

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2022

OR

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.)

170 Southport Drive
Morrisville, North Carolina
(Address of principal executive offices)

27560
(Zip Code)

(919) 468-0399

(Registrant's telephone number, including area code)

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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

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

As of January 27, 2023, there were 30,523,705 shares of the registrant's common stock, no par value per share, outstanding.

FORM 10-Q

For the Quarterly Period Ended December 31, 2022

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

CHARLES & COLVARD, LTD.
CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2022	June 30, 2022
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 11,960,102	\$ 15,668,361
Restricted cash	5,065,189	5,510,979
Accounts receivable, net	2,086,868	2,220,816
Inventory, net	13,091,953	11,024,276
Note receivable	-	250,000
Prepaid expenses and other assets	1,241,712	1,190,012
Total current assets	33,445,824	35,864,444
Long-term assets:		
Inventory, net	21,903,094	22,488,524
Property and equipment, net	2,215,274	1,901,176
Intangible assets, net	290,673	265,730
Operating lease right-of-use assets	2,488,052	2,787,419
Deferred income taxes, net	6,286,797	5,851,904
Note receivable	250,000	-
Other assets	50,300	49,658
Total long-term assets	33,484,190	33,344,411
TOTAL ASSETS	\$ 66,930,014	\$ 69,208,855
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 4,860,869	\$ 4,401,229
Operating lease liabilities, current portion	868,269	856,571
Accrued expenses and other liabilities	1,398,178	1,546,483
Total current liabilities	7,127,316	6,804,283
Long-term liabilities:		
Noncurrent operating lease liabilities	2,453,994	2,846,805
Total long-term liabilities	2,453,994	2,846,805
Total liabilities	9,581,310	9,651,088
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Common stock, no par value; 50,000,000 shares authorized; 30,912,108 shares issued and 30,523,705 shares outstanding at December 31, 2022 and 30,778,046 shares issued and 30,747,759 shares outstanding at June 30, 2022	57,242,211	57,242,211
Additional paid-in capital	26,131,216	25,956,491
Treasury stock, at cost, 388,403 shares and 30,287 shares at December 31, 2022 and June 30, 2022, respectively	(489,979)	(38,164)
Accumulated deficit	(25,534,744)	(23,602,771)
Total shareholders' equity	57,348,704	59,557,767
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 66,930,014	\$ 69,208,855

See Notes to Condensed Consolidated Financial Statements.

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

	<u>Three Months Ended December 31,</u>		<u>Six Months Ended December 31,</u>	
	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>
Net sales	\$ 10,366,122	\$ 13,753,135	\$ 17,740,204	\$ 24,033,446
Costs and expenses:				
Cost of goods sold	6,071,775	7,033,946	10,157,785	12,050,496
Sales and marketing	4,339,684	4,079,035	7,447,630	6,809,187
General and administrative	1,187,955	1,189,559	2,601,431	2,773,835
Total costs and expenses	<u>11,599,414</u>	<u>12,302,540</u>	<u>20,206,846</u>	<u>21,633,518</u>
(Loss) Income from operations	(1,233,292)	1,450,595	(2,466,642)	2,399,928
Other income (expense):				
Interest income	59,574	490	99,776	845
Loss on foreign currency exchange	-	-	-	(34)
Total other income (expense), net	<u>59,574</u>	<u>490</u>	<u>99,776</u>	<u>811</u>
(Loss) Income before income taxes	(1,173,718)	1,451,085	(2,366,866)	2,400,739
Income tax benefit (expense)	131,937	(283,473)	434,893	(406,102)
Net (loss) income	<u>\$ (1,041,781)</u>	<u>\$ 1,167,612</u>	<u>\$ (1,931,973)</u>	<u>\$ 1,994,637</u>
Net (loss) income per common share:				
Basic	\$ (0.03)	\$ 0.04	\$ (0.06)	\$ 0.07
Diluted	\$ (0.03)	\$ 0.04	\$ (0.06)	\$ 0.06
Weighted average number of shares used in computing net (loss) income per common share:				
Basic	30,344,954	30,287,677	30,408,018	30,159,543
Diluted	30,344,954	31,315,488	30,408,018	31,237,948

See Notes to Condensed Consolidated Financial Statements.

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

Six Months Ended December 31, 2022

	Common Stock		Additional Paid-in Capital	Treasury Stock	Accumulated Deficit	Total Shareholders' Equity
	Number of Shares	Amount				
Balance at June 30, 2022	30,747,759	\$ 57,242,211	\$ 25,956,491	\$ (38,164)	\$ (23,602,771)	\$ 59,557,767
Stock-based compensation	-	-	96,232	-	-	96,232
Cancellation of restricted stock	(44,688)	-	-	-	-	-
Repurchases of common stock	(358,116)	-	-	(451,815)	-	(451,815)
Net loss	-	-	-	-	(890,192)	(890,192)
Balance at September 30, 2022	30,344,955	\$ 57,242,211	\$ 26,052,723	\$ (489,979)	\$ (24,492,963)	\$ 58,311,992
Stock-based compensation	-	-	78,493	-	-	78,493
Issuance of restricted stock	178,750	-	-	-	-	-
Net loss	-	-	-	-	(1,041,781)	(1,041,781)
Balance at December 31, 2022	<u>30,523,705</u>	<u>\$ 57,242,211</u>	<u>\$ 26,131,216</u>	<u>\$ (489,979)</u>	<u>\$ (25,534,744)</u>	<u>\$ 57,348,704</u>

Six Months Ended December 31, 2021

	Common Stock		Additional Paid-in Capital	Treasury Stock	Accumulated Deficit	Total Shareholders' Equity
	Number of Shares	Amount				
Balance at June 30, 2021	29,913,095	\$ 56,057,109	\$ 25,608,593	\$ -	\$ (25,976,686)	\$ 55,689,016
Stock-based compensation	-	-	279,407	-	-	279,407
Issuance of restricted stock	242,725	-	-	-	-	-
Stock option exercises	183,637	397,112	(139,742)	-	-	257,370
Net income	-	-	-	-	827,025	827,025
Balance at September 30, 2021	30,339,457	\$ 56,454,221	\$ 25,748,258	\$ -	\$ (25,149,661)	\$ 57,052,818
Stock-based compensation	-	-	199,004	-	-	199,004
Stock option exercises	255,590	447,877	(159,329)	-	-	288,548
Net income	-	-	-	-	1,167,612	1,167,612
Balance at December 31, 2021	<u>30,595,047</u>	<u>\$ 56,902,098</u>	<u>\$ 25,787,933</u>	<u>\$ -</u>	<u>\$ (23,982,049)</u>	<u>\$ 58,707,982</u>

See Notes to Condensed Consolidated Financial Statements.

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

	Six Months Ended December 31,	
	2022	2021
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	\$ (1,931,973)	\$ 1,994,637
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	308,900	238,210
Stock-based compensation	174,725	478,411
Provision for uncollectible accounts	-	52,000
Provision for sales returns	422,000	652,000
Inventory write-downs	119,000	232,000
Provision for accounts receivable discounts	4,899	29,250
Deferred income taxes	(434,893)	405,159
Changes in operating assets and liabilities:		
Accounts receivable	(292,951)	(2,718,303)
Inventory	(1,601,247)	(2,899,591)
Prepaid expenses and other assets, net	247,025	(483,054)
Accounts payable	459,640	2,096,372
Accrued income taxes	-	943
Accrued expenses and other liabilities	(529,418)	43,297
Net cash (used in) provided by operating activities	<u>(3,054,293)</u>	<u>121,331</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(617,283)	(775,705)
Payments for intangible assets	(30,658)	(27,730)
Net cash used in investing activities	<u>(647,941)</u>	<u>(803,435)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Stock option exercises	-	545,918
Repurchases of common stock	(451,815)	-
Net cash (used in) provided by financing activities	<u>(451,815)</u>	<u>545,918</u>
NET DECREASE IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH	(4,154,049)	(136,186)
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, BEGINNING OF PERIOD	21,179,340	21,446,951
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, END OF PERIOD	<u>\$ 17,025,291</u>	<u>\$ 21,310,765</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes	\$ 5,900	\$ -

See Notes to Condensed Consolidated Financial Statements.

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

1. DESCRIPTION OF BUSINESS

Charles & Colvard, Ltd. (the “Company”), a North Carolina corporation, was founded in 1995. The Company manufactures, markets, and distributes *Charles & Colvard Created Moissanite*[®] (hereinafter referred to as moissanite or moissanite jewels) and finished jewelry featuring moissanite, including *Forever One*[™], the Company’s premium moissanite gemstone brand, for sale in the worldwide fine jewelry market. The Company also markets and distributes *Caydia*[®] lab grown diamonds and finished jewelry featuring lab grown diamonds for sale in the worldwide fine jewelry market. Moissanite, also known by its chemical name silicon carbide (“SiC”), is a rare mineral first discovered in a meteorite crater. Because naturally occurring SiC crystals are too small for commercial use, larger crystals must be grown in a laboratory. Lab grown diamonds are also grown using technology that replicates the natural diamond growing process. The only differentiation between that of a lab grown diamond and a mined diamond is its origin. The result is a man-made diamond that is chemically, physically, and optically the same as those grown beneath the earth’s surface.

