email: [\*\*\*\*]  
Fax No.: 919-[\*\*\*\*]

With copy of any notices  
of a legal nature to:

Wyrick Robbins Yates & Ponton LLP  
Attn: Jason Wood  
4101 Lake Boone Trail  
Raleigh, NC 27607  
Email: [\*\*\*\*]  
Fax No.: 919-[\*\*\*\*]

For purposes of Section 6(c):

**CHARLES & COLVARD DIRECT, LLC**

By: /s/ Kyle S. Macemore  
Kyle S. Macemore, Manager

**MOISSANITE.COM, LLC**

By: /s/ Kyle S. Macemore  
Kyle S. Macemore, Manager

**EXHIBIT A**

**Products:**

SiC [\*\*\*\*] crystals in sizes [\*\*\*\*]”, [\*\*\*\*] ", or [\*\*\*\*]". Notwithstanding [\*\*\*\*] in its Purchase Orders, shipments of Products will be [\*\*\*\*], provided that [\*\*\*\*] may not be more than [\*\*\*\*] of the total crystals delivered by Cree in any shipment unless mutually agreed to in advance by C&C. All delivered orders [\*\*\*\*] will be applied toward C&C’s outstanding Purchase Orders [\*\*\*\*] based on useable material shipped (not Product price).

**Pricing for [\*\*\*\*] SiC crystals (all prices are per gram):**

Tiered Pricing Schedule

Volume kg/ Qtr	[****]” Boule	[****]” Boule	Larger Diameters ([****]”, [****]”, [****]”)
Up to [****] kg	\$ [****]	\$ [****]	[****]
Next [****] kg	\$ [****]	\$ [****]	[****]
Next [****] kg	\$ [****]	\$ [****]	[****]
Next [****] kg	\$ [****]	\$ [****]	[****]
Next [****] kg	\$ [****]	\$ [****]	[****]
Next [****] kg	\$ [****]	\$ [****]	[****]
Additional Volume	[****]	[****]	[****]

The Parties agree that the foregoing pricing shall be subject to change from time to time, as mutually agreed upon in writing by the Parties, based upon improvements made by Cree to the Specifications of the SiC Materials.

As used in the Tiered Pricing Schedule above, “Volume” refers to the quantity of Products ordered by C&C for delivery in a particular Cree Fiscal Quarter that are originally confirmed or accepted by Cree for delivery in that quarter and actually delivered in that quarter, except as provided below. For example, if C&C orders [\*\*\*\*] kg for delivery in the fourth Fiscal Quarter of FY15, the Tiered Pricing Schedule would be applied as follows if all of the Products are confirmed for delivery and actually delivered in the fourth Fiscal Quarter:

Volume	Quantity in kg	Applicable price per kg (assuming all [****]” boules)	Extended Cost
Initial Volume Component 1	[****]	\$ [****]	\$ [****]
Incremental Volume Component 2	[****]	\$ [****]	\$ [****]
Incremental Volume Component 3	[****]	\$ [****]	\$ [****]
Total	[****]		\$ [****]

If any Products are not shipped in the Fiscal Quarter in which they were originally confirmed or accepted for shipment due to no fault of or other reason attributable to C&C, then the Product pricing in the order confirmation, which was based on the Volume in the Fiscal Quarter in which the Products were originally confirmed or accepted for shipment, will remain in effect. If Products are not shipped in the Fiscal Quarter in which they were originally confirmed or accepted for shipment solely due to the fault of or other reason directly attributable to C&C (including any agreement by Cree to delay shipment at C&C’s request), the price of such delayed Products will equal the price applicable to such Products if they had been ordered for and delivered in the Fiscal Quarter in which they are actually shipped. For example, if C&C orders [\*\*\*\*] kg of Product for delivery in the fourth Fiscal Quarter of FY15 and midway through the Fiscal Quarter requests Cree to delay delivery of [\*\*\*\*]kg until the first Fiscal Quarter of FY16 and Cree agrees, then the delayed Product will be considered part of the initial Volume component for the first Fiscal Quarter of FY16, and the Product pricing will be \$[\*\*\*\*] per kg (assuming all [\*\*\*\*]” boules and no other Product delivered during the first fiscal Quarter of FY16). The parties agree to cancel and reissue Purchase Orders and order confirmations as needed for accurate recordkeeping purposes to reflect any such pricing changes.

