CHARLES & COLVARD LTD
Form 10-Q
August 13, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2013

OR

o Transition report pursuant to Section 13 of 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.)
300 Perimeter Park Drive, Suite A Morrisville, North Carolina (Address of principal executive offices)	27560 (Zip Code)

(919) 468-0399
(Registrant's telephone number, including area code)

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 x No o

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

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of August 9, 2013, there were 20,000,578 shares of the registrant's common stock, no par value per share, outstanding.

CHARLES & COLVARD, LTD.

FORM 10-Q
For the Quarterly Period Ended June 30, 2013

TABLE OF CONTENTS

		Page Number
PART I – FINANCIAL INFORMATION		
Item 1.	Financial Statements	
	Condensed Consolidated Balance Sheets (unaudited) as of June 30, 2013 and December 31, 2012	3
	Condensed Consolidated Statements of Operations (unaudited) for the three and six months ended June 30, 2013 and 2012	4
	Condensed Consolidated Statements of Cash Flows (unaudited) for the six months ended June 30, 2013 and 2012	5
	Notes to Condensed Consolidated Financial Statements (unaudited)	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	17
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	29
Item 4.	Controls and Procedures	29
PART II – OTHER INFORMATION		
Item 1.	Legal Proceedings	30
Item 1A.	Risk Factors	30
Item 6.	Exhibits	30
	Signatures	31

Table of Contents
PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

CHARLES & COLVARD, LTD.
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2013 (unaudited)	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$9,271,219	$11,860,842
Accounts receivable, net	7,857,189	8,138,358
Interest receivable	1,585	694
Held-to-maturity investments	502,362	505,068
Inventory, net	9,031,685	8,442,430
Prepaid expenses and other assets	1,129,158	737,406
Deferred income taxes	1,211,772	1,211,772
Total current assets	29,004,970	30,896,570
Long-term assets:		
Inventory, net	27,353,831	24,353,580
Property and equipment, net	1,528,557	1,746,792
Intangible assets, net	379,454	346,732
Deferred income taxes	2,671,650	2,520,818
Other assets	13,266	12,199
Total long-term assets	31,946,758	28,980,121
TOTAL ASSETS	$60,951,728	$59,876,691
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,542,711	$2,112,585
Accrued cooperative advertising	308,000	200,000
Accrued expenses and other liabilities	533,902	574,522
Total current liabilities	3,384,613	2,887,107
Long-term liabilities:		
Accrued income taxes	389,540	383,730
Total liabilities	3,774,153	3,270,837
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value	53,340,844	53,318,044
Additional paid-in capital – stock-based compensation	9,193,253	8,459,020
Accumulated deficit	(5,356,522)	(5,171,210)
Total shareholders' equity	57,177,575	56,605,854
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$60,951,728	$59,876,691

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net sales	$6,512,500	$5,058,227	$13,017,574	$9,236,612
Costs and expenses:				
Cost of goods sold	3,389,315	1,642,759	6,271,293	3,670,445
Sales and marketing	2,532,995	1,583,895	4,779,204	3,085,816
General and administrative	1,344,408	1,285,294	2,193,785	2,642,466
Research and development	9,041	8,381	15,024	16,789
Loss on abandonment of assets	95,052	-	95,052	-
Total costs and expenses	7,370,811	4,520,329	13,354,358	9,415,516
(Loss) income from operations	(858,311)	537,898	(336,784)	(178,904)
Other income (expense):				
Interest income	6,972	17,823	14,474	41,688
Interest expense	(234)	(127)	(974)	(604)
Total other income, net	6,738	17,696	13,500	41,084
(Loss) income before income taxes	(851,573)	555,594	(323,284)	(137,820)
Income tax net benefit (expense)	359,988	(7,022)	137,972	310,546
Net (loss) income	$(491,585)	$548,572	$(185,312)	$172,726
Net (loss) income per common share:				
Basic	$(0.02)	$0.03	$(0.01)	$0.01
Fully diluted	$(0.02)	$0.03	$(0.01)	$0.01
Weighted average number of shares used in computing net (loss) income per common share:				
Basic	19,812,397	19,564,451	19,736,068	19,517,481
Fully diluted	19,812,397	19,972,267	19,736,068	19,905,582

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

CHARLES & COLVARD, LTD.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$(185,312)	$172,726
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	384,749	265,607
Amortization of bond premium	2,706	2,652
Stock-based compensation	743,633	569,230
Provision for uncollectible accounts	(60,805)	245,460
Provision for sales returns	(135,000)	170,000
Provision for inventory reserves	75,000	26,000
Benefit for deferred income taxes	(150,832)	-
Loss on abandonment of assets	95,052	-
Changes in assets and liabilities:		
Accounts receivable	476,974	215,840
Interest receivable	(891)	10,220
Inventory	(3,664,506)	734,983
Prepaid expenses and other assets, net	(392,819)	(174,519)
Accounts payable	430,126	(316,446)
Accrued cooperative advertising	108,000	100,000
Accrued income taxes	5,810	(358,493)
Other accrued liabilities	(40,620)	(247,293)
Net cash (used in) provided by operating activities	(2,308,735)	1,415,967
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(202,610)	(485,878)
Proceeds from call of long-term investments	-	2,500,000
Patent, license rights, and trademark costs	(91,678)	(40,498)
Net cash (used in) provided by investing activities	(294,288)	1,973,624
CASH FLOWS FROM FINANCING ACTIVITIES:		
Stock option exercises	13,400	119,914
Net cash provided by financing activities	13,400	119,914
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(2,589,623)	3,509,505
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	11,860,842	6,701,701
CASH AND CASH EQUIVALENTS, END OF PERIOD	$9,271,219	$10,211,206
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$974	$604
Cash paid during the period for income taxes	$7,050	$11,800

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

1. DESCRIPTION OF BUSINESS

Charles & Colvard, Ltd. (the "Company"), a North Carolina corporation founded in 1995, manufactures, markets, and distributes Charles & Colvard Created Moissanite® jewels (hereinafter referred to as moissanite or moissanite jewels), finished jewelry featuring moissanite, and fashion jewelry for sale in the worldwide jewelry market. Moissanite, also known by its chemical name of silicon carbide ("SiC"), is a rare mineral first discovered in a meteor crater. Because naturally occurring SiC crystals are too small for commercial use, larger crystals must be grown in a laboratory. Leveraging its advantage of being the sole source worldwide of created moissanite jewels, the Company's strategy is to establish itself with reputable, high-quality, and sophisticated brands and to position moissanite as an affordable, luxurious alternative to other gemstones, such as diamond. The Company believes this is possible due to moissanite's exceptional brilliance, fire, luster, durability, and rarity like no other jewel available on the market. The Company sells loose moissanite jewels and finished jewelry at wholesale to distributors, manufacturers, and retailers and at retail to end consumers through its wholly owned operating subsidiaries Moissanite.com, LLC and Charles & Colvard Direct, LLC.

2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation - The accompanying unaudited 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 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 June 30, 2013 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2013.

The consolidated financial statements as of and for the three and six months ended June 30, 2013 and 2012 included in this Quarterly Report on Form 10-Q are unaudited. The balance sheet as of December 31, 2012 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, together with Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 filed with the SEC on March 29, 2013 (the "2012 Annual Report").

The accompanying consolidated financial statements as of and for the three and six months ended June 30, 2013 and 2012 include the accounts of the Company and its wholly owned subsidiaries Moissanite.com, LLC, formed in 2011; Charles & Colvard Direct, LLC, formed in 2011; and Charles & Colvard (HK) Ltd., the Company's Hong Kong subsidiary that became a dormant entity in the second quarter of 2009 and the operations of which ceased in 2008. All intercompany accounts have been eliminated.

Significant Accounting Policies - In the opinion of the Company's management, the significant accounting policies used for the three and six months ended June 30, 2013 are consistent with those used for the year ended December 31, 2012. Accordingly, please refer to the 2012 Annual Report for the Company's significant accounting policies.

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. The most significant estimates impacting the Company's consolidated financial statements relate to valuation and classification of inventories, accounts receivable reserves, deferred tax assets, uncertain tax positions, stock compensation expense, and cooperative advertising. Actual results could differ materially from those estimates.

Reclassifications - Certain amounts in the prior year's condensed consolidated financial statements have been reclassified to conform to the current year presentation.

Table of Contents

Recently Adopted/Issued Accounting Pronouncements - All new and recently issued, but not yet effective, accounting pronouncements have been deemed to be not relevant to the Company and therefore are not expected to have any impact once adopted.

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 primarily by its two distribution channels that it uses to sell its loose jewel and finished jewelry product lines. Accordingly, the Company determined its two operating and reporting segments to be wholesale distribution transacted through the parent entity and direct-to-consumer distribution transacted through the Company’s wholly owned operating subsidiaries, Moissanite.com, LLC and Charles & Colvard Direct, LLC. The accounting policies of these segments 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 Consolidated Financial Statements in the 2012 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 (loss). The Company’s inventories are maintained in the parent entity’s wholesale distribution segment and are transferred without intercompany markup to the operating subsidiaries as product line cost of goods sold when sold to the end consumer. Product line cost of goods sold is defined as product cost of goods sold in each of the Company’s wholesale distribution and direct-to-consumer distribution operating segments excluding non-capitalized expenses from the Company’s manufacturing and production control departments, comprising personnel costs, depreciation, rent, utilities, and corporate overhead allocations; freight out; inventory valuation allowance adjustments; and other inventory adjustments, comprising costs of quality issues, damaged goods, and inventory write-offs.

The Company allocates certain general and administrative and information technology-related expenses from its parent entity to its two direct-to-consumer operating subsidiaries primarily based on net sales and headcount, respectively. Unallocated expenses, which also include interest and taxes, remain in the parent entity’s wholesale distribution segment.