The Company sells loose moissanite jewels, loose lab grown diamonds, and finished jewelry featuring both moissanite and lab grown diamonds at wholesale prices to distributors, manufacturers, retailers, and designers, including some of the largest distributors and jewelry manufacturers in the world. The Company’s finished jewelry and loose moissanite jewels and lab grown diamonds that are mounted into fine jewelry by other manufacturers are sold at retail outlets and via the Internet. The Company sells at retail prices to end-consumers through its own *Charles & Colvard Signature Showroom*, which opened in October 2022, and also through its wholly owned operating subsidiary, charlesandcolvard.com, LLC, third-party online marketplaces, drop-ship, and other pure-play, exclusively e-commerce outlets. The Company also sells at discount retail prices to end-consumers through moissaniteoutlet.com, LLC, a wholly owned operating subsidiary of charlesandcolvard.com, LLC, and third-party online marketplaces.

2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation – The accompanying unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information. However, certain information or footnote disclosures normally included in complete financial statements prepared in accordance with U.S. GAAP have been condensed, or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). In the opinion of the Company’s management, the unaudited condensed consolidated financial statements in this Quarterly Report on Form 10-Q include all normal and recurring adjustments necessary for the fair statement of the results for the interim periods presented. The results for the six months ended December 31, 2022 are not necessarily indicative of the results to be expected for the fiscal year ending June 30, 2023.

The condensed consolidated financial statements as of December 31, 2022 and for the three and six months ended December 31, 2022 and 2021 included in this Quarterly Report on Form 10-Q are unaudited. The balance sheet as of June 30, 2022 is derived from the audited financial statements as of that date. The accompanying statements should be read in conjunction with the audited financial statements and related notes contained in Item 8 of the Company’s Annual Report on Form 10-K (the “2022 Annual Report”) for the fiscal year ended June 30, 2022 filed with the SEC on September 2, 2022.

The accompanying condensed consolidated financial statements as of December 31, 2022, for the three and six months ended December 31, 2022 and 2021, and as of the fiscal year ended June 30, 2022, include the accounts of the Company and its wholly owned subsidiaries charlesandcolvard.com, LLC, including its wholly-owned subsidiary, moissaniteoutlet.com, LLC, which was formed and incorporated as of February 24, 2022; Charles & Colvard Direct, LLC; and Charles & Colvard (HK) Ltd., the Company’s Hong Kong subsidiary, which was entered into dormancy as of September 30, 2020 following its re-activation in December 2017. Charles & Colvard (HK) Ltd. previously became dormant in the second quarter of 2009 and has had no operating activity since 2008. Charles & Colvard Direct, LLC, had no operating activity during the six-month periods ended December 31, 2022 or 2021. All intercompany accounts have been eliminated.

Significant Accounting Policies – In the opinion of the Company’s management, the Company’s significant accounting policies used for the three and six months ended December 31, 2022, are consistent with those used for the fiscal year ended June 30, 2022. Accordingly, please refer to Note 2 to the Consolidated Financial Statements in the 2022 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. As future events and their effects, including the impact of the COVID-19 pandemic and the related responses, cannot be fully determined with precision, actual results of operations, cash flow, and financial position could differ significantly from estimates. The most significant estimates impacting the Company’s condensed consolidated financial statements relate to valuation and classification of inventories, accounts receivable reserves, deferred tax assets, stock-based compensation, and revenue recognition. Changes in estimates are reflected in the condensed consolidated financial statements in the period in which the change in estimate occurs.

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

Restricted Cash – In accordance with the terms of the Company’s cash collateralized \$5.00 million credit facility from JPMorgan Chase Bank, N.A. (“JPMorgan Chase”), which expires by its terms on July 31, 2023, the Company is required to keep \$5.05 million in a cash deposit account held by JPMorgan Chase. Such amount is held as security for the Company’s credit facility from JPMorgan Chase. Accordingly, this cash deposit held by JPMorgan Chase is classified as restricted cash for financial reporting purposes on the Company’s condensed consolidated balance sheets. For additional information regarding the Company’s cash collateralized credit facility, see Note 10, “Debt.”

Pursuant to the terms and conditions of the Company’s broker-dealer agreement with Oppenheimer & Co., Inc. (“Oppenheimer”), with whom the Company has engaged to transact common stock share repurchases in connection with its stock repurchase program, the Company is required to maintain a funded liquid margin account held by Oppenheimer for the benefit of the Company. The purpose of this account is to fund the Company’s common stock purchases and any underlying transaction costs and fees. Depending upon the level and timing of stock repurchase activity, the funded margin account cash balance will fluctuate from time to time. At December 31, 2022 and June 30, 2022, cash in the amount of approximately \$30 and approximately \$461,000, respectively, was held by Oppenheimer. Such cash amount held by Oppenheimer was classified as restricted cash for financial reporting purposes on the Company’s condensed consolidated balance sheets. For additional information regarding the Company’s stock repurchase program, see Note 11, “Shareholders’ Equity and Stock-Based Compensation.”

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

	December 31, 2022	June 30, 2022
Cash and cash equivalents	\$ 11,960,102	\$ 15,668,361
Restricted cash	5,065,189	5,510,979
Total cash, cash equivalents, and restricted cash	\$ 17,025,291	\$ 21,179,340

Reclassification – Certain amounts in the Company’s condensed consolidated financial statements for the quarterly period ended December 31, 2022 have been reclassified to conform to current presentation, principally amounts presented in Note 7, “Accrued Expenses and Other Liabilities”, relating to the combination of accrued sales taxes and accrued franchise taxes, which had previously been presented separately. These reclassifications had no impact on the Company’s condensed consolidated financial position or condensed consolidated results of operations as of or for the three and six months ended December 31, 2022 and 2021 and as of the year ended June 30, 2022.

Recently Adopted/Issued Accounting Pronouncements – In March 2020, and as updated in January 2021, in response to concerns about structural risks of interbank offered rates (“IBORs”), and, particularly, the risk of cessation of the London Interbank Offered Rate (“LIBOR”), the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2020-04, *Reference Rate Reform (Topic 848)* (“ASU 2020-04”), which provides guidance to ease the burden in accounting for or recognizing the effects of referenced interest rate reform on financial reporting. ASU 2020-04 is elective and may be applied as of March 12, 2020 through December 31, 2022. As described in more detail in Note 10, “Debt”, borrowings under the Company’s line of credit during the fiscal year ended June 30, 2022 would have been based on a rate equal to the one-month LIBOR. As of December 31, 2022, the Company had not borrowed against its line of credit, and therefore, did not elect to apply ASU 2020-04 as of or for the quarterly period then ended.

3. SEGMENT INFORMATION AND GEOGRAPHIC DATA

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

The Company manages its business through two operating and reportable segments based on its distribution channels to sell its product lines, loose jewels and finished jewelry: its “Online Channels” segment, which consists of e-commerce outlets including charlesandcolvard.com, moissaniteoutlet.com, third-party online marketplaces, drop-ship retail, and other pure-play, exclusively e-commerce outlets; and its “Traditional” segment, which consists of wholesale and retail customers, including its own *Charles & Colvard Signature Showroom*. The accounting policies of the Online Channels segment and Traditional segment are the same as those described in Note 2, “Basis of Presentation and Significant Accounting Policies” of this Quarterly Report on Form 10-Q and in the Notes to the Consolidated Financial Statements in the 2022 Annual Report.

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

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

Summary financial information by reportable segment is as follows:

	Three Months Ended December 31, 2022		
	Online Channels	Traditional	Total
Net sales			
Finished jewelry	\$ 7,123,440	\$ 1,312,768	\$ 8,436,208
Loose jewels	722,388	1,207,526	1,929,914
Total	<u>\$ 7,845,828</u>	<u>\$ 2,520,294</u>	<u>\$ 10,366,122</u>
Product line cost of goods sold			
Finished jewelry	\$ 3,446,197	\$ 739,134	\$ 4,185,331
Loose jewels	263,285	607,965	871,250
Total	<u>\$ 3,709,482</u>	<u>\$ 1,347,099</u>	<u>\$ 5,056,581</u>
Product line gross profit			
Finished jewelry	\$ 3,677,243	\$ 573,634	\$ 4,250,877
Loose jewels	459,103	599,561	1,058,664
Total	<u>\$ 4,136,346</u>	<u>\$ 1,173,195</u>	<u>\$ 5,309,541</u>
Operating loss	\$ (346,102)	\$ (887,190)	\$ (1,233,292)
Depreciation and amortization	\$ 56,505	\$ 114,684	\$ 171,189
Capital expenditures	\$ 22,620	\$ 164,263	\$ 186,883