**Specifications:**

**For Purchase Orders received and accepted prior the Effective Date, Product pricing and Specifications will be determined as provided in the Expiring Agreement. For Purchase Orders received and accepted on or after the Effective Date, Product pricing and Specifications will be determined as provided in this Agreement.**

*Quantity:* The quantity of “usable material” of SiC crystals delivered to C&C pursuant to the Agreement and any Sales Agreements will be determined according to the following:

- A. Grams of usable material will be calculated on a crystal-by-crystal basis according to the following equation: [\*\*\*\*]. “[\*\*\*\*]” means [\*\*\*\*] as defined in section A under “Defects” (below).
- B. Crystals shipped to C&C must contain at least [\*\*\*\*] grams of usable material for the [\*\*\*\*]" crystals and [\*\*\*\*] grams of usable material for the [\*\*\*\*]" crystals. The usable material for the [\*\*\*\*]" crystals will be determined and mutually agreed upon in writing at a later date. This usable area must be contiguous.

*Color:* Tone/color number [\*\*\*\*] and [\*\*\*\*] as used in the C&C boule-grading screen will be considered acceptable tone and color material. The Parties agree that Grade [\*\*\*\*] should represent [\*\*\*\*] and Grade [\*\*\*\*] should represent [\*\*\*\*]. (Note: Grade [\*\*\*\*] is preferred. Grade [\*\*\*\*] material is acceptable.)

*Mix:* Unless otherwise agreed in writing by the Parties, at least [\*\*\*\*]% of the usable material in each shipment will meet the grading standards for [\*\*\*\*] gemstones provided that C&C purchases at least the Minimum Purchase Commitment in a Fiscal Quarter.

*Defects:*

- (A) Material volume of acceptable color will be reduced by the percentage of the defects listed in the table below. C&C shall set the acceptable standards for the quality of both the color and defects of all material purchased pursuant to this Agreement. Unless otherwise mutually agreed by the parties in writing, however, the grading of the material by both Cree and C&C will adhere to those standards and methods identified in Notes 1 & 2 below, or otherwise mutually agreed in writing by the Parties, applied on a consistent basis.

ID	D-Type	
1	[****]	Reduce
2	[****]	Reduce
3	[****]	Reduce
4	[****]	No reduction
5	[****]	Reduce
6	[****]	Reduce
7	[****]	No reduction
8	[****]	Reduce
9	[****]	Reduce



- (B) Within a given color band ([\*\*\*\*] or [\*\*\*\*]) grade depth across the height of the boule, when the concentration of reduced defects in aggregate as noted above exceeds [\*\*\*\*]% cross sectional area (concentrated or dispersed), the discount on the affected band shall be [\*\*\*\*].
- (C) Within a given color band grade ([\*\*\*\*] or [\*\*\*\*]) depth across the height of the boule, if the reduced defect percent in aggregate is greater than [\*\*\*\*]%, but less than [\*\*\*\*]% and is [\*\*\*\*] as per diagram below, the slab shall be priced at [\*\*\*\*].

[\*\*\*\*]

*Physical Dimensions:*

Side View of Boule shall be [\*\*\*\*]:

- 1) Dome: Top of boule shall be [\*\*\*\*]. Boules [\*\*\*\*] shall not exceed [\*\*\*\*]. For boules delivered with [\*\*\*\*] exceeding [\*\*\*\*], the total usable length will be calculated based on the [\*\*\*\*].

[\*\*\*\*]

- 2) Perpendicularity of bottom to side (as measured at sides and/or at windows): With boule resting on [\*\*\*\*], largest allowable [\*\*\*\*] shall be [\*\*\*\*]. If boule does not meet this standard, it will be rejected and Cree will have the option to rework the boule to meet this standard.