Summary financial information by reporting segment is as follows:

	Three Months Ended June 30,					
	2013			2012		
	Wholesale	Direct-to-Consumer	Total	Wholesale	Direct-to-Consumer	Total
Net sales						
Loose jewels	$3,984,058	$91,238	$4,075,296	$4,031,721	$54,100	$4,085,821
Finished jewelry	1,905,430	531,774	2,437,204	715,394	257,012	972,406
Total	$5,889,488	$623,012	$6,512,500	$4,747,115	$311,112	$5,058,227
Product line cost of goods sold						
Loose jewels	$1,334,472	$11,795	$1,346,267	$1,109,333	$7,340	$1,116,673
Finished jewelry	1,330,109	290,816	1,620,925	6,896	106,034	112,930
Total	$2,664,581	$302,611	$2,967,192	$1,116,229	$113,374	$1,229,603
Product line gross profit						

Loose jewels	$2,649,586	$79,443	$2,729,029	$2,922,388	$46,760	$2,969,148
Finished jewelry	575,321	240,958	816,279	708,498	150,978	859,476
Total	$3,224,907	$320,401	$3,545,308	$3,630,886	$197,738	$3,828,624
Operating income (loss)	$624,419	$(1,482,730)	$(858,311)	$1,219,750	$(681,852)	$537,898
Depreciation and amortization	$101,876	$90,486	$192,362	$98,985	$50,022	$149,007
Capital expenditures	$108,645	$5,968	$114,613	$128,849	$5,236	$134,085

7

Table of Contents

	Six Months Ended June 30, 2013			2012		
	Wholesale	Direct-to-Consumer	Total	Wholesale	Direct-to-Consumer	Total
Net sales						
Loose jewels	$8,278,212	$144,998	$8,423,210	$6,445,640	$93,598	$6,539,238
Finished jewelry	3,634,153	960,211	4,594,364	2,306,955	390,419	2,697,374
Total	$11,912,365	$1,105,209	$13,017,574	$8,752,595	$484,017	$9,236,612
Product line cost of goods sold						
Loose jewels	$3,050,412	$18,542	$3,068,954	$1,916,272	$12,014	$1,928,286
Finished jewelry	1,931,079	473,467	2,404,546	720,328	153,775	874,103
Total	$4,981,491	$492,009	$5,473,500	$2,636,600	$165,789	$2,802,389
Product line gross profit						
Loose jewels	$5,227,800	$126,456	$5,354,256	$4,529,368	$81,584	$4,610,952
Finished jewelry	1,703,074	486,744	2,189,818	1,586,627	236,644	1,823,271
Total	$6,930,874	$613,200	$7,544,074	$6,115,995	$318,228	$6,434,223
Operating income (loss)	$2,264,325	$(2,601,109)	$(336,784)	$1,161,620	$(1,340,524)	$(178,904)
Depreciation and amortization	$192,855	$191,894	$384,749	$177,725	$87,882	$265,607
Capital expenditures	$189,316	$13,294	$202,610	$369,118	$116,760	$485,878

	June 30, 2013			December 31, 2012		
	Wholesale	Direct-to-Consumer	Total	Wholesale	Direct-to-Consumer	Total
Total assets	$55,133,852	$5,817,876	$60,951,728	$58,823,642	$1,053,049	$59,876,691

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Product line cost of goods sold	$2,967,192	$1,229,603	$5,473,500	$2,802,389
Non-capitalized manufacturing and production control expenses	208,389	332,259	608,640	738,388
Freight out	51,453	24,114	87,962	41,497
Inventory valuation allowances	94,000	72,000	75,000	26,000
Other inventory adjustments	68,281	(15,217)	26,191	62,171
Cost of goods sold	$3,389,315	$1,642,759	$6,271,293	$3,670,445

The Company's net inventories by product line maintained in the parent entity's wholesale distribution segment are as follows:

Table of Contents

	June 30, 2013	December 31, 2012
Loose jewels		
Raw materials	$2,845,538	$3,189,320
Work-in-process	8,736,576	3,650,322
Finished goods	17,255,067	19,074,526
Finished goods on consignment	108,405	75,131
Total	$28,945,586	$25,989,299
Finished jewelry		
Raw materials	$299,425	$259,366
Work-in-process	629,928	250,628
Finished goods	5,815,319	5,451,178
Finished goods on consignment	604,308	748,022
Total	$7,348,980	$6,709,194

Supplies inventories of approximately $91,000 and $98,000 at June 30, 2013 and December 31, 2012, respectively, included in finished goods inventories in the consolidated financial statements are omitted from inventories by product line because they are used in both product lines and are not maintained separately.

The Company recognizes sales by geographic area based on the country in which the customer is based. A portion of the Company's international wholesale distribution segment sales represents products sold internationally that may be re-imported to United States ("U.S.") retailers. Sales to international end consumers made by the Company's direct-to-consumer distribution segment are included in U.S. sales because products are shipped and invoiced to a U.S.-based intermediary party that assumes all international shipping and credit risks. The following presents certain data by geographic area:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net sales				
United States	$5,373,178	$4,028,212	$10,485,467	$7,419,159
International	1,139,322	1,030,015	2,532,107	1,817,453
Total	$6,512,500	$5,058,227	$13,017,574	$9,236,612

	June 30, 2013	December 31, 2012
Property and equipment, net		
United States	$1,528,557	$1,746,792
International	-	-
Total	$1,528,557	$1,746,792

	June 30, 2013	December 31, 2012
Intangible assets, net		
United States	$209,972	$152,038
International	169,482	194,694
Total	$379,454	$346,732

9

Table of Contents

4. INVESTMENTS

Investments consist of long-term U.S. government agency securities carried at amortized cost using the effective interest method. The Company classifies its marketable securities as held-to-maturity based upon management's positive intention and ability to hold these securities until their maturity dates.

The following table summarizes information about held-to-maturity investments at June 30, 2013:

	Amortized Cost	Gross Unrealized Gains	Estimated Fair Value
U.S. government agency securities	$502,362	$ 4,338	$506,700

As of June 30, 2013, the estimated fair value of the investments was greater than the amortized cost. Because management intends to hold the investments until their maturity dates, this unrealized gain was not recorded in the consolidated financial statements.

The maturities of held-to-maturity investments at June 30, 2013 were as follows:

	Less than 1 Year	Total
U.S. government agency securities	$502,362	$502,362

5. 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

- 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 instruments identified as subject to fair value measurements on a recurring basis are cash and cash equivalents, trade accounts receivable, held-to-maturity investments, trade accounts payable, and accrued expenses. All instruments other than held-to-maturity investments are reflected in the consolidated balance sheets at carrying value, which approximates fair value due to the short-term nature of these instruments. The estimated fair value of the Company's held-to-maturity investments as of June 30, 2013 utilized Level 2 inputs of similar investments traded on active securities exchanges.

Assets that are measured at fair value on a non-recurring basis include property and equipment and intangible assets, comprising patents, license rights, and trademarks. These items are recognized at fair value when they are considered to be impaired. Level 3 inputs are primarily based on the estimated future cash flows of the asset determined by market inquiries to establish fair market value of used machinery or future revenue expected to be generated with the assistance of patents, license rights, and trademarks.

Table of Contents

6. INVENTORIES

The Company's total inventories, net of reserves, consisted of the following as of June 30, 2013 and December 31, 2012:

	June 30, 2013	December 31, 2012
Raw materials	$3,144,963	$3,448,686
Work-in-process	9,366,504	3,900,950
Finished goods	23,605,336	24,978,221
Finished goods on consignment	718,713	843,153
Less inventory reserves	(450,000)	(375,000)
Total	$36,385,516	$32,796,010
Current portion	$9,031,685	$8,442,430
Long-term portion	27,353,831	24,353,580
Total	$36,385,516	$32,796,010

Inventories are stated at the lower of cost or market on an average cost basis. Inventory costs include direct material and labor, inbound freight, purchasing and receiving costs, inspection costs, and warehousing costs. Any inventory on hand at the measurement date in excess of the Company's current requirements based on historical and anticipated levels of sales is classified as long-term on the Company's consolidated balance sheets. The Company's classification of long-term inventory requires it to estimate the portion of on-hand inventory that can be realized over the next 12 months and does not include precious metal, labor, and other inventory purchases expected to be both purchased and realized over the next 12 months.

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 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 June 30, 2013 and December 31, 2012, work-in-process inventories issued to active production jobs approximated $4.75 million and $1.12 million, respectively.

The Company's 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 nor is obsolescence a significant factor. The Company has very small market penetration in the worldwide jewelry market, and the Company has the exclusive right in the U.S. through mid-2015 and in many other countries through mid-2016 to produce and sell created SiC for use in jewelry applications. In view of the foregoing factors, management has concluded that no excess or obsolete loose jewel inventory reserve requirements existed as of June 30, 2013.

In 2010, the Company began manufacturing finished jewelry featuring moissanite. Relative to loose moissanite jewels, finished jewelry is more fashion oriented and subject to styling trends that could render certain designs obsolete. The majority of the Company's finished jewelry featuring moissanite is held in inventory for resale and consists of such basic 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 manufactures small individual quantities of designer-inspired moissanite fashion jewelry as part of its sample line that are used in the selling process to its wholesale customers.

In 2011, the Company began purchasing fashion finished jewelry comprised of base metals and non-precious gemstones for sale through Lulu Avenue™, the direct-to-consumer home party division of its wholly owned operating subsidiary, Charles & Colvard Direct, LLC. This finished jewelry is fashion oriented and subject to styling trends that may change with each catalog season, of which there are several each year. Typically in the jewelry industry, slow-moving or discontinued lines are sold as closeouts or liquidated in alternative sales channels. The Company reviews the finished jewelry inventory on an ongoing basis for any lower of cost or market and obsolescence issues and has established an obsolescence reserve on its fashion finished jewelry at June 30, 2013 of $39,000. The Company concluded that no such finished jewelry inventory reserve requirements relating to the Company's fashion finished jewelry existed as of December 31, 2012 or relating to its new line of finished jewelry featuring moissanite existed as of June 30, 2013 or December 31, 2012.

Table of Contents

Periodically, the Company ships finished goods inventory to wholesale customers on consignment terms. Under these terms, the customer assumes the risk of loss and has an absolute right of return for a specified period. Finished goods on consignment at June 30, 2013 and December 31, 2012 are net of shrinkage reserves of $6,000 and $20,000, respectively, to allow for certain loose jewels and finished jewelry on consignment with wholesale customers that may not be returned or may be returned in a condition that does not meet the Company's current grading or quality standards.

Total net loose jewel inventories at June 30, 2013 and December 31, 2012, including inventory on consignment net of reserves, were $28.95 million and $25.99 million, respectively. The loose jewel inventories at June 30, 2013 and December 31, 2012 include shrinkage reserves of $88,000 and $36,000, respectively, including shrinkage reserves of $0 and $17,000 on inventory on consignment at June 30, 2013 and December 31, 2012, respectively. Loose jewel inventories at June 30, 2013 and December 31, 2012 also include recuts reserves of $134,000 and $109,000, respectively.