	Three Months Ended December 31, 2021		
	Online Channels	Traditional	Total
Net sales			
Finished jewelry	\$ 8,452,535	\$ 2,086,631	\$ 10,539,166
Loose jewels	871,119	2,342,850	3,213,969
Total	<u>\$ 9,323,654</u>	<u>\$ 4,429,481</u>	<u>\$ 13,753,135</u>
Product line cost of goods sold			
Finished jewelry	\$ 3,432,950	\$ 1,271,026	\$ 4,703,976
Loose jewels	333,785	1,100,780	1,434,565
Total	<u>\$ 3,766,735</u>	<u>\$ 2,371,806</u>	<u>\$ 6,138,541</u>
Product line gross profit			
Finished jewelry	\$ 5,019,585	\$ 815,605	\$ 5,835,190
Loose jewels	537,334	1,242,070	1,779,404
Total	<u>\$ 5,556,919</u>	<u>\$ 2,057,675</u>	<u>\$ 7,614,594</u>
Operating income	\$ 1,432,727	\$ 17,868	\$ 1,450,595
Depreciation and amortization	\$ 53,470	\$ 60,528	\$ 113,998
Capital expenditures	\$ 27,040	\$ 350,545	\$ 377,585
	Six Months Ended December 31, 2022		
	Online Channels	Traditional	Total
Net sales			
Finished jewelry	\$ 11,527,029	\$ 2,449,585	\$ 13,976,614
Loose jewels	1,171,285	2,592,305	3,763,590
Total	<u>\$ 12,698,314</u>	<u>\$ 5,041,890</u>	<u>\$ 17,740,204</u>
Product line cost of goods sold			
Finished jewelry	\$ 5,416,308	\$ 1,375,723	\$ 6,792,031
Loose jewels	425,984	1,270,889	1,696,873
Total	<u>\$ 5,842,292</u>	<u>\$ 2,646,612</u>	<u>\$ 8,488,904</u>
Product line gross profit			
Finished jewelry	\$ 6,110,721	\$ 1,073,862	\$ 7,184,583
Loose jewels	745,301	1,321,416	2,066,717
Total	<u>\$ 6,856,022</u>	<u>\$ 2,395,278</u>	<u>\$ 9,251,300</u>
Operating loss	\$ (955,647)	\$ (1,510,995)	\$ (2,466,642)
Depreciation and amortization	\$ 119,892	\$ 189,008	\$ 308,900
Capital expenditures	\$ 159,608	\$ 457,675	\$ 617,283

	Six Months Ended December 31, 2021		
	Online Channels	Traditional	Total
Net sales			
Finished jewelry	\$ 12,939,493	\$ 3,285,960	\$ 16,225,453
Loose jewels	1,753,966	6,054,027	7,807,993
Total	<u>\$ 14,693,459</u>	<u>\$ 9,339,987</u>	<u>\$ 24,033,446</u>
Product line cost of goods sold			
Finished jewelry	\$ 5,144,174	\$ 1,894,285	\$ 7,038,459
Loose jewels	647,890	2,846,121	3,494,011
Total	<u>\$ 5,792,064</u>	<u>\$ 4,740,406</u>	<u>\$ 10,532,470</u>
Product line gross profit			
Finished jewelry	\$ 7,795,319	\$ 1,391,675	\$ 9,186,994
Loose jewels	1,106,076	3,207,906	4,313,982
Total	<u>\$ 8,901,395</u>	<u>\$ 4,599,581</u>	<u>\$ 13,500,976</u>
Operating income	\$ 1,754,398	\$ 645,530	\$ 2,399,928
Depreciation and amortization	\$ 121,172	\$ 117,038	\$ 238,210
Capital expenditures	\$ 86,300	\$ 689,405	\$ 775,705

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

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	2021	2022	2021
Product line cost of goods sold	\$ 5,056,581	\$ 6,138,541	\$ 8,488,904	\$ 10,532,470
Non-capitalized manufacturing and production control expenses	686,834	416,828	1,063,887	759,229
Freight out	358,617	465,207	634,354	682,712
Inventory write-downs	-	-	119,000	232,000
Other inventory adjustments	(30,257)	13,370	(148,360)	(155,915)
Cost of goods sold	<u>\$ 6,071,775</u>	<u>\$ 7,033,946</u>	<u>\$ 10,157,785</u>	<u>\$ 12,050,496</u>

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

The following presents net sales by geographic area:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	2021	2022	2021
Net sales				
United States	\$ 9,989,702	\$ 13,021,717	\$ 17,085,074	\$ 22,846,447
International	376,420	731,418	655,130	1,186,999
Total	<u>\$ 10,366,122</u>	<u>\$ 13,753,135</u>	<u>\$ 17,740,204</u>	<u>\$ 24,033,446</u>

4. FAIR VALUE MEASUREMENTS

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

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

The Company evaluates assets and liabilities subject to fair value measurements on a recurring and non-recurring basis to determine the appropriate level to classify them for each reporting period. This determination requires significant judgments to be made by management of the Company. The financial instruments identified as subject to fair value measurements on a recurring basis are cash and cash equivalents, notes receivable, trade accounts receivable, and trade accounts payable. All financial instruments are reflected in the condensed consolidated balance sheets at carrying value, which approximates fair value due to the nature of these financial instruments. Assets that are measured at fair value on a non-recurring basis include property and equipment, leasehold improvements, and intangible assets comprising patents, license rights, and trademarks. These items are recognized at fair value when they are considered to be impaired. For the three and six months ended December 31, 2022 and 2021, no impairment was recorded.

5. INVENTORIES

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

	December 31, 2022	June 30, 2022
Finished jewelry:		
Raw materials	\$ 1,427,479	\$ 1,697,361
Work-in-process	758,703	1,260,728
Finished goods	14,160,399	12,100,910
Finished goods on consignment	2,417,645	2,135,856
Total finished jewelry	<u>\$ 18,764,226</u>	<u>\$ 17,194,855</u>
Loose jewels:		
Raw materials	\$ 1,455,749	\$ 1,985,355
Work-in-process	8,720,482	8,485,713
Finished goods	5,473,592	5,454,266
Finished goods on consignment	260,271	303,491
Total loose jewels	<u>15,910,094</u>	<u>16,228,825</u>
Total supplies inventory	<u>320,727</u>	<u>89,120</u>
Total inventory	<u>\$ 34,995,047</u>	<u>\$ 33,512,800</u>

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

	December 31, 2022	June 30, 2022
Short-term portion	\$ 13,091,953	\$ 11,024,276
Long-term portion	21,903,094	22,488,524
Total	<u>\$ 34,995,047</u>	<u>\$ 33,512,800</u>

The Company's work-in-process inventories include raw SiC crystals on which processing costs, such as labor and sawing, have been incurred; and components, such as metal castings and finished goods set with moissanite jewels, that have been issued to jobs in the manufacture of finished jewelry. The Company's moissanite jewel manufacturing process involves the production of intermediary shapes, called "preforms," that vary depending upon the expected size and shape of the finished jewel. To maximize manufacturing efficiencies, preforms may be made in advance of current finished inventory needs but remain in work-in-process inventories. As of December 31, 2022 and June 30, 2022, work-in-process inventories issued to active production jobs approximated \$1.37 million and \$2.76 million, respectively.

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

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

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

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

6. NOTE RECEIVABLE

On March 5, 2021, the Company entered into a \$250,000 convertible promissory note agreement (the "Convertible Promissory Note"), with an unrelated third-party strategic marketing partner. The Convertible Promissory Note is unsecured and was scheduled originally to mature on March 5, 2022. In February 2022, the Company entered into an amendment to the Convertible Promissory Note that was effective as of December 9, 2021 and changed the maturity date to September 30, 2022. Effective September 26, 2022, the Company further amended the Convertible Promissory Note (the "September 2022 Amendment") and changed the maturity date to June 20, 2024 (the "Maturity Date"). Prior to the September 2022 Amendment, the Company accounted for the Convertible Promissory Note as a current note receivable within the accompanying condensed consolidated financial statements. However, in accordance with the terms of the September 2022 Amendment, the note receivable is classified as a noncurrent note receivable within the accompanying condensed consolidated financial statements as of December 31, 2022.

Interest is accrued at a simple rate of 0.14% per annum and will continue to accrue until the Convertible Promissory Note is converted in accordance with the conversion privileges contained within the Convertible Promissory Note or is repaid. Principal outstanding during an event of default accrues interest at the rate of 5% per annum. Prior to the September 2022 Amendment, accrued and unpaid interest on the Convertible Promissory Note was classified as a current asset and included in prepaid expenses and other assets in the accompanying condensed consolidated financial statements. In accordance with the terms of the September 2022 Amendment, accrued and unpaid interest on the Convertible Promissory Note is classified as a noncurrent asset and included in other noncurrent assets in the accompanying condensed consolidated financial statements as of December 31, 2022.

Subject to the borrower's completion of a specified equity financing transaction (an "Equity Financing") on or prior to the Maturity Date, the unpaid principal amount, including accrued and unpaid interest, automatically converts into equity units of the most senior class of equity securities issued to investors in the Equity Financing at the lesser of 80% of the per unit price of the units purchased by investors or the price equal to \$33,500,000 divided by the aggregate number of outstanding units of the borrower immediately prior to the closing of the financing. Unless converted as provided in the Convertible Promissory Note, the principal amount, including accrued and unpaid interest, will, on the Maturity Date, at the Company's option either (i) become due and payable to the Company, or (ii) convert into equity units at the specified conversion price in accordance with the terms of the Convertible Promissory Note.