[\*\*\*\*]

**Notes**

- 1 Master Boule [\*\*\*\*]: new boules as [\*\*\*\*] this will grade as [\*\*\*\*]. Master Boule [\*\*\*\*]: new boules as [\*\*\*\*] this (but [\*\*\*\*] Master Boule [\*\*\*\*]) will grade as [\*\*\*\*]. Unless otherwise mutually agreed, any boules darker than grade [\*\*\*\*] will not be purchased by C&C.
- 2 Micropipe grading will be performed according to the Cree document identified as the [\*\*\*\*]. The area determined according to this procedure multiplied by [\*\*\*\*], defines the area of non-usable material for micropipes.

The Parties acknowledge and agree that any changes to the foregoing Specifications must be mutually agreed upon by the parties in writing and could impact Cree's manufacturing process, leading to changes in the price or delivery of SiC Materials hereunder.

**THIRD AMENDMENT TO LEASE AGREEMENT**

**THIS THIRD AMENDMENT TO LEASE AGREEMENT** (this “**Third Amendment**”) is entered into as of the 29th day of January, 2021 (the “**Third Amendment Effective Date**”), by and between **SBP OFFICE OWNER, L.P.**, a Delaware limited partnership (“**Landlord**”), and **CHARLES & COLVARD, LTD.**, a North Carolina corporation (“**Tenant**”).

**BACKGROUND:**

A. Landlord’s predecessor-in-interest, Southport Business Park Limited Partnership, and Tenant entered into that Lease Agreement dated December 9, 2013 (as amended by that First Amendment to Lease dated December 23, 2013, and that Second Amendment to Lease dated April 15, 2014, the “**Lease**”), for the lease of approximately 36,344 rentable square feet of space (the “**Premises**”) in the building located at 170 Southport Drive, Morrisville, North Carolina, all as more particularly described in the Lease.

B. Landlord and Tenant desire to enter into this Third Amendment to, among other things, extend the Term.

C. The defined terms used in this Third Amendment, as indicated by the initial capitalization thereof, shall have the same meaning ascribed to such terms in the Lease, unless otherwise specifically defined herein.

**NOW, THEREFORE**, for and in consideration of Ten and No/100 Dollars (\$10.00) and of the mutual covenants, agreements and undertakings herein set forth and other valuable considerations, the receipt and sufficiency of which are hereby acknowledged, Landlord and Tenant hereby agree as follows:

1. **Lease Term.** The Term is hereby extended for a period commencing November 1, 2021 (the “**Extension Commencement Date**”), and expiring October 31, 2026 (the “**Extension Expiration Date**”, the period from the Extension Commencement Date through the Extension Expiration Date, hereinafter referred to as the “**2021-2026 Extension Period**”), unless sooner terminated as provided in the Lease. Tenant shall accept the Premises on the Third Amendment Effective Date in its “as is, where is” condition. Tenant shall have no right to extend the Term beyond October 31, 2026, except that Tenant shall continue to have the right to extend the Term for one (1) five (5) year period from the Extension Expiration Date pursuant to the terms of **Exhibit C** of the Lease.

2. **Rent.**

(a) **Minimum Rent Prior to 2021-2026 Extension Period.** Nothing herein shall alter the Monthly Minimum Rent and other charges payable by Tenant under the Lease for any period preceding the 2021-2026 Extension Period.

(b) **Minimum Rent During 2021-2026 Extension Period.** During the 2021-2026 Extension Period, the Minimum Rent payable by Tenant shall be as follows:

[Third Amendment continues on following page]

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Lease Period	Minimum Rent Per Rentable Square Foot of the Premises Per Annum	Monthly Installment
11/1/21 – 10/31/22*	\$23.50	\$71,173.67
11/1/22 – 10/31/23	\$24.15	\$73,130.94
11/1/23 – 10/31/24	\$24.81	\$75,142.04
11/1/24 – 10/31/25	\$25.49	\$77,208.45
11/1/25 – 10/31/26	\$26.19	\$79,331.68

\* Subject to the terms of the Abatement Period set forth below.