Total net jewelry inventories at June 30, 2013 and December 31, 2012, including inventory on consignment net of reserves, finished jewelry featuring moissanite manufactured by the Company since entering the finished jewelry business in 2010, and fashion finished jewelry purchased by the Company for sale through Lulu Avenue™, were $7.35 million and $6.71 million, respectively. Jewelry inventories consist primarily of finished goods, a portion of which the Company acquired as part of a January 2009 settlement agreement with a former manufacturer customer to reduce the outstanding receivable to the Company. Due to the lack of a plan to market this inventory at that time, a jewelry inventory reserve was established to reduce the majority of the acquired jewelry inventory value to scrap value, or the amount the Company would expect to obtain by melting the gold in the jewelry and returning to loose-jewel finished goods inventory those jewels that meet grading standards. The scrap reserve established for this acquired inventory at the time of the agreement is adjusted at each reporting period for the market price of gold and has generally declined as the associated jewelry is sold down. At June 30, 2013, the balance increased to $169,000 from $132,000 at December 31, 2012 as a result of a decrease in the market price of gold, offset in part by sell down of the inventory during the quarter. The reserve will increase when the market price of gold decreases so as to lower the net realizable value of the inventory due to the lower gold price. Because the finished jewelry the Company began manufacturing in 2010 after it entered that business was made pursuant to an operational plan to market and sell the inventory, it is not subject to this reserve. In addition, the finished jewelry inventories at June 30, 2013 and December 31, 2012 include shrinkage reserves of $20,000 and $98,000, respectively, including shrinkage reserves of $6,000 and $3,000 on inventory on consignment, respectively. The finished jewelry inventories at June 30, 2013 also include an inventory reserve for obsolescence of $39,000.

The need for adjustments to inventory reserves is evaluated on a period-by-period basis.

7. INCOME TAXES

The Company recognized an income tax net benefit of approximately $360,000 and $138,000 for the three and six months ended June 30, 2013, respectively, compared to an income tax expense of approximately $7,000 and an income tax net benefit of approximately $311,000 for the three and six months ended June 30, 2012, respectively.

During 2008, the Company recorded a full valuation allowance against certain deferred tax assets consisting primarily of net operating loss carryforwards. Due to continued uncertainty over sufficient future taxable income to fully utilize these deferred tax assets, the Company did not record an income tax expense for the pretax income earned during the three months ended June 30, 2012 or an income tax benefit for the pretax loss incurred during the six months ended June 30, 2012.

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. For the year ended December 31, 2012,

cumulative positive taxable income over the last three tax years had been generated, offsetting the negative evidence of cumulative losses in previous years. The Company also determined that its expectations of future taxable income in upcoming tax years would be sufficient to result in full utilization of these net operating loss carryforwards and deferred tax assets prior to any statutory expiration. As a result, the Company's management determined that sufficient positive evidence existed as of December 31, 2012 to conclude that it is more likely than not that the majority of its deferred tax assets are realizable, and it reduced its valuation allowance accordingly. A valuation allowance remains against certain deferred tax assets relating to state net operating loss carryforwards from the Company's e-commerce and home party operating subsidiaries due to the timing uncertainty of when the subsidiaries will generate cumulative positive taxable income to utilize the associated deferred tax assets. A valuation allowance also remains against certain deferred tax assets relating to investment loss carryforwards because the Company's current investments are classified as held-to-maturity, indicating they will be redeemed at par value and will not generate gains sufficient or of the appropriate character to utilize the associated deferred tax assets.

Table of Contents

For the three months ended June 30, 2013, the Company recognized $358,000 of current period income tax benefit, offsetting an income tax expense recorded in the first quarter of 2013 of approximately $211,000. The resulting income tax net benefit of $147,000 for the six months ended June 30, 2013 represents an effective tax rate of 45.4% on the year-to-date pre-tax book loss. The effective tax rate for the six months ended June 30, 2013 differs from the federal statutory rate of 34.0% primarily due to the impact of state income taxes, stock-based compensation expense that is not deductible for tax purposes, and other book-to-tax reconciling items. This effective tax rate has increased from December 31, 2012 due to anticipation of higher taxable income in the current fiscal year, and an additional $7,000 of income tax expense was accrued and paid in the first quarter of 2013 related to the prior tax year, primarily for adjustment of the federal alternative minimum tax. Additionally, the Company recorded approximately $4,000 of income tax benefit for a discrete permanent tax deduction difference during the three and six months ended June 30, 2013 and approximately $2,000 and $6,000 of income tax expense for estimated tax, penalties, and interest associated with uncertain tax positions during the three and six months ended June 30, 2013, respectively.

During the three months ended June 30, 2012, the Company recognized approximately $7,000 of income tax expense for estimated tax, penalties, and interest associated with uncertain tax positions. During the six months ended June 30, 2012, the Company entered into a voluntary disclosure agreement with a taxing authority for which the Company had previously recorded a liability for an uncertain tax position. As a result of the agreement, the Company reduced its total recorded liabilities relating to uncertain tax positions by approximately $320,000 and recognized a corresponding income tax benefit. This benefit was offset by approximately $9,000 of income tax expense for estimated tax, penalties, and interest for other uncertain tax positions.

8. COMMITMENTS AND CONTINGENCIES

Lease Commitments

In March 2004, the Company entered into a seven-year lease, beginning in August 2004, for approximately 16,500 square feet of mixed-use space from an unaffiliated third party at a base cost with escalations throughout the lease term plus additional common-area expenses based on the Company's proportionate share of the lessor's operating costs. The lease provided for two rent holidays, during which no rent was payable, and a moving allowance. In January 2011, the Company amended the lease effective January 1, 2011 to extend the term through January 2017 in exchange for a reduced rental rate and 50% rent abatement in the first 12 months of the extended term. The amended lease includes 3% annual rent escalations and a one-time option to terminate the lease effective as of July 31, 2014. The Company recognizes rent expense on a straight-line basis, giving consideration to the rent holidays, the moving allowance paid to the Company, and the rent abatement. At the Company's option, the amended lease can be extended for one five-year period.

As of June 30, 2013, the Company's future minimum payments under this operating lease were as follows:

2013	$69,653
2014	143,486
2015	147,791
2016	152,224
2017	13,066
Total	$526,220

Rent expense for the three months ended June 30, 2013 and 2012 was approximately $77,000 and $49,000, respectively. Rent expense for the six months ended June 30, 2013 and 2012 was approximately $133,000 and $100,000, respectively.

Table of Contents

Purchase Commitments

On June 6, 1997, the Company entered into an amended and restated exclusive supply agreement with Cree, Inc. (“Cree”). The exclusive supply agreement had an initial term of ten years that was extended in January 2005 to July 2015. In connection with the amended and restated exclusive supply agreement, the Company has committed to purchase from Cree a minimum of 50%, by dollar volume, of its raw material SiC crystal requirements. If the Company’s orders require Cree to expand beyond specified production levels, the Company must commit to purchase certain minimum quantities. Effective February 8, 2013, the Company entered into an amendment to a prior letter agreement with Cree, which provides a framework for the Company’s purchases of SiC crystals under the amended and restated exclusive supply agreement. Pursuant to this amendment, the Company agreed to purchase at least $4.00 million of SiC crystals in an initial new order. After the initial new order, the Company has agreed to issue non-cancellable, quarterly orders that must equal or exceed a set minimum order quantity. The total purchase commitment under the amendment until July 2015, including the initial new order, is dependent upon the grade of the material and ranges between approximately $7.64 million and approximately $18.56 million.

9. STOCK-BASED COMPENSATION

The following table summarizes the components of the Company’s stock-based compensation included in net (loss) income:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Employee stock options	$161,227	$115,372	$300,497	$280,646
Restricted stock awards	335,740	164,449	443,136	288,584
Income tax benefit	(162,247)	(59,623)	(201,184)	(104,629)
Totals	$334,720	$220,198	$542,449	$464,601

No stock-based compensation was capitalized as a cost of inventory during the three and six months ended June 30, 2013 and 2012.

Stock Options - The following is a summary of the stock option activity for the six months ended June 30, 2013:

	Shares	Weighted Average Exercise Price
Outstanding, December 31, 2012	1,147,847	$ 2.31
Granted	176,002	$ 3.79
Exercised	(13,125)	$ 1.02
Forfeited	(71,460)	$ 2.12
Expired	(70,786)	$ 2.21
Outstanding, June 30, 2013	1,168,478	$ 2.56

The weighted average grant-date fair value of stock options granted during the six months ended June 30, 2013 was $2.68. The total fair value of stock options that vested during the six months ended June 30, 2013 was approximately $331,000. The fair value of each stock option is estimated on the date of grant using the Black-Scholes-Merton option pricing model with the following weighted average assumptions for stock options granted during the six months ended June 30, 2013:

Dividend yield	0.0 %
Expected volatility	92.9%
Risk-free interest rate	0.83%
Expected lives (years)	5.0

Although the Company issued dividends in prior years, a dividend yield of zero was used due to the uncertainty of future dividend payments. Volatility is a measure of the amount by which a financial variable such as share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The Company estimates expected volatility giving primary consideration to the historical volatility of its common stock. The risk-free interest rate is based on the published yield available on U.S. Treasury issues with an equivalent term remaining equal to the expected life of the stock option. The expected lives of the stock options represent the estimated period of time until exercise or forfeiture and are based on historical experience of similar awards.

Table of Contents

The following table summarizes information about stock options outstanding at June 30, 2013:

Options Outstanding			Options Exercisable			Options Vested or Expected to Vest		
Balance as of 6/30/2013	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of 6/30/2013	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of 6/30/2013	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
1,168,478	7.72	$ 2.56	803,203	7.25	$ 2.23	1,122,013	7.66	$ 2.52

As of June 30, 2013, the unrecognized stock-based compensation expense related to unvested stock options was approximately $699,000, which is expected to be recognized over a weighted average period of approximately 24 months.

The aggregate intrinsic value of stock options outstanding, exercisable, and vested or expected to vest at June 30, 2013 was approximately $1.89 million, $1.59 million, and $1.87 million, respectively. This amount is before applicable income taxes and represents the closing market price of the Company's common stock at June 30, 2013 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. During the three and six months ended June 30, 2013, the aggregate intrinsic value of stock options exercised was approximately $6,000 and $37,000, respectively.

Restricted Stock - The following is a summary of the restricted stock activity for the six months ended June 30, 2013:

	Shares	Weighted Average Grant Date Fair Value
Unvested, December 31, 2012	191,843	$ 3.38
Granted	253,403	$ 3.95
Vested	(173,843)	$ 3.75
Canceled	-	$ -
Unvested, June 30, 2013	271,403	$ 3.68

As of June 30, 2013, the unrecognized stock-based compensation expense related to unvested restricted stock was approximately $934,000, which is expected to be recognized over a weighted average period of approximately 23 months.