7. ACCRUED EXPENSES AND OTHER LIABILITIES

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

	December 31, 2022	June 30, 2022
Accrued compensation and related benefits	\$ 453,917	\$ 614,443
Deferred revenue	469,157	452,866
Accrued sales taxes and franchise taxes	266,773	341,706
Accrued cooperative advertising	208,330	137,467
Other accrued expenses	1	1
Total accrued expenses and other liabilities	<u>\$ 1,398,178</u>	<u>\$ 1,546,483</u>

8. INCOME TAXES

For both the three and six months ended December 31, 2022, the Company's average effective tax rate was 20.46% which consisted of the federal income tax rate of 21.00% and a blended state income tax rate benefit of 0.54%, net of the federal benefit. For both the three and six months ended December 31, 2021, the Company's statutory tax rate was 22.24% which consisted of the federal income tax rate of 21% and a blended state income tax rate of 1.24%, net of the federal benefit. The Company's effective income tax rate reflects the effect of federal and state income taxes on earnings and the impact of differences in book and tax accounting arising primarily from the permanent tax benefits associated with stock-based compensation transactions during the quarter. For the six months ended December 31, 2022 and 2021, the Company's effective tax rate was 18.37% and 16.92%, respectively.

The Company recognized a net income tax benefit of approximately \$132,000 and \$435,000 for the three and six months ended December 31, 2022, respectively, compared with a net income tax expense of approximately \$283,000 and \$406,000 for the three and six months ended December 31, 2021, respectively.

As of each reporting date, management considers new evidence, both positive and negative, that could impact the Company's view with regard to future realization of deferred tax assets. As of December 31, 2022, management determined that the Company's expectations of future taxable income in upcoming tax years, including estimated growth rates applied to future expected taxable income that includes significant management estimates and assumptions, would continue to be sufficient to result in full utilization of the Company's remaining federal net operating loss carryforwards and certain of the deferred tax assets prior to any statutory expiration. As a result, management determined that sufficient positive evidence existed as of December 31, 2022, to conclude that it is more likely than not deferred tax assets of approximately \$6.29 million remain realizable. Conversely, management further determined that sufficient negative evidence continued to exist to conclude it was uncertain that the Company would have sufficient future taxable income to utilize certain of its deferred tax assets. Therefore, management continued to maintain a valuation allowance against the Company's deferred tax assets relating to certain state net operating loss carryforwards from its e-commerce subsidiary due to the timing uncertainty of when it will generate positive taxable income to utilize the associated deferred tax assets. In addition, a valuation allowance remains against certain deferred tax assets relating to operating loss carryforwards relating to the Company's dormant subsidiary located in Hong Kong.

9. COMMITMENTS AND CONTINGENCIES

Lease Arrangements

On December 9, 2013, the Company entered into a Lease Agreement, as amended on December 23, 2013, April 15, 2014, and January 29, 2021 (the "Lease Agreement"), for its corporate headquarters, which occupies approximately 36,350 square feet of office, storage and light manufacturing space and is classified as an operating lease for financial reporting purposes. The expiration date of the base term of the Lease Agreement is October 31, 2026 and the terms of the Lease Agreement contain no early termination provisions. Provided there is no outstanding uncured event of default under the Lease Agreement, the Company has an option to extend the lease term for a period of five years. The Company's option to extend the term of the Lease Agreement must be exercised in writing on or before 270 days prior to expiration of the then-current term. If the option is exercised, the monthly minimum rent for each of the extended terms will be adjusted to the then prevailing fair market rate.

The Company took possession of the leased property on May 23, 2014, once certain improvements to the leased space were completed and did not have access to the property before this date. Upon execution of the third amendment to the Lease Agreement (the "Lease Amendment") on January 29, 2021, the Lease Amendment included a rent abatement in the amount of approximately \$214,000, which is reflected in the rent payments used in the calculation of the right-of-use ("ROU") asset and lease liability once remeasured upon the execution of the Lease Amendment to extend the lease term. The Lease Amendment also included an allowance for leasehold improvements offered by the landlord in an amount not to exceed approximately \$545,000. As of the quarter ended December 31, 2022, the Company has been reimbursed approximately \$506,000 by the landlord for qualified leasehold improvements in accordance with the terms of the Lease Amendment. This reimbursement by the landlord reduced the remaining ROU asset by the same amount and is being recognized prospectively over the remaining term of the lease.

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

As of December 31, 2022, the Company's balance sheet classifications of its leases are as follows:

Operating Leases:

Noncurrent operating lease ROU assets	\$ 2,488,052
Current operating lease liabilities	\$ 868,269
Noncurrent operating lease liabilities	2,453,994
Total operating lease liabilities	<u>\$ 3,322,263</u>

The Company's total operating lease cost was approximately \$175,000 and \$214,000 for the three months ended December 31, 2022 and 2021, respectively. The Company's total operating lease cost was approximately \$349,000 and \$413,000 for the six months ended December 31, 2022 and 2021, respectively.

As of December 31, 2022, the Company's estimated incremental borrowing rate used and assumed discount rate with respect to operating leases was 2.81% and the remaining operating lease term was 3.83 years.

As of December 31, 2022, the Company's remaining future payments under operating leases for each fiscal year ending June 30 are as follows:

2023	\$	438,785
2024		893,660
2025		918,236
2026		943,487
2027		317,327
Total lease payments		3,511,495
Less: imputed interest		189,232
Present value of lease payments		3,322,263
Less: current lease obligations		868,269
Total long-term lease obligations	\$	2,453,994

The Company makes cash payments for amounts included in the measurement of its lease liabilities. During the three months ended December 31, 2022 and 2021, cash paid for operating leases was approximately \$235,000 and \$8,000, respectively. During the six months ended December 31, 2022 and 2021, cash paid for operating leases was approximately \$466,000 and \$170,000, respectively.

Purchase Commitments

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

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

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

The Company's total purchase commitment under the Supply Agreement, as amended, until June 2025 is approximately \$52.95 million, of which approximately \$24.75 million remains to be purchased as of December 31, 2022. Over the life of the Supply Agreement, as amended, the Company's future minimum annual purchase commitments of SiC crystals range from approximately \$4.00 million to \$10.00 million each year.

During the six months ended December 31, 2022 and 2021, the Company purchased approximately \$1.80 million and \$3.00 million, respectively, of SiC crystals from Wolfspeed pursuant to the terms of the Supply Agreement, as amended.

Inflation

Heightened levels of inflation and the potential worsening of macro-economic conditions present a risk for the Company, its suppliers, and the stability of the broader retail and e-commerce industry. During the first six months of the Company's fiscal year ending June 30, 2023 ("Fiscal 2023"), the Company has experienced impacts to its labor and overhead rates and suppliers have signaled inflation related cost pressures, which is expected to flow through to the Company's costs and pricing. While the Company has seen some impact from inflation on its financial results in the first six months of Fiscal 2023, if inflation remains at current levels for an extended period, or increases, and the Company is unable to successfully mitigate the impact, the Company's costs are likely to continue to increase, resulting in further pressure on its revenues, margins, and cash flows. In addition, inflation and the increases in the cost of borrowing from rising interest rates could constrain the overall purchasing power of the Company's customers for its products and services, in particular in the near term to the extent inflation assumptions are less than current inflationary pressures.

10. DEBT

Line of Credit

Effective July 7, 2021, the Company obtained from JPMorgan Chase a \$5.00 million cash collateralized line of credit facility (the "JPMorgan Chase Credit Facility"). The JPMorgan Chase Credit Facility may be used for general corporate and working capital purposes, including permitted acquisitions and certain additional indebtedness for borrowed money, installment obligations, and obligations under capital and operating leases. The JPMorgan Chase Credit Facility is secured by a cash deposit in the amount of \$5.05 million held by JPMorgan Chase as collateral for the line of credit facility and was scheduled to mature on July 31, 2022. Effective July 28, 2022, the JPMorgan Chase Credit Facility was amended to, among other things, extend the maturity date to July 31, 2023, and append the Company's obligations under the JPMorgan Chase Credit Facility to be guaranteed by the Company's wholly owned subsidiaries, Charles & Colvard Direct, LLC, charlesandcolvard.com, LLC, and moissaniteoutlet.com, LLC.

Each advance under the JPMorgan Chase Credit Facility, as amended, accrues interest at a rate equal to the sum of JPMorgan Chase's monthly secured overnight financing rate ("SOFR rate") to which JPMorgan Chase is subject with respect to the adjusted SOFR rate as established by the U.S. Federal Reserve Board, plus a margin of 1.25% per annum and an unsecured to secured interest rate adjustment of 0.10% per annum. Prior to its amendment, each advance under the JPMorgan Chase Credit Facility would have accrued interest at a rate equal to JPMorgan Chase's monthly LIBOR rate multiplied by a statutory reserve rate for eurocurrency funding to which JPMorgan Chase is subject with respect to the adjusted LIBOR rate as established by the U.S. Federal Reserve Board, plus a margin of 1.25% per annum. Interest is calculated monthly on an actual/360-day basis and payable monthly in arrears. Principal outstanding during an event of default, at JPMorgan Chase's option, accrues interest at a rate of 3% per annum in excess of the above rate. Any advance may be prepaid in whole or in part without penalty at any time.

As of December 31, 2022, the Company had not borrowed against the JPMorgan Chase Credit Facility and had no outstanding debt as of the period then ended.