Notwithstanding contrary provisions that may be contained in this Third Amendment, for the period commencing November 1, 2021, and ending January 31, 2022 (the “**Abatement Period**”), Landlord will forebear the obligation of Tenant to pay Minimum Rent at the rate of \$23.50 per rentable square foot of the Premises per annum (the “**Abated Payments**”), with the Abated Payments equaling \$213,521.00. The foregoing agreement by Landlord has been made relying on Tenant’s agreement to perform all of its obligations in all material respects under the Lease as and when required. As a result, in the event that an Event of Default occurs under the Lease and continues beyond any notice and cure period, in addition to Landlord’s other remedies which may be available to Landlord under the Lease or applicable law, Tenant shall reimburse Landlord an amount equal to the Unamortized Amount (as defined below) within ten (10) days following Tenant’s receipt of a written invoice therefor along with a good faith accounting of the charges set forth therein. The term Unamortized Amount refers to the result obtained by multiplying the Abated Payments by a fraction, the numerator of which is the number of months which remain or would have remained during the Term following the date of the Event of Default, and the denominator of which is fifty-seven (57).

(c) **Additional Rent.** Tenant shall continue to pay Additional Rent and other amounts due under the Lease (other than Minimum Rent) as set forth therein.

3. **Third Amendment Allowance.** Pursuant to the terms of this Third Amendment, Landlord shall pay to Tenant an allowance of up to \$545,160.00 (the “**Third Amendment Allowance**”) for the purpose of reimbursing Tenant for the direct costs incurred by Tenant after the date hereof in designing, permitting, constructing and completing any desired physical improvements to or in the Demised Premises, Lot and/or Building system upgrades and the payment of any and all contractors, consultants and materialmen in connection therewith (the “**Third Amendment Improvements**”); provided, however, that if the aggregate actual cost of the Third Amendment Improvements is less than \$545,160.00, Landlord shall only reimburse Tenant for the actual cost of such Third Amendment Improvements. Tenant shall not perform any Third Amendment Improvements prior to Landlord’s written approval of the plans and specifications therefor (such approval not to be unreasonably withheld, conditioned or delayed), and in any event all Third Amendment Improvements shall be performed in accordance with the Lease. Tenant may request Landlord’s approval by sending an email request to smesnard@trinity-partners.com and to tstrutzenberg@trinitycapitaladvisors.com, and/or emails to such other Landlord representatives that Landlord may advise from time to time. Notwithstanding anything to the contrary set forth in this Third Amendment or otherwise in the Lease, Landlord agrees that in the event that Tenant has requested consent (which may be made via email as set forth above) (each a “**Third Amendment Alteration Notice**”) from Landlord to the construction of any specific Third Amendment Improvements and/or the plans and specifications therefor and Landlord fails to respond to Tenant within five (5) business days after the receipt by Landlord of any Third Amendment Alteration Notice with its approval or disapproval, along with detailed specification of the reasons therefor in the event of any such disapproval, then Landlord shall be deemed to have approved any such Third Amendment Alterations and/or the plans and specifications therefor.

The Third Amendment Allowance shall be provided to Tenant in installment payments (in draws of not less than \$100,000.00 per draw) as the Third Amendment Improvements are performed. Landlord may, however, hold back up to ten percent (10%) of the total Third Amendment Allowance until such time as the Third Amendment Improvements have been completed in accordance with any approved plans and specifications therefor in all material respects and Landlord has received all Unconditional Lien Waivers (as defined below).