Dividends - The Company has not paid any cash dividends in the current year through June 30, 2013.

10. NET (LOSS) INCOME PER COMMON SHARE

Basic net (loss) income per common share is computed by dividing net (loss) income by the weighted average number of common shares outstanding during the periods. Fully diluted net (loss) 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 that are computed using the treasury stock method.

Antidilutive stock awards are comprised of stock options and unvested restricted shares which would have been antidilutive in the application of the treasury stock method in accordance with “Earnings Per Share” topic of the Financial Accounting Standard Board Accounting Standards Codification.

Table of Contents

The following table reconciles the differences between the basic and fully diluted earnings per share presentations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Numerator:				
Net (loss) income	$(491,585)	$548,572	$(185,312)	$172,726
Denominator:				
Weighted average common shares outstanding:				
Basic	19,812,397	19,564,451	19,736,068	19,517,481
Stock options	-	407,816	-	388,101
Fully diluted	19,812,397	19,972,267	19,736,068	19,905,582
Net (loss) income per common share:				
Basic	$(0.02)	$0.03	$(0.01)	$0.01
Fully diluted	$(0.02)	$0.03	$(0.01)	$0.01

For the three months ended June 30, 2013 and 2012, stock options to purchase approximately 289,000 and 313,000 shares, respectively, were excluded from the computation of fully diluted net (loss) income per common share because the exercise price of the stock options 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 (loss) income per common share. For the six months ended June 30, 2013 and 2012, stock options to purchase approximately 463,000 and 390,000 shares, respectively, were excluded from the computation of fully diluted net (loss) income per common share because the exercise price of the stock options 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 (loss) income per common share.

11. MAJOR CUSTOMERS AND CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, investments, and trade accounts receivable. The Company maintains cash, cash equivalents, and investments with high-quality financial institutions and invests in low-risk securities, primarily money market funds or long-term U.S. government agency obligations. At times, cash balances may exceed the Federal Deposit Insurance Corporation (“FDIC”) insurable limits of $250,000 per depositor at each financial institution. Amounts on deposit in excess of FDIC insurable limits at June 30, 2013 approximated $6.78 million.

Trade receivables potentially subject the Company to credit risk. The Company’s standard wholesale customer payment terms on trade receivables are generally between 30 and 90 days, though it may offer extended terms in limited circumstances and on significant orders from time to time. The Company believes its competitors and other vendors in the wholesale jewelry industry have also expanded their use of extended payment terms and, in aggregate, the Company believes that by expanding its use of extended payment terms, it has provided a competitive response in its market and that its net sales have been favorably impacted. The Company is unable to estimate the impact of this program on its net sales, but if it ceased providing extended payment terms in select instances, the Company believes it would not be competitive for some wholesale customers in the marketplace and that its net sales and profits would likely decrease. 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, 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. The Company has not experienced any significant

accounts receivable write-offs related to revenue arrangements with extended payment terms.

As of June 30, 2013, three customers accounted for 19%, 18%, and 13% of trade accounts receivable, respectively. As of December 31, 2012, one customer accounted for 30% of trade accounts receivable.

Table of Contents

A significant portion of sales is derived from certain customer relationships. The following is a summary of customers that represent greater than or equal to 10% of total gross sales:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Customer A	19%	11 %	12%	8 %
Customer B	19%	2 %	10%	1 %
Customer C	6 %	16 %	7 %	10 %
Customer D	6 %	14 %	9 %	13 %
Customer E	1 %	17 %	16%	30 %

12. SUBSEQUENT EVENTS

Departure of Chief Financial Officer

On August 5, 2013, Timothy L. Krist, Chief Financial Officer and Treasurer, resigned from his position with the Company, effective as of August 5, 2013.

In connection with his resignation, Mr. Krist entered into a Separation of Employment Agreement (the “Separation Agreement”), dated August 7, 2013. The terms of the Separation Agreement provide that Mr. Krist has the right to revoke the Separation Agreement until August 14, 2014.

Under the Separation Agreement, Mr. Krist is entitled to receive severance in an amount equal to one year of his current base annual salary (less applicable taxes and withholdings), payable in bi-weekly installment payments in accordance with the Company’s regular payroll schedule in exchange for a standard release of employment claims. The Company will also pay COBRA premiums for coverage of Mr. Krist and his eligible dependents for one year if Mr. Krist timely and properly elects continuation coverage. The Separation Agreement also contains such confidentiality provisions and other terms and conditions as are usual and customary for agreements of this type. All of Mr. Krist’s obligations under his Employment Agreement with the Company, dated June 23, 2009, regarding confidentiality, non-competition, proprietary information, and related matters will continue.

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, or the Securities Act, 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
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:

- Our future financial performance depends upon increased consumer acceptance, growth of sales of our products, and operational execution of our strategic initiatives.
- We are currently substantially dependent on a limited number of distributors, jewelry manufacturers, and retailers for the sale of our products.
- 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.
- The financial difficulties or insolvency of one or more of our major customers could adversely affect results.
- We expect to remain dependent upon Cree, Inc., or Cree, for the sole supply of our silicon carbide, or SiC, crystals for the foreseeable future.
- Our current wholesale customers may potentially perceive us as a competitor in the finished jewelry business.
- We face intense competition in the worldwide jewelry industry.
- Our business and our results of operations could be materially adversely affected as a result of general economic and market conditions, including the current economic environment.
- We are subject to certain risks due to our international distribution channels and vendors.
- Sales of moissanite jewelry could be dependent upon the pricing of precious metals, which is beyond our control.
- Seasonality of our business may adversely affect our net sales and operating income.
- 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.
- 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.
- Governmental regulation and oversight might adversely impact our operations.
- Some anti-takeover provisions of our charter documents and agreements may delay or prevent a takeover of our company.
- If we fail to evaluate, implement, and integrate strategic acquisition or disposition opportunities successfully, our business may suffer.

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.

Table of Contents

The following discussion is designed to provide a better understanding of our unaudited 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 year ended December 31, 2012. Historical results and percentage relationships among any amounts in the consolidated financial statements are not necessarily indicative of trends in operating results for future periods.

Overview

We manufacture, market, and distribute Charles & Colvard Created Moissanite® jewels (which we refer to as moissanite or moissanite jewels), finished jewelry featuring moissanite, and fashion jewelry for sale in the worldwide jewelry market. Moissanite, also known by its chemical name of silicon carbide, or SiC, is a rare mineral first discovered in a meteor crater. Because naturally occurring SiC crystals are too small for commercial use, larger crystals must be grown in a laboratory. Leveraging our advantage of being the sole source worldwide of created moissanite jewels, our strategy is to establish Charles & Colvard with reputable, high-quality, and sophisticated brands and to position moissanite as an affordable, luxurious alternative to other gemstones, such as diamond. We believe this is possible due to moissanite's exceptional brilliance, fire, luster, durability, and rarity like no other jewel available on the market.

We manage our business primarily by our two distribution channels that we use to sell our product lines, loose jewels and finished jewelry. Accordingly, we determined our two operating and reporting segments to be wholesale distribution transacted through our parent entity and direct-to-consumer distribution transacted through our wholly owned operating subsidiaries, Moissanite.com, LLC and Charles & Colvard Direct, LLC. We sell our loose moissanite jewels at wholesale to some of the largest distributors and manufacturers in the world, which mount them into fine jewelry to be sold at retail outlets and via the Internet. We also sell loose moissanite jewels and finished jewelry featuring moissanite at wholesale to retailers to be sold to end consumers and, in the third quarter of 2011, we established a direct-to-consumer e-commerce sales channel through our wholly owned operating subsidiary Moissanite.com, LLC that sells both loose moissanite jewels and finished jewelry featuring moissanite. Additionally, in April 2012 we launched a pilot test of a direct-to-consumer home party sales channel through our wholly owned operating subsidiary Charles & Colvard Direct, LLC, or Charles & Colvard Direct, that sells fashion and moissanite finished jewelry. We believe the expansion of our sales channels to the jewelry trade and the end consumer with branded finished moissanite jewelry creates a more compelling consumer value proposition to drive increased demand.

We are continuing to focus on our core business of manufacturing and distributing the loose moissanite jewel and finished jewelry featuring moissanite through wholesale sales channels, because this is currently the primary way we reach consumers. We believe there is substantial opportunity to grow our wholesale business and to capture a larger share of the jewelry market as we execute our strategy to increase consumer awareness of moissanite.

The wholesale finished jewelry business that we launched in 2010 is currently expanding through select retailers and television shopping networks. We believe there is significant opportunity to further expand our wholesale finished jewelry business through e-commerce, television shopping, and brick-and-mortar retailers, including major "big-box" chain retailers. We also believe our finished jewelry business, including finished jewelry sold through our direct-to-consumer e-commerce and home party sales channels, allows us to have more control over the end product and enhance our relationships with consumers, as well as provide incremental sales and gross profit dollars due to the higher price points of finished jewelry containing moissanite relative to loose jewels. To that end, we are focusing on the following critical aspects of our strategic plan during 2013:

- Developing brand strategies - Our goal is to build multiple strong brands around the moissanite jewel and finished jewelry collections in attractive and desirable jewelry designs, especially those featuring larger center stones that leverage moissanite's point of differentiation and value proposition. We believe branding will allow us to increase consumer awareness, which we expect to help drive sales and develop consumer brand recognition and loyalty.

In June 2012, we launched a moissanite jewel with optical properties that are significantly whiter than our standard VG grade jewels. We are marketing these whiter jewels under the Forever Brilliant® trademark as a premier brand to differentiate from other grades of our moissanite as well as moissanite sold by potential competitors in the future.

Table of Contents

We expect demand for our Forever Brilliant® loose jewel and finished jewelry featuring the Forever Brilliant® jewel to grow, both in our wholesale channel and on our Moissanite.com e-commerce website, and that Forever Brilliant® will become an increasingly important brand for Charles & Colvard as we execute future branding initiatives. We are also exploring additional product lines and branding strategies involving technologies for treating moissanite to produce such colors as pink, blue, and yellow, among others.

In October 2012, Charles & Colvard Direct entered into an exclusive services and licensing agreement with JudeFrances, a well-known designer jewelry brand. Under the agreement, JudeFrances custom designs and sources finished fashion and moissanite jewelry and provides branding direction for Lulu Avenue™, the home party direct sales brand of Charles & Colvard Direct. We believe this agreement serves as the point of differentiation that positions Lulu Avenue™ ahead of other jewelry home party direct sales companies and will excite both consumers and women searching for unique business ownership opportunities. We continue to seek additional opportunities to partner with recognized finished jewelry designers for our wholesale and other retail sales channels to create exclusive, branded pieces.