11. SHAREHOLDERS' EQUITY AND STOCK-BASED COMPENSATION

Repurchases of Common Stock

Pursuant to authority granted by the Company's Board of Directors on April 29, 2022, the Company can repurchase up to approximately \$5.00 million in shares outstanding of the Company's common stock over the three-year period ending April 29, 2025. Pursuant to the terms of the repurchase authorization, the common stock share repurchases are generally at the discretion of the Company's management. As the Company repurchases its common shares, which have no par value, the Company reports such shares held as treasury stock in the accompanying condensed consolidated balance sheets with the purchase price recorded within treasury stock.

During the six-month period ended December 31, 2022, the Company repurchased 358,116 shares of the Company's common stock for an aggregate price of \$451,815 pursuant to the repurchase authorization. The Company repurchased no shares of the Company's common stock during the three-month period ended December 31, 2022.

Dividends

The Company has paid no cash dividends during the current fiscal year through December 31, 2022.

Stock-Based Compensation

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	2021	2022	2021
Employee stock options	\$ 49,704	\$ 57,448	\$ 122,202	\$ 127,014
Restricted stock awards	28,789	141,556	52,523	351,397
Totals	<u>\$ 78,493</u>	<u>\$ 199,004</u>	<u>\$ 174,725</u>	<u>\$ 478,411</u>

No stock-based compensation was capitalized as a cost of inventory during the three and six months ended December 31, 2022 and 2021.

Stock Options

The following is a summary of the stock option activity for the six months ended December 31, 2022:

	Shares	Weighted Average Exercise Price
Outstanding, June 30, 2022	1,658,803	\$ 1.32
Granted	270,787	\$ 1.02
Forfeited	(19,336)	\$ 2.00
Expired	(2,664)	\$ 0.98
Outstanding, December 31, 2022	<u>1,907,590</u>	<u>\$ 1.27</u>

The weighted average grant date fair value of stock options granted during the six months ended December 31, 2022 and 2021 was approximately \$0.59 and \$1.53, respectively. The total fair value of stock options that vested during the six months ended December 31, 2022 and 2021 was approximately \$176,000 and \$166,000, respectively.

The following table summarizes information about stock options outstanding at December 31, 2022:

Options Outstanding			Options Exercisable			Options Vested or Expected to Vest		
Balance as of December 31, 2022	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of December 31, 2022	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of December 31, 2022	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
1,907,590	6.86	\$ 1.27	1,392,768	5.97	\$ 1.21	1,854,215	6.80	\$ 1.26

As of December 31, 2022, the unrecognized stock-based compensation expense related to unvested stock options was approximately \$322,000, which is expected to be recognized over a weighted average period of approximately 20 months.

The aggregate intrinsic value of stock options outstanding, exercisable, and vested or expected to vest at December 31, 2022 and 2021 was approximately \$57,000 and \$3.04 million, respectively. These amounts are before applicable income taxes and represent the closing market price of the Company's common stock at December 31, 2022 less the grant price, multiplied by the number of stock options that had a grant price that is less than the closing market price. These values represent the amount that would have been received by the optionees had these stock options been exercised on that date. During the six months ended December 31, 2021, the aggregate intrinsic value of stock options exercised was approximately \$717,000. During the six months ended December 31, 2021, the total estimated tax benefit associated with certain stock options that were exercised was approximately \$76,000. No stock options were exercised during the six-month period ended December 31, 2022.

Restricted Stock

The following is a summary of the restricted stock activity for the six months ended December 31, 2022:

	Shares	Weighted Average Grant Date Fair Value
Unvested, June 30, 2022	178,750	\$ 2.75
Granted	178,750	\$ 0.97
Vested	(134,063)	2.75
Cancelled	(44,687)	\$ 2.75
Unvested, December 31, 2022	<u>178,750</u>	<u>\$ 0.97</u>

The unvested restricted shares as of December 31, 2022 are all performance-based restricted shares that are scheduled to vest, subject to achievement of the underlying performance goals, in July 2023. As of December 31, 2022, the estimated unrecognized stock-based compensation expense related to unvested restricted shares subject to achievement of performance goals was approximately \$144,000, all of which is expected to be recognized over a weighted average period of approximately seven months.

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

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	2021	2022	2021
Numerator:				
Net (loss) income	\$ (1,041,781)	\$ 1,167,612	\$ (1,931,973)	\$ 1,994,637
Denominator:				
Weighted average common shares outstanding:				
Basic	30,344,954	30,287,677	30,408,018	30,159,543
Effect of dilutive securities	-	1,027,811	-	1,078,405
Diluted	<u>30,344,954</u>	<u>31,315,488</u>	<u>30,408,018</u>	<u>31,237,948</u>
Net (loss) income per common share:				
Basic	\$ (0.03)	\$ 0.04	\$ (0.06)	\$ 0.07
Diluted	\$ (0.03)	\$ 0.04	\$ (0.06)	\$ 0.06

For the three and six months ended December 31, 2022, stock options to purchase approximately 1.91 million shares were excluded from the computation of diluted net loss per common share because the effect of inclusion of such amounts would be anti-dilutive to net loss per common share. For the three and six months ended December 31, 2021 stock options to purchase approximately 836,000 and 786,000 shares, respectively, were excluded from the computation of diluted net income per common share for each period presented herein. These shares were excluded from the computation of diluted net income per common share because the exercise price of the stock options for the period presented herein was greater than the average market price of the common shares or the effect of inclusion of such amounts would be anti-dilutive to net income per common share. Approximately 179,000 shares of unvested restricted stock are excluded from the computation of basic net (loss) income and diluted net (loss) income per common share as of December 31, 2022 and 2021, respectively, because the shares are performance-based and the underlying conditions had not been met as of the periods presented herein.

13. MAJOR CUSTOMERS AND CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash on deposit and cash equivalents held with banks and trade accounts receivable. The Company places cash deposits with federally insured financial institutions and maintains its cash at banks and financial institutions it considers to be of high credit quality. However, the Company's cash deposits may at times exceed the Federal Deposit Insurance Corporation's insurable limits. Accordingly, balances in excess of federally insured limitations may not be insured. The Company has not experienced losses on these accounts, and management believes that the Company is not exposed to significant risks on such accounts.

Trade receivables potentially subject the Company to credit risk. Payment terms on trade receivables for the Company's Traditional segment customers are generally between 30 and 90 days, though it may offer extended terms with specific customers and on significant orders from time to time. The Company extends credit to its customers based upon a number of factors, including an evaluation of the customer's financial condition and credit history that is verified through trade association reference services, the customer's payment history with the Company, the customer's reputation in the trade, and/or an evaluation of the Company's opportunity to introduce its moissanite jewels or finished jewelry featuring moissanite and lab grown diamonds to new or expanded markets. Collateral is not generally required from customers. The need for an allowance for doubtful accounts is determined based upon factors surrounding the credit risk of specific customers, historical trends, and other information. For additional information regarding the Company's measurement and disclosure of credit losses on financial assets, including trade accounts receivable, see Note 4, "Fair Value Measurements."

At times, a portion of the Company's accounts receivable will be due from customers that have individual balances of 10% or more of the Company's total gross accounts receivable.

The following is a summary of customers that represent 10% or more of total gross accounts receivable as of the dates presented:

	December 31, 2022	June 30, 2022
Customer A	20%	20%
Customer B	20%	**0%
Customer C	*0%	29%
Customer D	*0%	13%

* Customer C and Customer D did not have individual balances that represented 10% or more of total gross accounts receivable as of December 31, 2022.

** Customer B did not have individual balances that represented 10% or more of total gross accounts receivable as of June 30, 2022.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	2021	2022	2021
Customer A	12%	16%	14%	15%
Customer C	*0%	*0%	*0%	11%

* Customer C did not have net sales that represented 10% or more of total net sales for the three months ended December 31, 2022 and 2021 and the six months ended December 31, 2022.

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

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

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

1. Our business and our results of operations could be materially adversely affected as a result of general economic and market conditions;
2. Our future financial performance depends upon increased consumer acceptance, growth of sales of our products, and operational execution of our strategic initiatives;
3. The effects of COVID-19 and other potential future public health crises, epidemics, pandemics or similar events on our business, operating results, and cash flows are uncertain;
4. We face intense competition in the worldwide gemstone and jewelry industry;
5. Our information technology, or IT, infrastructure, and our network may be impacted by a cyber-attack or other security incident as a result of the rise of cybersecurity events;
6. Constantly evolving privacy regulatory regimes are creating new legal compliance challenges;
7. We are subject to certain risks due to our international operations, distribution channels and vendors;
8. Our business and our results of operations could be materially adversely affected as a result of our inability to fulfill orders on a timely basis;
9. We are currently dependent on a limited number of distributor and retail partners in our Traditional segment for the sale of our products;
10. We may experience quality control challenges from time to time that can result in lost revenue and harm to our brands and reputation;
11. Seasonality of our business may adversely affect our net sales and operating income;
12. Our operations could be disrupted by natural disasters;
13. Sales of moissanite and lab grown diamond jewelry could be dependent upon the pricing of precious metals, which is beyond our control;
14. Our current customers may potentially perceive us as a competitor in the finished jewelry business;
15. We depend on a single supplier for substantially all of our silicon carbide, or SiC, crystals, the raw materials we use to produce moissanite jewels; if our supply of high-quality SiC crystals is interrupted, our business may be materially harmed;
16. If the e-commerce opportunity changes dramatically or if e-commerce technology or providers change their models, our results of operations may be adversely affected;
17. Governmental regulation and oversight might adversely impact our operations;
18. The execution of our business plans could significantly impact our liquidity;
19. The financial difficulties or insolvency of one or more of our major customers or their lack of willingness and ability to market our products could adversely affect results;
20. Negative or inaccurate information on social media could adversely impact our brand and reputation;
21. We rely on assumptions, estimates, and data to calculate certain of our key metrics and real or perceived inaccuracies in such metrics may harm our reputation and negatively affect our business;
22. 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;
23. Environmental, social, and governance matters may impact our business, reputation, financial condition, and results of operations;
24. If we fail to evaluate, implement, and integrate strategic acquisition or disposition opportunities successfully, our business may suffer;
25. Our failure to maintain compliance with The Nasdaq Stock market's continued listing requirements could result in the delisting of our common stock;

26. Some anti-takeover provisions of our charter documents may delay or prevent a takeover of our Company; and
27. We cannot guarantee that our share repurchase program will be utilized to the full value approved, or that it will enhance long-term stockholder value and repurchases we consummate could increase the volatility of the price of our common stock and could have a negative impact on our available cash balance.