Provided Tenant is not then in an Event of Default of the Lease beyond any applicable notice and cure period, Landlord shall reimburse Tenant the requested portion of the Third Amendment Allowance, in cash, within thirty (30) days after receipt of Tenant's request therefor and provided the following events have taken place with respect to each requested draw:

(i) Approval by Landlord of the then-completed Third Amendment Improvements, said approval not to be unreasonably withheld, delayed or conditioned. In the event that Tenant has requested any approval (which may be made via email as set forth above) (each a "**Third Amendment Approval Notice**") from Landlord of any such completed Third Amendment Improvements for which Tenant is requesting a disbursement of all or any portion of the Third Amendment Allowance and Landlord fails to respond in writing to Tenant within five (5) business days after the receipt by Landlord of any such Third Amendment Approval Notice with its approval or disapproval, along with the specific reasons therefor in the event of any such disapproval, then Landlord shall be deemed to have approved any such Third Amendment Alterations.

(ii) Receipt by Landlord of a certification by Tenant's contractor or Tenant officer certifying that the Third Amendment Improvements have been completed in accordance with the plans and specifications approved by Landlord for such Third Amendment Improvements.

(iii) Subject to the terms of this Section 3(iii), receipt by Landlord of a waiver of lien in recordable form under North Carolina law from Tenant's general contractor, subcontractors, materialmen and any others providing labor and/or materials in connection with the Third Amendment Improvements for which a disbursement of the Third Amendment Allowance is being requested (it being understood that a waiver of lien may be conditioned upon the applicable contractor's receipt of the payment that is contemplated by the applicable disbursement request). Provided, however, Landlord may withhold the final draw until such time as Landlord has received final, unconditional lien waiver(s) from all such contractor(s) (each, an "**Unconditional Lien Waiver**").

(iv) Receipt by Landlord from Tenant of copies of paid invoices or any other reasonable evidence establishing the actual costs paid by Tenant for the construction and/or completion of the applicable portion of Third Amendment Improvements for which Tenant is requesting reimbursement through disbursement of any portion of the Third Amendment Allowance.

If the total actual cost of the Third Amendment Improvements exceeds the Third Amendment Allowance, Tenant shall be solely responsible for such amounts in excess of the Third Amendment Allowance. If Tenant has not requested and earned all or any portion of the Third Amendment Allowance on or before October 31, 2023, Landlord's obligation to provide any remaining Third Amendment Allowance to Tenant shall be null and void.

For the avoidance of doubt, as of the Third Amendment Effective Date, Tenant is not in an Event of Default.

4. Notices. The notice addresses for Landlord and Tenant set forth in the Lease are hereby deleted and replaced with the following:

If to Landlord:  
c/o Trinity Partners Management  
3020 Carrington Mill Blvd., Suite 425  
Morrisville, NC 27560  
Attn: Southport Asset Manager

If to Tenant:  
Charles & Colvard, Ltd.  
170 Southport Drive  
Morrisville, NC 27560  
Attn: Senior Counsel

And

Kapp Morrison LLP  
7900 Glades Road, Suite 550  
Boca Raton, FL 33434  
Attn: Stuart Kapp, Esq. and Joseph Cohen, Esq.  
Email: skapp@kappmorrison.com; jcohen@kappmorrison.com

5. Assignment. Notwithstanding anything to the contrary set forth in this Third Amendment or the Lease, Landlord's consent shall not be required with respect to the sale of any shares of Tenant on a public stock exchange and any of the provisions of Section 13 of the Lease shall be inapplicable thereto.

6. Ratification. All terms and conditions of the Lease, as amended hereby, are hereby ratified and shall remain in full force and effect. Tenant represents that Tenant is not aware of a default by Landlord or Tenant under the terms of the Lease, nor, to Tenant's actual knowledge, are there any conditions which would, with the passage of time, the giving of notice, or both, constitute a default by Tenant or Landlord under the Lease. Landlord and Tenant represent that (i) the individuals executing this Third Amendment on behalf of Landlord and Tenant, respectively, have full authority and power to execute and deliver this Third Amendment, and (ii) this Third Amendment constitutes a valid and binding obligation on the parties hereto. This Third Amendment contains all of the agreements of the parties hereto with respect to the matters contained herein, and no prior agreement, arrangement or understanding pertaining to any such matters shall be effective for any purpose. Landlord acknowledges, confirms and agrees that as of the date hereof, to Landlord's actual knowledge, Tenant is not in default under the Lease, nor do there exist any conditions which would, with the passage of time, the giving of notice, or both, constitute a default by Tenant under the Lease.