In June 2013, we engaged Cindy Riccio Communications, Inc., or CRC, a New York-based public relations, marketing, and events agency, as our agency of record to generate optimal exposure with consumer media for both our Lulu Avenue™ and Forever Brilliant® brands, with the goal to increase consumer awareness of our brands specifically and moissanite generally. Several media events are planned in the second half of 2013 where magazine editors, fashion columnists, and bloggers will be invited to experience first-hand our Lulu Avenue™ fashion and moissanite finished jewelry and our Forever Brilliant® loose jewels. We are also exploring through CRC exposure opportunities for our brands in leading fashion periodicals and blogging sites.

We believe our efforts to position Forever Brilliant® as the whitest and brightest moissanite jewel available anywhere in the world, the introduction of designer finished jewelry brands, and the engagement of a branding public relations agency will help us to build brand recognition and increase consumer awareness of our products. We also expect that this strategy of building brand recognition will help to support revenue streams as our intellectual property rights expire in the future.

- Expanding our direct-to-consumer e-commerce business - Our direct-to-consumer e-commerce website, Moissanite.com, features an intuitive site design with robust functionality to enhance the customer experience and convert more traffic into sales. We continue to expand the website's jewelry collections and its loose moissanite jewel assortment by featuring a variety of colors and shapes, and we are investing resources in targeted advertising and marketing campaigns. In 2013, we plan to continue fine-tuning such marketing efforts to maximize return on investment, increasing product assortment, and building new site functionality designed to increase sales conversion rates. We believe our direct-to-consumer e-commerce sales channel will not only add to our top-line revenues in a significant manner, but will also play a key role in our campaign to increase overall consumer awareness of moissanite. We also envision e-commerce as a part of a broader effort to establish online connections with consumers that build our brands and our business with retail partners.

- Developing our direct-to-consumer home party business - In October 2012, our direct-to-consumer home party business, Lulu Avenue™, began the integration of JudeFrances designs into the current jewelry line and also engaged a number of independent sales representatives that had been selling the JudeFrances jewelry line with a previous company. The first phase of the integration was completed in March 2013. In addition, in April 2013, we hired a President of Lulu Avenue™ whose focus is on the scale-up of the sales force, and in March 2013, we hired a Director of Finance and Administration, who leads the back office technology and supply chain efforts of Lulu Avenue™. With these new key personnel and the marketing personnel added in the fourth quarter of 2012, we are positioned to complete the final phase of the integration process targeted for the third quarter of 2013. We believe our direct-to-consumer home party sales channel will provide future sales growth and play a key role in our campaign to increase overall consumer awareness of moissanite.

19

Table of Contents

As we execute our strategy to build and reinvest in the business, expenses and investment of cash will be required ahead of the revenue streams we expect in the future, and this may result in some unprofitable quarters as we experienced in the second quarter of 2013. Despite this, we have maintained as one of our primary goals to generate positive cash flow each quarter to protect our cash position. We were not successful in achieving this goal during the six months ended June 30, 2013 primarily as a result of our significant inventory build of Forever Brilliant® loose jewels to meet demand, which we believe is a temporary use of cash until we can ship our current backlog, establish an in-stock position for future orders, and collect on our trade receivables generated from these sales. We will continue to diligently focus on cost containment and monitor our cash burn rate as we grow the business.

Our total consolidated net sales for the six months ended June 30, 2013 of $13.02 million were 41% greater than total consolidated net sales during the same period of 2012. Wholesale distribution segment net sales for the six months ended June 30, 2013 of $11.91 million were 36% greater than wholesale distribution segment net sales during the same period of 2012. Direct-to-consumer distribution segment net sales for the six months ended June 30, 2013 of $1.11 million were 128% greater than direct-to-consumer distribution segment net sales during the same period of 2012.

Loose jewel sales comprised 65% of our total consolidated net sales and increased 29% to $8.42 million, for the six months ended June 30, 2013 compared with $6.54 million in the same period of 2012. Finished jewelry sales comprised 35% of our total consolidated net sales and increased 70% to $4.59 million, compared with $2.70 million in the same period of 2012. We expect these increases in sales by product mix to continue as we execute our strategy of developing new wholesale and direct-to-consumer sales channels and expanding our finished jewelry business.

Operating expenses increased by $1.34 million, or 23%, to $7.08 million for the six months ended June 30, 2013, compared with $5.75 million in the same period of 2012. Of this increase, sales and marketing expenses increased $1.69 million, or 55%, to $4.78 million, primarily as a result of personnel additions and advertising and marketing initiatives incurred to position our company for future growth, especially with respect to the two wholly owned operating subsidiaries formed in 2011 for our e-commerce and home party direct sales businesses; and a reallocation beginning in 2013 of certain information technology shared resources based on headcount. As we grow our business, we intend to continue to closely manage our operating expenses by seeking the most cost effective and efficient solutions to our operating requirements. We recorded a net loss of $185,000, or $0.01 per share, for the six months ended June 30, 2013, primarily due to an increase in operating expenses and a lower gross profit margin, offset in part by our higher sales and an income tax net benefit recognized during the period. Our lower overall gross profit margin resulted from a slightly lower product margin on loose jewels due to sales mix and discounts; and a lower product margin on finished jewelry primarily due to sales mix and a $802,000 sale of slow moving jewelry inventory during the second quarter of 2013.

The execution of our strategy to grow our company, with the ultimate goal of increasing consumer awareness and clearly communicating the value proposition of moissanite, is challenging and not without risk. As such, there can be no assurance that future results for each reporting period will exceed past results in sales, operating cash flow, and/or net income due to the challenging business environment in which we operate, our changing business model, and our investment in various initiatives to support our growth strategies. However, as we execute our growth strategy and messaging initiatives, we remain committed to our current priorities of generating positive cash flow and strengthening our financial position through cost-management efforts while both monetizing our existing inventory and manufacturing our new whiter Forever Brilliant® loose jewel and finished jewelry to meet sales demand. We believe the results of these efforts will propel our revenue growth and profitability and further enhance shareholder value in coming years, but we fully recognize the business and economic challenges in which we operate.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which we prepared in accordance with accounting principles generally accepted in the United States. The preparation of these 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, actual results of operations may materially differ. We have disclosed our critical accounting policies and estimates in our Annual Report on Form 10-K for the year ended December 31, 2012, and that disclosure should be read in conjunction with this Quarterly Report on Form 10-Q.

Table of Contents

Results of Operations

The following table sets forth certain consolidated statements of operations data for the three and six months ended June 30, 2013 and 2012:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net sales	$6,512,500	$5,058,227	$13,017,574	$9,236,612
Costs and expenses:				
Cost of goods sold	3,389,315	1,642,759	6,271,293	3,670,445
Sales and marketing	2,532,995	1,583,895	4,779,204	3,085,816
General and administrative	1,344,408	1,285,294	2,193,785	2,642,466
Research and development	9,041	8,381	15,024	16,789
Loss on abandonment of assets	95,052	-	95,052	-
Total costs and expenses	7,370,811	4,520,329	13,354,358	9,415,516
(Loss) income from operations	(858,311)	537,898	(336,784)	(178,904)
Other income (expense):				
Interest income	6,972	17,823	14,474	41,688
Interest expense	(234)	(127)	(974)	(604)
Total other income, net	6,738	17,696	13,500	41,084
(Loss) income before income taxes	(851,573)	555,594	(323,284)	(137,820)
Income tax net benefit (expense)	359,988	(7,022)	137,972	310,546
Net (loss) income	$(491,585)	$548,572	$(185,312)	$172,726

Consolidated Net Sales

Consolidated net sales for the three and six months ended June 30, 2013 and 2012 comprise the following:

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2013	2012	Dollars	Percent	2013	2012	Dollars	Percent
Loose jewels	$4,075,296	$4,085,821	$(10,525)	-	$8,423,210	$6,539,238	$1,883,972	29 %
Finished jewelry	2,437,204	972,406	1,464,798	151 %	4,594,364	2,697,374	1,896,990	70 %
Total consolidated net sales	$6,512,500	$5,058,227	$1,454,273	29 %	$13,017,574	$9,236,612	$3,780,962	41 %

Consolidated net sales were $6.51 million for the three months ended June 30, 2013 compared to $5.06 million for the three months ended June 30, 2012, an increase of $1.45 million, or 29%. Consolidated net sales were $13.02 million for the six months ended June 30, 2013 compared to $9.24 million for the six months ended June 30, 2012, an increase of $3.78 million, or 41%.The improvement in consolidated net sales for the three and six months ended June 30, 2013 was due primarily to an increase in loose jewel sales to our existing wholesale customer base resulting from our new whiter Forever Brilliant® moissanite jewel and the growth of our wholesale customers' moissanite finished jewelry lines with styles that include both Forever Brilliant® and our loose jewel standard grades. The improvement in consolidated net sales was also attributable to a $802,000 sale of slow moving jewelry inventory during the second quarter of 2013 and the growth in sales of our direct-to-consumer businesses, Moissanite.com and Lulu Avenue™, which collectively increased 100% to $623,000 and 128% to $1.11 million during the three and six months ended June 30, 2013, respectively. We anticipate orders and related sales of loose moissanite jewels and finished jewelry featuring moissanite in both our wholesale distribution segment and direct-to-consumer distribution segment will

continue to improve as we execute our growth strategies.

Table of Contents

Sales of loose jewels represented 63% and 65% of total consolidated net sales for the three and six months ended June 30, 2013, respectively, compared to 81% and 71% of total consolidated net sales for the corresponding periods of the prior year. For the three months ended June 30, 2013, loose jewel sales were $4.08 million compared to $4.09 million for the corresponding period of the prior year, a decrease of $11,000, or less than 1%. For the six months ended June 30, 2013, loose jewel sales were $8.42 million compared to $6.54 million for the corresponding period of the prior year, an increase of $1.88 million, or 29%. The slight decrease for the three months ended June 30, 2013 was primarily due to the timing of reorders from our existing wholesale customer base and allowing our largest retail customers to rebalance their inventory stocks for the upcoming holiday season. We expect with the increased raw material SiC crystals being ordered from Cree and our increased production of loose jewels that we will be in stock of the most popular shapes and sizes of Forever Brilliant® by the end of the third quarter of 2013. The increase for the six months ended June 30, 2013 was primarily attributable to robust sales we are experiencing from our existing wholesale customer base, especially of our new whiter Forever Brilliant® moissanite jewel, as they grow their moissanite businesses. This increase in loose jewel sales was offset in part by an approximate $552,000 return of loose jewels for stock rebalancing received during the second quarter of 2013 from a wholesale customer.