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

The following discussion is designed to provide a better understanding of our unaudited condensed consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance, and a summary of our operating results. This information should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q, and the consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended June 30, 2022, or the 2022 Annual Report. Historical results and percentage relationships related to any amounts in the condensed consolidated financial statements are not necessarily indicative of trends in operating results for future periods.

Overview

Our Mission

At Charles & Colvard, Ltd., our mission is to provide a more conscious and conflict-free fine jewelry experience for our customers. We are dedicated to blazing a more brilliant path forward with our *Made, Not Mined*[™] gemstones and committed to creating fine jewelry with a conscience.

About Charles & Colvard

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

We sell loose moissanite jewels, lab grown diamonds, and finished jewelry set with these gems through two operating segments: our Online Channels segment, which encompasses our digital properties components, comprised of our charlesandcolvard.com and moissaniteoutlet.com websites, e-commerce outlets, including marketplaces, drop-ship customers, and other pure-play, exclusively e-commerce customers; and our Traditional segment, which consists of domestic and international distributors and retail customers, including end-consumers through our first *Charles & Colvard Signature Showroom*, which opened in October 2022. We report segment information based on the "management" approach. This segment reporting approach designates the internal reporting used by management for making operating decisions and assessing performance as the source of our operating and reportable segments.

We operate in an e-commerce environment characterized by both complexity in global markets and ongoing economic uncertainties in the U.S. and internationally. Our strategy is to build a globally revered and accessible brand of gemstones and finished fine jewelry products set with moissanite and lab grown diamonds. We believe that our goods appeal to a wide consumer audience and leverage our advantage of being the original and leading worldwide source of moissanite and purveyor of premium lab grown diamonds. We believe a direct relationship with consumers is an important component to this strategy, which entails delivering tailored educational content, engaging in interactive dialogue with our audience, and positioning our brand to meet the demands of today's discerning consumer. A significant component of our strategy in this environment is to focus on our core products, improving the quality and predictability of the delivery of our products and services, and placing those products quickly into the hands of our U.S. and international customers at affordable prices. Moreover, recognizing today that our customers and vendors are resource constrained, we are endeavoring to develop and extend our portfolio of products in a disciplined manner with a focus on domestic markets close to our core capabilities, as well as growing our global marketplace sales. We continue to focus on affordability initiatives. We also expect to continue innovating and investing in lab created gemstone technologies to fulfill evolving product requirements for our customers and investing in our people so that we have the technical and production skills necessary to succeed without limiting our ability to build sound financial returns to our investors.

We believe our expanding application of an omni-channel sales strategy across the fine jewelry trade and to the end consumer with accessible gemstones and value branded finished jewelry featuring *Charles & Colvard Created Moissanite*[®] and *Caydia*[®] lab grown diamonds positions our products at the many touchpoints where consumers are when they are making their buying decisions – thereby continuing to create greater exposure for our brand and increasing consumer demand.

Fiscal 2023 Financial Outlook

Our strategic goals for the fiscal year ending June 30, 2023, or Fiscal 2023, are centered on continuing to expand Charles & Colvard's brand on a global scale and to increase the size of our business through top-line growth. As lab-created gemstones are being embraced by emerging generations, we believe our ability to establish moissanite and our lab grown diamonds along with the Charles & Colvard brand directly with conscious consumers is key to our future success and ability to fuel our growth. We plan to continue executing on our key Fiscal 2023 strategies with an ongoing commitment to spending judiciously and generating sustainable earnings improvement.

As we disclosed last quarter, in October 2022, we officially opened the first *Charles & Colvard Signature Showroom* located in our corporate headquarters in North Carolina's Research Triangle Park. The opening of this new showroom provided local consumers in the Raleigh metropolitan area the ability to shop in person for our collections of fine luxury jewelry featuring moissanite and lab grown diamonds in time for the calendar year-end holiday season. During our fiscal quarter ended December 31, 2022, we took several steps to broaden available selections of finished jewelry, which features our exclusive brand of premium lab grown diamonds, with an expanded *Couture Collection* assortment of finished jewelry that showcases a combination of mixed cuts of our *Caydia*[®] lab grown diamonds and recycled precious metals featuring new designs of rings, earrings, and pendant styles that we believe is the future of *Made, Not Mined*[™] fine jewelry. We believe this collection showcases a combination of mixed cut gemstones in single designs to create consumer interest. Also, during the second fiscal quarter, we expanded our *Ouro Edition* of fine jewelry to include *Caydia*[®] lab grown diamond fashion pieces. The *Ouro Edition* is our curation of polished recycled 14 karat gold jewelry pieces with a design focus on geometric shapes. We believe that *Ouro* – which is Portuguese for gold – will bring a fresh approach to our finished jewelry in modern dimensional styles in yellow gold to bring our fine luxury jewelry to the forefront of modern fashion. In addition, with the launch of our latest lab grown precious gemstones in color, which we announced last October, we are now offering a colorful new dimension of our *Made, Not Mined*[™] fine jewelry repertoire featuring lab grown ruby, sapphire, and emerald gemstones. We further offered an expanded assortment of *Caydia*[®] lab grown diamonds to include higher total carat weight items adding finished jewelry featuring lab grown diamonds with total carat weights of up to and in some cases exceeding 4.0 carats. Previously, we focused primarily on smaller total carat weight items of finished jewelry featuring our *Caydia*[®] lab grown diamonds. Lastly, in December 2022, we expanded our bridal and engagement fine jewelry collections of styles featuring *Forever One*[™] moissanite to continue to showcase and promote finished jewelry featuring our core product gemstone.

In early December 2022, we hosted a multiple-day private press event in New York City that included interviews with editors of numerous fashion and jewelry print and electronic media publications to showcase and promote our brand of fine jewelry. Throughout the fiscal quarter ended December 31, 2022, our finished jewelry products were featured in multiple national and local print and electronic media publications, such as *InStyle*, *HuffPost*, *Forbes*, *AC Magazine*, *The Knot*[®], *National Jeweler*, WRAL, and the *Triangle Business Journal*. During the quarter, we also launched local print media public relations campaigns in *Midtown Magazine* and *Raleigh Magazine* to promote the opening of our *Charles & Colvard Signature Showroom*. Also in December, the popularity of our *Made, Not Mined*[™] *Caydia*[®] lab grown diamonds was the subject of a proprietary news feature broadcast on *Spectrum News Channel 1*, which is a primary cable news channel network that is broadcast statewide throughout North Carolina. Lastly, and in conjunction with our community outreach programs, during the December year-end holiday season, we sponsored the *29th Annual Jingle Ball* at the North Carolina Museum of Natural Science, which is hosted by Capital City Clauses, Inc., a federally registered 501(c)(3) nonprofit corporation whose mission is to enrich children's lives in the Raleigh metropolitan area by providing toy gifting and basic needs to those who are underprivileged and in need during the Christmas holidays and beyond.

As evidenced by our results for the first six months of Fiscal 2023, domestic and global inflation and rising interest rates, coupled with ongoing fears of recession, continue to erode consumer confidence and present major challenges for the global retail and e-commerce industry. While American consumers spent more this holiday season to keep up with higher prices, consumer shopping lulls we experienced during the non-peak holiday weeks during the calendar year-end holiday season were deeper than we anticipated and we expect that consumers will continue to feel pressured financially, particularly during the first half of calendar year 2023. We are facing similar challenges to other retailers, including those in the e-commerce space, but particularly those in the luxury retail arena. At the same time, however, we believe these challenges are providing us the opportunity to continue reevaluating technologies and strategies that can help position us in a potentially more profitable position. We plan to continue to invest in our business and view current challenges as opportunities to help accelerate our growth trajectory and return to profitability.