7. Counterparts. This Third Amendment may be executed in two or more counterparts. Furthermore, the parties agree that (i) this Third Amendment may be transmitted between them by electronic mail and (ii) electronic signatures shall have the effect of original signatures relative to this Third Amendment.

8. Brokerage. Tenant represents and warrants to Landlord that neither Tenant nor any of its representatives, employees or agents have consulted or negotiated with any broker or finder with regard to this Third Amendment except Lee & Associates ("Landlord's Broker") and Cushman & Wakefield U.S., Inc. ("Tenant's Broker"). Landlord shall cause any commission due to Landlord's Broker to be paid by Landlord pursuant to a separate written agreement between Landlord and Landlord's Broker (the parties acknowledging that any commission due to Tenant's Broker shall be paid by Landlord's Broker pursuant to a separate written agreement between Landlord's Broker and Tenant's Broker). Tenant shall indemnify, defend and hold Landlord harmless from any claims for fees or commissions from anyone with whom Tenant has consulted or negotiated with regard to this Third Amendment except Landlord's Broker and Tenant's Broker.

9. Confidentiality. Except as required by applicable U.S. Securities and Exchange Commission regulations, Tenant shall hold strictly confidential the information contained in this Third Amendment (including, without limitation, the rent table set forth above in Section 2(b)).

**IN WITNESS WHEREOF**, the parties hereto have caused this Third Amendment to be executed by persons duly empowered to bind the parties to perform their respective obligations hereunder the day and year first above written.

**LANDLORD:**

**SBP OFFICE OWNER, L.P.**,  
a Delaware limited partnership

By: SBP Office Owner GP, L.L.C.,  
a Delaware limited liability company,  
its general partner

By: /s/ Andres Panza  
Name: Andres Panza  
Title: Authorized Signatory  
Date: 1/29/2021

**TENANT:**

**CHARLES & COLVARD, LTD.**,  
a North Carolina corporation

By: /s/ Don O'Connell  
Name: Don O'Connell  
Title: President & CEO  
Date: 1/29/2021

**CERTIFICATION PURSUANT TO SECURITIES AND EXCHANGE ACT OF 1934  
RULE 13a-14(a) AS ADOPTED PURSUANT TO SECTION 302  
OF THE SARBANES-OXLEY ACT OF 2002**

I, Don O'Connell, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2020 of Charles & Colvard, Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 4, 2021

By: /s/ Don O'Connell  
Don O'Connell  
President and Chief Executive Officer

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**CERTIFICATION PURSUANT TO SECURITIES AND EXCHANGE ACT OF 1934  
RULE 13a-14(a) AS ADOPTED PURSUANT TO SECTION 302  
OF THE SARBANES-OXLEY ACT OF 2002**

I, Clint J. Pete, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2020 of Charles & Colvard, Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 4, 2021

By: /s/ Clint J. Pete  
Clint J. Pete  
Chief Financial Officer

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**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Charles & Colvard, Ltd. (the “Company”) on Form 10-Q for the quarterly period ended December 31, 2020 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Don O’Connell, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Don O’Connell

Don O’Connell

President and Chief Executive Officer

February 4, 2021

This Certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and shall not be deemed “filed” by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and shall not be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Report, irrespective of any general incorporation language contained in such filing.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Charles & Colvard, Ltd. (the "Company") on Form 10-Q for the quarterly period ended December 31, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Clint J. Pete, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Clint J. Pete

Clint J. Pete

Chief Financial Officer

February 4, 2021

This Certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and shall not be deemed "filed" by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and shall not be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Report, irrespective of any general incorporation language contained in such filing.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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