Sales of finished jewelry represented 37% and 35% of total consolidated net sales for the three and six months ended June 30, 2013, respectively, compared to 19% and 29% of total consolidated net sales for the corresponding periods of the prior year. For the three months ended June 30, 2013, finished jewelry sales were $2.44 million compared to $972,000 for the corresponding period of the prior year, an increase of $1.46 million, or 151%. For the six months ended June 30, 2013, finished jewelry sales were $4.59 million compared to $2.70 million for the corresponding period of the prior year, an increase of $1.90 million, or 70%. These increases were primarily attributable in our wholesale distribution segment to our ongoing expansion into the finished jewelry business, the growth of our wholesale customers' moissanite finished jewelry businesses, a $802,000 sale of slow moving jewelry inventory during the second quarter of 2013; and the growth of our e-commerce and home party businesses in our direct-to-consumer distribution segment.

United States, or U.S., net sales accounted for approximately 83% and 81% of total consolidated net sales for the three and six months ended June 30, 2013, respectively, compared to 80% and 80% of total consolidated net sales for the corresponding periods of the prior year. U.S. net sales increased 33% and 41% during the three and six months ended June 30, 2013, respectively, from the corresponding periods of the prior year primarily as a result of an increase in loose jewel sales to our wholesale customer base resulting from the launch of our new whiter Forever Brilliant® moissanite jewel and the growth of our wholesale customers' moissanite finished jewelry lines. The increase in U.S. sales was also attributable to a $802,000 sale of slow moving jewelry inventory during the second quarter of 2013 and the growth of our direct-to-consumer businesses, Moissanite.com and Lulu Avenue™.

Our two largest U.S. customers during the three months ended June 30, 2013 each accounted for 19% of total consolidated sales compared to 11% and 2%, respectively, during the same period of 2012. Three U.S. customers accounted for 17%, 16%, and 14% of total consolidated sales during the three months ended June 30, 2012 but did not account for a significant percentage of total consolidated sales during the same period of 2013. Our three largest U.S. customers during the six months ended June 30, 2013 accounted for 16%, 12%, and 10%, respectively, of total consolidated sales compared to 30%, 8%, and 1%, respectively, during the same period of 2012. Two U.S. customers accounted for 13% and 10% of total consolidated sales during the six months ended June 30, 2012 but did not account for a significant percentage of total consolidated sales during the same period of 2013. 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 17% and 19% of total consolidated net sales for the three and six months ended June 30, 2013, respectively, compared to 20% and 20% of total consolidated net sales for the corresponding periods of the prior year. International sales increased 11% and 39% during the three and six months ended June 30, 2013, respectively, from the corresponding periods of the prior year primarily as a result of an increase

in loose jewel sales to our wholesale customer base, especially of our new whiter Forever Brilliant® moissanite jewel as distribution expands internationally, resulting from the growth of our wholesale customers' moissanite businesses. No international customers accounted for more than 10% of total consolidated sales during the three and six months ended June 30, 2013 or 2012. A portion of our international consolidated sales represents jewels sold internationally that may be re-imported to U.S. retailers. Our top three international distributors by sales volume during the three months ended June 30, 2013 were located in Italy, Hong Kong, and India. Our top three international distributors by sales volume during the six months ended June 30, 2013 were located in India, Hong Kong, and Italy.

Table of Contents

Costs and Expenses

Cost of Goods Sold

Cost of goods sold for the three and six months ended June 30, 2013 and 2012 are as follows:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013	2012	Change Dollars	Percent	2013	2012	Change Dollars	Percent
Product line cost of goods sold								
Loose jewels	$1,346,267	$1,116,673	$229,594	21 %	$3,068,954	$1,928,286	$1,140,668	59 %
Finished jewelry	1,620,925	112,930	1,507,995	1,335 %	2,404,546	874,103	1,530,443	175 %
Total product line cost of goods sold	2,967,192	1,229,603	1,737,589	141 %	5,473,500	2,802,389	2,671,111	95 %
Non-product line cost of goods sold	422,123	413,156	8,967	2 %	797,793	868,056	(70,263)	-8 %
Total cost of goods sold	$3,389,315	$1,642,759	$1,746,556	106 %	$6,271,293	$3,670,445	$2,600,848	71 %

Total cost of goods sold was $3.39 million for the three months ended June 30, 2013 compared to $1.64 million for the three months ended June 30, 2012, an increase of $1.75 million, or 106%. Total cost of goods sold was $6.27 million for the six months ended June 30, 2013 compared to $3.67 million for the six months ended June 30, 2012, an increase of $2.60 million, or 71%. Product line cost of goods sold is defined as product cost of goods sold in each of our wholesale distribution and direct-to-consumer distribution operating segments excluding non-capitalized expenses from our manufacturing and production control departments, comprising personnel costs, depreciation, rent, utilities, and corporate overhead allocations; freight out; inventory valuation allowance adjustments; and other inventory adjustments, comprising costs of quality issues, damaged goods, and inventory write-offs.

The increase in cost of goods sold for the three months ended June 30, 2013 compared to the same period in 2012 was primarily due to a $230,000 increase in loose jewel product line cost of goods sold resulting from a greater percentage of higher-cost Forever Brilliant® loose jewel sales during the quarter; a $1.51 million increase in finished jewelry product line cost of goods sold resulting from the 151% increase in finished jewelry sales, lower product margins driven primarily by a $802,000 sale of slow moving jewelry inventory during the second quarter of 2013, and a $97,000 accounting reclassification of first quarter 2012 finished jewelry cost of goods sold that was recorded in the second quarter of 2012 from product line cost of goods sold to non-product line cost of goods sold; and a net increase in non-product line cost of goods sold of $9,000. The net increase in non-product line cost of goods sold comprises an $84,000 increase in other inventory adjustments; a $27,000 increase in freight out; and a $22,000 increase in inventory valuation allowances, including inventory shrinkage, recuts, repairs, and scrap reserves; offset in part by a $124,000 decrease in non-capitalized manufacturing and production control expenses. See Note 3, “Segment Information and Geographic Data,” in the Notes to Condensed Consolidated Financial Statements for further discussion of non-product line cost of goods sold.

The increase in cost of goods sold for the six months ended June 30, 2013 compared to the same period in 2012 was primarily due to a $1.14 million increase in loose jewel product line cost of goods sold resulting from the 29% increase in loose jewel sales and a greater percentage of higher-cost Forever Brilliant® loose jewel sales during the current year; and a $1.53 million increase in finished jewelry product line cost of goods sold resulting from the 70%

increase in finished jewelry sales and lower product margins driven primarily by a $802,000 sale of slow moving jewelry inventory during the second quarter of 2013. The increase in cost of goods sold was offset in part by a net decrease in non-product line cost of goods sold of $70,000. The net decrease in non-product line cost of goods sold comprises a $130,000 decrease in non-capitalized manufacturing and production control expenses and a $36,000 decrease in other inventory adjustments, offset in part by a $49,000 increase in inventory valuation allowances, including inventory shrinkage, recuts, repairs, and scrap reserves; and a $47,000 increase in freight out.

Information technology-related costs were historically included in general and administrative expenses. Beginning in 2013, our management determined that certain information technology shared resources should be allocated based on headcount to more accurately assign operating costs between our wholesale and direct-to-consumer operating segments. The net result of this allocation for the three and six months ended June 30, 2013 compared to the same periods in the prior year were a $308,000 and a $516,000 aggregate decrease, respectively, in general administrative expenses; a $185,000 and a $315,000 aggregate increase, respectively, in sales and marketing expenses; and a $123,000 and a $201,000 aggregate increase, respectively, in cost of goods sold. For the three and six months ended June 30, 2013, the allocation to cost of goods sold, which is included as non-product line cost of goods sold, comprised $71,000 and $113,000, respectively, of compensation costs; $24,000 and $45,000, respectively, of depreciation and amortization expense; $16,000 and $24,000, respectively, of professional services; $10,000 and $16,000, respectively, of office-related expenses; and $2,000 and $3,000, respectively, of travel-related expenses.

Table of Contents

Sales and Marketing

Sales and marketing expenses for the three and six months ended June 30, 2013 and 2012 are as follows:

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2013	2012	Dollars	Percent	2013	2012	Dollars	Percent
Sales and marketing	$2,532,995	$1,583,895	$949,100	60 %	$4,779,204	$3,085,816	$1,693,388	55 %

Sales and marketing expenses were $2.53 million for the three months ended June 30, 2013 compared to $1.58 million for the three months ended June 30, 2012, an increase of $949,000, or 60%. Sales and marketing expenses were $4.78 million for the six months ended June 30, 2013 compared to $3.09 million for the six months ended June 30, 2012, an increase of $1.69 million, or 55%.

The increase in sales and marketing expenses for the three months ended June 30, 2013 compared to the same period in 2012 was primarily due to a $337,000 net increase in compensation costs; a $207,000 net increase in professional services related to the addition of temporary personnel, consulting services, public relations services, and the maintenance of software platforms for our direct-to-consumer e-commerce and home party lines of business; a $155,000 net increase in advertising expenses; a $130,000 increase in office-related expenses to support a larger sales and marketing organization; a $66,000 increase in travel-related expenses resulting from new sales and marketing personnel and expanding business opportunities; and a $54,000 increase in depreciation expense related to the Moissanite.com and Lulu Avenue™ e-commerce websites. Compensation costs increased primarily as a result of an increase in salaries and related employee benefits in the aggregate of $344,000, an increase in stock-based compensation expense of $112,000, an increase in bonus expense of $53,000, and an increase in employee relocation costs of $1,000. These increases in compensation costs were offset in part by a decrease in severance pay of $158,000 and a decrease in commissions of $15,000 due to the timing of orders by specific customers under which commission plans of sales representatives are based. The increase in advertising expenses comprises an increase in agency expenses of $126,000 primarily in support of our Moissanite.com and Lulu Avenue™ direct-to-consumer businesses, a net increase in cooperative advertising expenses of $49,000, an increase in targeted marketing and trade shows of $25,000, and an increase in production advertising of $5,000. The increase in cooperative advertising expenses resulted primarily from the increase in sales of loose jewels compared to the same period in the prior year and management's estimate of future utilization based on our historical experience with each customer and the related contractual arrangements to provide certain levels of cooperative advertising for our customers. These increases in advertising expenses were offset in part by a decrease in print media advertising of $31,000 due to timing of services and a decrease in Internet marketing of $19,000 due primarily to greater efficiencies gained in paid search advertising in support of our Moissanite.com and Lulu Avenue™ e-commerce websites.