Inflation

Heightened levels of inflation and the potential worsening of macro-economic conditions present a risk for us, our suppliers, and the stability of the broader retail and e-commerce industry. During the first six months of Fiscal 2023, we have experienced impacts to our labor and overhead rates and suppliers have signaled inflation related cost pressures, which will flow through to our costs and pricing. While we have seen some impact from inflation on our financial results in the first six months of Fiscal 2023, if inflation remains at current levels for an extended period, or increases, and we are unable to successfully mitigate the impact, our costs are likely to continue to increase, resulting in further pressure on our revenues, margins, and cash flows. In addition, inflation and the increases in the cost of borrowing from rising interest rates could constrain the overall purchasing power of our customers for our products and services, in particular in the near term to the extent inflation assumptions are less than current inflationary pressures. We remain committed to our ongoing efforts to increase the efficiency of our operations and improve the cost competitiveness and affordability of our products and services, which may, in part, offset cost increases and the adverse effects from inflation.

We discuss our strategic outlook, key strategies, and general economic and market conditions for Fiscal 2023 in Part I, Item 1, “Business” and in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, contained in our 2022 Annual Report.

COVID-19

The ultimate impact of COVID-19 on our operations and financial performance in future periods, including management’s ability to execute its strategic initiatives in the expected timeframes, remains uncertain and will depend on future pandemic related developments, including the duration of the pandemic, any potential subsequent waves of COVID-19 and its variant viral infections, the effectiveness, distribution and acceptance of COVID-19 vaccines, and related government actions to prevent and manage disease spread, all of which are uncertain and cannot be predicted. We cannot at this time predict the full impact of the COVID-19 pandemic, but we anticipate that the COVID-19 pandemic is likely to continue to impact our business, financial condition, results of operations, and cash flows in Fiscal 2023.

For additional risks to the Company related to the COVID-19 pandemic, see “Part I, Item 1A. Risk Factors”, contained in our 2022 Annual Report.

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, or U.S. GAAP. 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, those actual results of operations may materially differ. The most significant estimates impacting our consolidated financial statements relate to the valuation and classification of inventories, accounts receivable reserves, deferred tax assets, stock-based compensation, and revenue recognition. We also have other policies that we consider key accounting policies, but these policies typically do not require us to make estimates or judgments that are difficult or subjective.

We have disclosed our critical accounting policies and estimates in our 2022 Annual Report, and that disclosure should be read in conjunction with this Quarterly Report on Form 10-Q. There have been no significant changes in our critical accounting policies and estimates during the first six months of Fiscal 2023.

Results of Operations

The following table sets forth certain consolidated statements of operations data for the three and six months ended December 31, 2022 and 2021:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2022	2021	2022	2021
Net sales	\$ 10,366,122	\$ 13,753,135	\$ 17,740,204	\$ 24,033,446
Costs and expenses:				
Cost of goods sold	6,071,775	7,033,946	10,157,785	12,050,496
Sales and marketing	4,339,684	4,079,035	7,447,630	6,809,187
General and administrative	1,187,955	1,189,559	2,601,431	2,773,835
Total costs and expenses	11,599,414	12,302,540	20,206,846	21,633,518
(Loss) Income from operations	(1,233,292)	1,450,595	(2,466,642)	2,399,928
Other income (expense):				
Interest income	59,574	490	99,776	845
Loss on foreign currency exchange	-	-	-	(34)
Total other income (expense), net	59,574	490	99,776	811
(Loss) Income before income taxes	(1,173,718)	1,451,085	(2,366,866)	2,400,739
Income tax benefit (expense)	131,937	(283,473)	434,893	(406,102)
Net (loss) income	\$ (1,041,781)	\$ 1,167,612	\$ (1,931,973)	\$ 1,994,637

Consolidated Net Sales

Consolidated net sales for the three and six months ended December 31, 2022 and 2021 comprise the following:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2022	2021			2022	2021		
Finished jewelry	\$ 8,436,208	\$ 10,539,166	\$(2,102,958)	(20)%	\$ 13,976,614	\$ 16,225,453	\$(2,248,839)	(14)%
Loose jewels	1,929,914	3,213,969	(1,284,055)	(40)%	3,763,590	7,807,993	(4,044,403)	(52)%
Total consolidated net sales	\$ 10,366,122	\$ 13,753,135	\$(3,387,013)	(25)%	\$ 17,740,204	\$ 24,033,446	\$(6,293,242)	(26)%

Consolidated net sales were \$10.37 million for the three months ended December 31, 2022 compared to \$13.75 million for the three months ended December 31, 2021, a decrease of approximately \$3.39 million, or 25%. Consolidated net sales were \$17.74 million for the six months ended December 31, 2022 compared to \$24.03 million for the six months ended December 31, 2021, a decrease of approximately \$6.29 million, or 26%. We had lower net sales in both operating business segments during the three- and six-month periods ended December 31, 2022. Overall consumer confidence has continued to show signs of weakening due to general economic uncertainties, coupled with domestic and worldwide inflation, including recessionary fears, and rising interest rates. Notwithstanding the year-end 2022 holiday shopping season, these conditions have brought about lower consumer demand for our finished jewelry products, which resulted in lower net sales in our Online Channels segment during the three and six months ended December 31, 2022. These same general economic conditions also caused weakness in demand for moissanite jewels from our domestic distributors, which in turn resulted in lower loose jewel product net sales during the three- and six-month periods ended December 31, 2022 in our Traditional segment.

Sales of finished jewelry represented 81% and 79% of total consolidated net sales for the three and six months ended December 31, 2022, respectively, compared to 77% and 68%, respectively, of total consolidated net sales for the corresponding periods of the prior year. For the three months ended December 31, 2022, finished jewelry sales were \$8.44 million compared to \$10.54 million for the corresponding period of the prior year, a decrease of approximately \$2.10 million, or 20%. For the six months ended December 31, 2022, finished jewelry sales were \$13.98 million compared to \$16.23 million for the corresponding period of the prior fiscal year, a decrease of approximately \$2.25 million, or 14%. These decreases in finished jewelry sales for the three- and six-month periods ended December 31, 2022 were due to lower demand across all of our finished jewelry products as a result of adverse global and domestic general economic conditions.

Sales of loose jewels represented 19% and 21% of total consolidated net sales for the three and six months ended December 31, 2022, respectively, compared to 23% and 32%, respectively, of total consolidated net sales for the corresponding periods of the prior fiscal year. For the three months ended December 31, 2022, loose jewel sales were \$1.93 million compared to \$3.21 million for the corresponding period of the prior year, a decrease of \$1.28 million, or 40%. For the six months ended December 31, 2022, loose jewel sales were \$3.77 million compared to \$7.81 million for the corresponding period of the prior fiscal year, a decrease of \$4.04 million, or 52%. The decrease in loose jewel sales for the three- and six-month periods ended December 31, 2022 was principally due to lower sales of loose jewels through our distribution network in our Online Channels segment and Traditional segment, as a result of global and domestic general adverse macroeconomic conditions.

U.S. net sales accounted for approximately 96% of total consolidated net sales for each of the three- and six-month periods ended December 31, 2022, compared to 95% of total consolidated net sales for each of the corresponding periods of the prior year. U.S. net sales decreased to \$9.99 million, or 23%, during the three months ended December 31, 2022 from the corresponding period of the prior fiscal year. U.S. net sales decreased to \$17.09 million, or 25%, during the six months ended December 31, 2022 from the corresponding period of the prior year. U.S. net sales decreased during the three and six months ended December 31, 2022 primarily as a result of decreased sales to U.S. customers in both our Online Channels segment and Traditional segment for the same reasons outlined above.

Our largest U.S. customer during the three and six months ended December 31, 2022 accounted for 12% and 14% of total consolidated net sales during each respective period. This same customer was also our largest U.S. customer during the three and six months ended December 31, 2021 when this customer accounted for 16% and 15% of total consolidated net sales during each of the respective three- and six-month periods. Our second largest U.S. customer during the six months ended December 31, 2021, accounted for 11% of total consolidated net sales during the period then ended. Other than our U.S. customers noted above during the three- and six-month periods ended December 31, 2022 and 2021, we had no other customers with sales that represented 10% or more of total consolidated net sales for the periods then ended. We expect that we, along with our customers, will remain dependent on our ability to maintain and enhance our customer-related 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 4% of total consolidated net sales for each of the three- and six-month periods ended December 31, 2022, respectively, compared to 5% of total consolidated net sales for each of the corresponding periods of the prior year. International net sales decreased 49% and 45% during the three and six months ended December 31, 2022, respectively, from the corresponding periods of the prior fiscal year due to lower demand in our international distributor market due to shutdowns in the Asia Pacific region during the current period, coupled with the strength of the U.S. dollar against foreign currencies. In light of the effects of ongoing global economic conditions, we continue to evaluate these and other potential distributors in international markets to determine the best long-term partners. As a result, and in light of the impact from the ongoing worldwide pandemic and international trade challenges, we expect that our sales in these markets may fluctuate significantly each reporting period.

We did not have an international customer account for 10% or more of total consolidated sales during the three and six months ended December 31, 2022 or 2021. A portion of our international consolidated sales represents jewels sold internationally that may be re-imported to U.S. retailers.