The increase in sales and marketing expenses for the six months ended June 30, 2013 compared to the same period in 2012 was primarily due to a $530,000 net increase in compensation costs; a $480,000 net increase in professional services related to the addition of temporary personnel, consulting services, public relations services, and the maintenance of software platforms for our direct-to-consumer e-commerce and home party lines of business; a $263,000 net increase in advertising expenses; a $232,000 increase in office-related expenses to support a larger sales and marketing organization; a $129,000 increase in depreciation expense related to the Moissanite.com and Lulu Avenue™ e-commerce websites; and a $59,000 increase in travel-related expenses resulting from new sales and marketing personnel and expanding business opportunities. Compensation costs increased primarily as a result of an increase in salaries and related employee benefits in the aggregate of $225,000, an increase in stock-based compensation expense of $193,000, and an increase in bonus expense of $157,000. These increases in compensation costs were offset in part by a decrease in severance pay of $22,000, a decrease in employee relocation costs of

$18,000, and a decrease in commissions of $5,000 due to the timing of orders by specific customers under which commission plans of sales representatives are based. The increase in advertising expenses comprises an increase in Internet marketing of $150,000 due primarily to greater paid search advertising during the first quarter of 2013 in support of our Moissanite.com and Lulu Avenue™ e-commerce websites, a net increase in cooperative advertising expenses of $61,000, an increase in agency expenses of $40,000 primarily in support of our Moissanite.com and Lulu Avenue™ direct-to-consumer businesses, an increase in production advertising of $10,000, and an increase in targeted marketing and trade shows of $7,000. The increase in cooperative advertising expenses resulted primarily from the increase in sales of loose jewels compared to the same period in the prior year and management's estimate of future utilization based on our historical experience with each customer and the related contractual arrangements to provide certain levels of cooperative advertising for our customers. These increases in advertising expenses were offset in part by a decrease in print media advertising of $5,000 due to timing of services.

Table of Contents

As previously discussed, beginning in 2013, certain information technology-related costs historically included in general and administrative expenses are now allocated to sales and marketing expenses and cost of goods sold. For the three and six months ended June 30, 2013 compared to the same period in the prior year, $185,000 and $315,000 in aggregate, respectively, of information technology-related costs were allocated to sales and marketing expenses, comprising $108,000 and $179,000, respectively, of compensation costs; $36,000 and $71,000, respectively, of depreciation and amortization expense; $25,000 and $38,000, respectively, of professional services; $14,000 and $24,000, respectively, of office-related expenses; and $2,000 and $3,000, respectively, of travel-related expenses.

We expect our total sales and marketing expenses will continue to increase as sales increase, but the rate of growth should slow and become a lower percentage of sales as expenses more variable in nature, such as advertising and commissions, increase as part of our strategy to build sales; but fixed expenses, such as compensation costs, remain relatively constant.

General and Administrative

General and administrative expenses for the three and six months ended June 30, 2013 and 2012 are as follows:

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2013	2012	Dollars	Percent	2013	2012	Dollars	Percent
General and administrative	$1,344,408	$1,285,294	$59,114	5 %	$2,193,785	$2,642,466	$(448,681)	-17 %

General and administrative expenses were $1.34 million for the three months ended June 30, 2013 compared to $1.29 million for the three months ended June 30, 2012, an increase of $59,000, or 5%. General and administrative expenses were $2.19 million for the six months ended June 30, 2013 compared to $2.64 million for the six months ended June 30, 2012, a decrease of $449,000, or 17%.

The increase in general and administrative expenses for the three months ended June 30, 2013 compared to the same period in 2012 was primarily due to a $189,000 net increase in compensation costs; a $30,000 increase in legal professional services; an $11,000 increase in travel-related expenses associated with investor, customer, and supplier meetings; an $8,000 increase in Board member compensation due to a greater number of committee meetings held during the year; and a $1,000 increase in commercial insurance expenses. These increases were offset in part by a $58,000 decrease in bad debt expense associated with our allowance for doubtful accounts reserve policy; a $57,000 decrease in office-related expenses; a $36,000 decrease in depreciation and amortization expense; a $16,000 decrease in consulting and other professional services primarily relating to the support of our enterprise resource planning system that was placed in service during the first quarter of 2012; a $9,000 decrease in software maintenance agreements; and a $5,000 decrease in personal property and franchise taxes. Compensation costs increased primarily as a result of an increase in stock-based compensation expense of $106,000, an increase in bonus expense of $64,000, and an increase in salaries and related employee benefits in the aggregate of $24,000, offset in part by a decrease in employee relocation costs of $5,000.

The decrease in general and administrative expenses for the six months ended June 30, 2013 compared to the same period in 2012 was primarily due to a $306,000 decrease in bad debt expense associated with our allowance for doubtful accounts reserve policy; a $76,000 decrease in consulting and other professional services primarily relating to the support of our enterprise resource planning system that was placed in service during the first quarter of 2012; a $61,000 decrease in depreciation and amortization expense; a $55,000 decrease in office-related expenses; a $30,000 decrease in legal professional services; a $17,000 decrease in software maintenance agreements; an $11,000 decrease in audit and tax professional services due to the timing of work performed; an $11,000 decrease in personal property

and franchise taxes; and a $3,000 decrease in travel-related expenses associated with investor, customer, and supplier meetings. These decreases were offset in part by a $116,000 net increase in compensation costs and a $5,000 increase in commercial insurance expenses. Compensation costs increased primarily as a result of an increase in bonus expense of $81,000 and an increase in stock-based compensation expense of $66,000, offset in part by a decrease in salaries and related employee benefits in the aggregate of $23,000 and a decrease in employee relocation costs of $8,000.

Table of Contents

As previously discussed, beginning in 2013, certain information technology-related costs historically included in general and administrative expenses are now allocated to sales and marketing expenses and cost of goods sold. For the three and six months ended June 30, 2013 compared to the same period in the prior year, $308,000 and $516,000 in aggregate, respectively, of information technology-related costs were allocated from general and administrative expenses, comprising $179,000 and $292,000, respectively, of compensation costs; $60,000 and $116,000, respectively, of depreciation and amortization expense; $41,000 and $62,000, respectively, of professional services; $24,000 and $40,000, respectively, of office-related expenses; and $4,000 and $6,000, respectively, of travel-related expenses.

Research and Development

Research and development expenses for the three and six months ended June 30, 2013 and 2012 are as follows:

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2013	2012	Dollars	Percent	2013	2012	Dollars	Percent
Research and development	$9,041	$8,381	$660	8 %	$15,024	$16,789	$(1,765)	-11 %

Research and development expenses were $9,000 for the three months ended June 30, 2013 compared to $8,000 for the three months ended June 30, 2012, an increase of $1,000, or 8%. Research and development expenses were $15,000 for the six months ended June 30, 2013 compared to $17,000 for the six months ended June 30, 2012, a decrease of $2,000, or 11%.

The increase in research and development expenses for the three months ended June 30, 2013 compared to the same period in 2012 was primarily due to a $3,000 increase in compensation costs for time allocated by operations personnel to research and development activities, offset in part by a $1,000 decrease in consulting professional services and a $1,000 decrease in office-related expenses.

The decrease in research and development expenses for the six months ended June 30, 2013 compared to the same period in 2012 was primarily due to a $7,000 decrease in consulting professional services and a $1,000 decrease in office-related expenses, offset in part by a $6,000 increase in compensation costs for time allocated by operations personnel to research and development activities.

Loss on Abandonment of Assets

Loss on abandonment of assets for the three and six months ended June 30, 2013 and 2012 are as follows:

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2013	2012	Dollars	Percent	2013	2012	Dollars	Percent
Loss on abandonment of assets	$95,052	$ -	$95,052	-	$95,052	$ -	$95,052	-

During the second quarter of 2013, we transitioned our Lulu Avenue™ direct sales front-end and back-office system to a new platform and abandoned the prior capitalized software modifications of approximately $95,000 associated with the previous platform, resulting in a loss on abandonment of assets for the three and six months ended June 30, 2013.

Interest Income

Interest income for the three and six months ended June 30, 2013 and 2012 is as follows:

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2013	2012	Dollars	Percent	2013	2012	Dollars	Percent
Interest income	$6,972	$17,823	$(10,851)	-61 %	$14,474	$41,688	$(27,214)	-65 %

Interest income was $7,000 for the three months ended June 30, 2013 compared to $18,000 for the three months ended June 30, 2012, a decrease of $11,000, or 61%. Interest income was $14,000 for the six months ended June 30, 2013 compared to $42,000 for the six months ended June 30, 2012, a decrease of $27,000, or 65%.

Table of Contents

The decrease in interest income for the three and six months ended June 30, 2013 compared to the same periods in 2012 resulted primarily from lower cash and investment balances of $9.77 million held at June 30, 2013 as compared to the balances of $11.47 million held at June 30, 2012. Additionally, this cash was invested in lower yielding money market accounts during the three and six months ended June 30, 2013 due to the $3.25 million in U.S. government agency securities called during the year ended December 31, 2012.

Provision for Income Taxes

We recognized an income tax net benefit of approximately $360,000 and $138,000 for the three and six months ended June 30, 2013, respectively, compared to an income tax expense of approximately $7,000 and an income tax net benefit of approximately $311,000 for the three and six months ended June 30, 2012, respectively.

During 2008, we recorded a full valuation allowance against certain deferred tax assets consisting primarily of net operating loss carryforwards. Due to continued uncertainty over sufficient future taxable income to fully utilize these deferred tax assets, we did not record an income tax expense for the pretax income earned during the three months ended June 30, 2012 or for the pretax loss incurred during the six months ended June 30, 2012.

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. For the year ended December 31, 2012, cumulative positive taxable income over the last three tax years had been generated, offsetting the negative evidence of cumulative losses in previous years. We also determined that our expectations of future taxable income in upcoming tax years would be sufficient to result in full utilization of these net operating loss carryforwards and deferred tax assets prior to any statutory expiration. As a result, management determined that sufficient positive evidence existed as of December 31, 2012 to conclude that it is more likely than not that the majority of our deferred tax assets are realizable, and we reduced our valuation allowance accordingly. A valuation allowance remains against certain deferred tax assets relating to state net operating loss carryforwards from our e-commerce and home party operating subsidiaries due to the timing uncertainty of when the subsidiaries will generate cumulative positive taxable income to utilize the associated deferred tax assets. A valuation allowance also remains against certain deferred tax assets relating to investment loss carryforwards because our current investments are classified as held-to-maturity, indicating they will be redeemed at par value and will not generate gains sufficient or of the appropriate character to utilize the associated deferred tax assets.

For the three months ended June 30, 2013, we recognized $358,000 of current period income tax benefit, offsetting an income tax expense recorded in the first quarter of 2013 of approximately $211,000. The resulting income tax net benefit of $147,000 for the six months ended June 30, 2013 represents an effective tax rate of 45.4% on the year-to-date pre-tax book loss. The effective tax rate for the six months ended June 30, 2013 differs from the federal statutory rate of 34.0% primarily due to the impact of state income taxes, stock-based compensation expense that is not deductible for tax purposes, and other book-to-tax reconciling items. This effective tax rate has increased from December 31, 2012 due to anticipation of higher taxable income in the current fiscal year, and an additional $7,000 of income tax expense was accrued and paid in the first quarter of 2013 related to the prior tax year, primarily for adjustment of the federal alternative minimum tax. Additionally, we recorded approximately $4,000 of income tax benefit for a discrete permanent tax deduction difference during the three and six months ended June 30, 2013 and approximately $2,000 and $6,000 of income tax expense for estimated tax, penalties, and interest associated with uncertain tax positions during the three and six months ended June 30, 2013, respectively.

During the three months ended June 30, 2012, we recognized approximately $7,000 of income tax expense for estimated tax, penalties, and interest associated with uncertain tax positions. During the six months ended June 30, 2012, we entered into a voluntary disclosure agreement with a taxing authority for which we had previously recorded a liability for an uncertain tax position. As a result of the agreement, we reduced our total recorded liabilities relating to uncertain tax positions by approximately $320,000 and recognized a corresponding income tax benefit. This benefit

was offset by approximately $9,000 of income tax expense for estimated tax, penalties, and interest for other uncertain tax positions.

Table of Contents

Liquidity and Capital Resources

We require cash to fund our operating expenses and working capital requirements, including outlays for capital expenditures. As of June 30, 2013, our principal sources of liquidity were cash and cash equivalents totaling $9.27 million, trade accounts receivable of $7.86 million, and short-term inventory of $9.03 million, as compared to cash and cash equivalents totaling $11.86 million, trade accounts receivable of $8.14 million, and short-term inventory of $8.44 million as of December 31, 2012. We had $502,000 of highly liquid U.S. government agency securities at June 30, 2013 that we classified as held-to-maturity current assets on our consolidated balance sheets due to our positive intention and ability to hold these securities until their maturity dates in 2013.

During the six months ended June 30, 2013, our working capital decreased by approximately $2.39 million to $25.62 million from $28.01 million at December 31, 2012. As described more fully below, the decrease in working capital at June 30, 2013 is primarily attributable to a decrease in cash and cash equivalents, a decrease in trade accounts receivable, a decrease in held-to-maturity investments, an increase in trade accounts payable, and a net increase in accrued expenses and other liabilities, offset in part by an increase in interest receivable, a greater allocation of inventory to short-term, and an increase in prepaid expenses and other assets.

During the six months ended June 30, 2013, $2.31 million of cash was used in operations. The primary drivers of negative cash flow were a net increase in inventory of $3.66 million and an increase in prepaid expenses and other assets of $393,000. These factors more than offset our net loss of $185,000 that included $955,000 of net non-cash expenses, a decrease in trade accounts receivable of $477,000, an increase in trade accounts payable of $430,000, and a net increase in accrued liabilities of $73,000. Inventories increased primarily as a result of new raw material SiC crystals purchased during the six months ended June 30, 2013 pursuant to our Amended and Restated Exclusive Supply Agreement with Cree, or the Cree Exclusive Supply Agreement; purchases of jewelry castings, findings, and other jewelry components; and production of moissanite gemstones, offset in part by sales during the quarter. Prepaid expenses and other assets increased primarily as a result of deposits made during the quarter in advance of goods or services received. Accounts payable increased primarily as a result of the timing of costs incurred but not yet paid as of June 30, 2013 associated with inventory-related purchases and professional services incurred but not yet due under our vendors' payment terms. Accounts receivable decreased primarily as a result of collection efforts during the first half of 2013, offset in part by extended wholesale customer payment terms that we offer from time to time that may not immediately increase liquidity as a result of current-period sales. We believe our competitors and other vendors in the wholesale jewelry industry have also expanded their use of extended payment terms and, in aggregate, we believe that by expanding our use of extended payment terms, we have provided a competitive response in our market and that our net sales have been favorably impacted. We are unable to estimate the impact of this program on our net sales, but if we ceased providing extended payment terms in select instances, we believe we would not be competitive for some wholesale customers in the marketplace and that our net sales and profits would likely decrease. We have not experienced any significant accounts receivable write-offs related to revenue arrangements with extended payment terms.

We manufactured approximately $4.16 million in loose jewels and $2.97 million in finished jewelry, 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 June 30, 2013. We expect our purchases of precious metals and labor to increase as we increase our finished jewelry business. In addition, from the beginning of 2006 through the second quarter of 2013, the price of gold has increased significantly (approximately 125%), resulting in higher retail price points for gold jewelry. Because the market price of gold and other precious metals is beyond our control, the recent 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 our reduced sales during the

periods when the purchase commitments were in effect, have resulted in levels of inventories that are higher than we might otherwise maintain. As of June 30, 2013, $27.35 million of our inventories were classified as long-term assets. Loose jewel sales and finished jewelry that we manufacture will utilize both the finished good loose jewels currently on hand and, as we deplete certain shapes and sizes, our on-hand raw material SiC crystals of $2.85 million and new raw material that we are purchasing from Cree.

In connection with the Cree Exclusive Supply Agreement, which expires in July 2015, we have committed to purchase from Cree a minimum of 50%, by dollar volume, of our raw material SiC crystal requirements. If our orders require Cree to expand beyond specified production levels, we must commit to purchase certain minimum quantities.

Table of Contents

Effective February 8, 2013, we entered into an amendment to a prior letter agreement with Cree, which provides a framework for our purchases of SiC crystals under the Cree Exclusive Supply Agreement. Pursuant to this amendment, we agreed to purchase at least $4.00 million of SiC crystals in an initial new order. After the initial new order, we have agreed to issue non-cancellable, quarterly orders that must equal or exceed a set minimum order quantity. Our total purchase commitment under the amendment until July 2015, including the initial new order, is dependent upon the grade of the material and ranges between approximately $7.64 million and approximately $18.56 million. During the six months ended June 30, 2013, we purchased $4.99 million of raw material SiC crystals pursuant to this amendment. We expect to use existing cash and cash equivalents and other working capital, together with future cash expected to be provided by operating activities, to finance this purchase commitment.

We made approximately $7,000 of income tax payments during the six months ended June 30, 2013, consisting of an approximate $6,000 federal alternative minimum tax payment; and an approximate $1,000 tax payment to a state taxing authority, the majority of which was to settle prior year tax liabilities. As of June 30, 2013, we had approximately $881,000 of remaining federal income tax credits, $533,000 of which expire between 2018 and 2021 and the balance without an expiration, which can be carried forward to offset future income taxes. As of June 30, 2013, we also had a federal tax net operating loss carryforward of approximately $5.73 million expiring between 2020 and 2030, which can be used to offset against future federal taxable income, a North Carolina tax net operating loss carryforward of approximately $8.40 million expiring between 2015 and 2025, and various other state tax net operating loss carryforwards expiring between 2016 and 2030, which can be used to offset against future state taxable income.

On August 6, 2013, the Board authorized the extension of the Company’s share repurchase program for an additional 12 months. The program, which was originally authorized on November 13, 2009, authorizes the Company to repurchase up to 1,000,000 shares of the Company’s common stock until August 12, 2014 in open market or in privately negotiated transactions. The Company expects to use available cash to finance these purchases and will determine the timing and amount of stock repurchases based on the Company’s evaluation of market conditions, the market price of the Company’s common stock, and management’s assessment of the Company’s liquidity and cash flow needs. The Company has no obligations to repurchase shares under the program and the program may be suspended or terminated at any time. As of August 6, 2013, 809,213 shares of the Company’s common stock remain available for repurchase under the program.

We believe that our existing cash and cash equivalents and other working capital, together with future cash expected to be provided by operating activities, will be sufficient to meet our working capital and capital expenditure needs over the next 12 months. Our future capital requirements and the adequacy of available funds will depend on many factors, including our rate of sales growth; the expansion of our sales and marketing activities, including the operating capital needs of our wholly owned subsidiaries; the timing and extent of raw materials and labor purchases in connection with loose jewel production to support our moissanite jewel business and precious metals and labor purchases in connection with jewelry production to support our finished jewelry business; the timing of capital expenditures; and risk factors described in more detail in “Risk Factors” in this report and in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012. Also, we may make investments in, or acquisitions of, complementary businesses, which could also require us to seek additional equity or debt financing.

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.

Table of Contents

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 June 30, 2013, 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 year ended December 31, 2012 various risks that may materially affect our business. There have been no material changes to such risks.

Item 6. Exhibits

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

Exhibit No.	Description
10.1	Employment Agreement, effective as of May 6, 2013, by and between Charles & Colvard, Ltd. and Steve Larkin (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K, as filed with the SEC on April 22, 2013)
31.1	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
31.2	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
32.1	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
32.2	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 quarter ended June 30, 2013 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 Cash Flows; and (iv) Notes to Condensed Consolidated Financial Statements.**

** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act, are deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise are not subject to liability under those sections.
30

Table of Contents

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.
	By:	/s/ Randy N. McCullough
August 12, 2013		Randy N. McCullough
		President and Chief Executive Officer
	By:	/s/ Kyle Macemore
August 12, 2013		Kyle Macemore
		Senior Vice President and Chief Financial Officer
		(Principal Financial Officer and Chief Accounting Officer)

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
10.1	Employment Agreement, effective as of May 6, 2013, by and between Charles & Colvard, Ltd. and Steve Larkin (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K, as filed with the SEC on April 22, 2013)
31.1	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
31.2	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
32.1	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
32.2	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 quarter ended June 30, 2013 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 Cash Flows; and (iv) Notes to Condensed Consolidated Financial Statements.**

** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act, are deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise are not subject to liability under those sections.