Costs and Expenses

Cost of Goods Sold

Cost of goods sold for the three and six months ended December 31, 2022 and 2021 are as follows:

	Three Months Ended				Six Months Ended December			
	December 31,		Change		31,		Change	
	2022	2021	Dollars	Percent	2022	2021	Dollars	Percent
Product line cost of goods sold:								
Finished jewelry	\$ 4,185,331	\$ 4,703,976	\$ (518,645)	(11)%	\$ 6,792,031	\$ 7,038,459	\$ (246,428)	(4)%
Loose jewels	871,250	1,434,565	(563,315)	(39)%	1,696,873	3,494,011	(1,797,138)	(51)%
Total product line cost of goods sold	5,056,581	6,138,541	(1,081,960)	(18)%	8,488,904	10,532,470	(2,043,566)	(19)%
Non-product line cost of goods sold	1,015,194	895,405	119,789	13%	1,668,881	1,518,026	150,855	10%
Total cost of goods sold	<u>\$ 6,071,775</u>	<u>\$ 7,033,946</u>	<u>\$ (962,171)</u>	(14)%	<u>\$ 10,157,785</u>	<u>\$ 12,050,496</u>	<u>\$ (1,892,711)</u>	(16)%

Total cost of goods sold was \$6.07 million for the three months ended December 31, 2022 compared to \$7.03 million for the three months ended December 31, 2021, a net decrease of approximately \$962,000, or 14%. Total cost of goods sold was \$10.16 million for the six months ended December 31, 2022 compared to \$12.05 million for the six months ended December 31, 2021, a net decrease of approximately \$1.89 million, or 16%. Product line cost of goods sold is defined as product cost of goods sold in each of our Online Channels segment and Traditional segment excluding non-capitalized expenses from our manufacturing and production control departments, comprising personnel costs, depreciation, rent, utilities, and corporate overhead allocations; freight out; inventory write-offs; and other inventory adjustments, comprising costs of quality issues, and damaged goods.

The decrease in total cost of goods sold for the three months ended December 31, 2022 compared to the same period in 2021 was primarily driven by decreased sales of finished jewelry and loose jewels during the three months ended December 31, 2022 in both our Online Channels segment and Traditional segment. We experienced lower demand in our Online Channels segment as a result of lower finished jewelry product demand during the quarter despite the calendar year-end 2022 holiday season where we saw consumer shopping lulls during the non-peak holiday shopping weeks that were deeper than we expected. Likewise, we experienced lower loose jewel product demand in our Traditional segment throughout the quarter.

The net increase in non-product line cost of goods sold for the three months ended December 31, 2022, comprises an approximate \$270,000 increase in non-capitalized manufacturing production control expenses principally related to the timing of when work-in-process goods are received into inventory and overhead costs are allocated. This increase was partially offset by an approximate \$107,000 decrease in freight out principally from decreased shipping volume during the three-month period and a \$44,000 decrease in other inventory adjustments principally related to changes in production standard cost variances compared to those in the first three months of Fiscal 2022.

The decrease in total cost of goods sold for the six months ended December 31, 2022 compared to the same period in 2021 was also primarily driven by the decreased sales of finished goods and loose jewels during the six-months ended December 31, 2022 in both of our Online Channels segment and Traditional segment. We experienced lower demand in our Online Channels segment as a result of lower finished jewelry product demand during the six-month-period despite the calendar year-end 2022 holiday season and likewise saw lower loose jewel product demand in our Traditional segment throughout the six-month period.

The net increase in non-product line cost of goods sold for the six months ended December 31, 2022, comprises an approximate \$305,000 increase in non-capitalized manufacturing production control expenses principally related to the timing of when work-in-process goods are received into inventory and overhead costs are allocated and an approximate \$8,000 increase in other inventory adjustments principally related to changes in production standard cost variances compared to those in the first six months of Fiscal 2022. These increases were partially offset by an approximate \$113,000 decrease in inventory write-offs in the first six months of the Fiscal 2022, compared to those in the comparable prior year period, and an approximate \$48,000 decrease in freight out principally from decreased shipping volume during the six-month period.

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

Sales and Marketing

Sales and marketing expenses for the three and six months ended December 31, 2022 and 2021 are as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2022	2021			2022	2021		
Sales and marketing	\$ 4,339,684	\$ 4,079,035	\$ 260,649	6%	\$ 7,447,630	\$ 6,809,187	\$ 638,443	9%

Sales and marketing expenses were \$4.34 million for the three months ended December 31, 2022 compared to \$4.08 million for the three months ended December 31, 2021, an increase of approximately \$261,000, or 6%. Sales and marketing expenses were \$7.45 million for the six months ended December 31, 2022 compared to \$6.81 million for the six months ended December 31, 2021, an increase of approximately \$638,000, or 9%.

The increase in sales and marketing expenses for the three months ended December 31, 2022 compared to the same period in 2021 was primarily due to an \$85,000 increase in compensation expenses; an \$81,000 increase in general business taxes; a \$31,000 increase in software-related costs incurred primarily in connection with new software-related agreements associated with upgraded sales-related operating systems; a \$26,000 increase in bank fees expenses, which are principally related to higher credit card transaction and payment platform fees; a \$24,000 increase in professional services principally comprising consulting services for marketing support in the current year period; an \$8,000 increase in telephone-related communications expenses; a \$6,000 increase in depreciation and amortization expense principally related to new sales-related systems hardware and software; a \$6,000 increase in charitable contributions; a \$2,000 increase in insurance expense related to increased premiums; a \$2,000 increase in travel expenses; and a \$5,000 net increase in general office-related expenses. These increases were offset partially by a \$15,000 net decrease in advertising and digital marketing expenses.

The net decrease in advertising and digital marketing expenses for the three months ended December 31, 2022 compared to the same period in 2021 was primarily due to a \$172,000 decrease in cooperative advertising in connection with lower sales from a retail customer with whom we have a cooperative advertising arrangement that is based on sales volume; a \$29,000 decrease in brand awareness marketing campaign expenditures in the current year period; and an \$11,000 decrease in print media expenses. These decreases were offset partially by a \$178,000 increase in digital advertising spend and a \$19,000 increase in outside agency fees.

Compensation expenses for the three months ended December 31, 2022 compared to the same period in 2021 increased primarily due to a \$121,000 increase in salaries, commissions, and related employee benefits in the aggregate. This increase was partially offset by a \$31,000 decrease in bonus expense and a \$5,000 decrease in employee stock-based compensation expense.

The increase in sales and marketing expenses for the six months ended December 31, 2022 compared to the same period in 2021 was primarily due to a \$165,000 increase in compensation expenses; a \$147,000 increase in advertising and digital marketing expenses; a \$118,000 increase in general business taxes; an \$81,000 increase in professional services principally comprising consulting services for marketing support in the current year period; a \$66,000 increase in bank fees expenses, which are principally related to higher credit card transaction and payment platform fees; a \$28,000 increase in software-related costs incurred primarily in connection with new software-related agreements associated with upgraded sales-related operating systems; a \$15,000 increase in charitable contributions; a \$9,000 increase in telephone-related communications expenses; a \$7,000 increase in employee-related recruiting and search fees for new hires; and a \$7,000 increase in depreciation and amortization expense principally related to new sales-related systems hardware and software. These increases were offset partially by a \$3,000 decrease in travel expenses and a \$2,000 net decrease in general office-related expenses.

Compensation expenses for the six months ended December 31, 2022 compared to the same period in 2021 increased primarily as a result of a \$198,000 increase in salaries, commissions, and related employee benefits in the aggregate. This increase was partially offset by a \$21,000 decrease in employee stock-based compensation expense and a \$12,000 decrease in bonus expense.

The increase in advertising and digital marketing expenses for the six months ended December 31, 2022 compared to the same period in 2021 comprises a \$272,000 increase in digital advertising spend; an \$81,000 increase in brand awareness marketing campaign expenditures in the current year period; and a \$40,000 increase in outside agency fees. These increases were offset partially by a \$127,000 decrease in expenses relating to our participation in the 2021 JCK Trade Show held in the prior year period for which we did not host a booth in the 2022 JCK Trade show held during the current year period; a \$94,000 decrease in cooperative advertising; and a \$25,000 decrease in print media expenses.

General and Administrative

General and administrative expenses for the three and six months ended December 31, 2022 and 2021 are as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,				December 31,			
	2022	2021	Dollars	Percent	2022	2021	Dollars	Percent
General and administrative	\$ 1,187,955	\$ 1,189,559	\$ (1,604)	(0)%	\$ 2,601,431	\$ 2,773,835	\$ (172,404)	(6)%

General and administrative expenses were \$1.19 million for the three months ended December 31, 2022 compared to \$1.19 million for the three months ended December 31, 2021, a decrease of approximately \$2,000, or less than 1%. General and administrative expenses were \$2.60 million for the six months ended December 31, 2022 compared to \$2.77 million for the six months ended December 31, 2021, a decrease of approximately \$172,000, or 6%.

The decrease in general and administrative expenses for the three months ended December 31, 2022 compared to the same period in 2021 was primarily due to a \$55,000 decrease in bank fees resulting from the revised fee structure associated with different banking arrangements in place in the current period versus those in the year ago quarter; a \$35,000 decrease in general business taxes and licenses; a \$25,000 decrease in compensation expenses; a \$22,000 decrease in employee-related recruiting and search fees for new hires; a \$20,000 decrease in bad debt expense associated with our allowance for doubtful accounts reserve policy; and a \$6,000 net decrease in miscellaneous other general and administrative expenses. These decreases were partially offset by a \$55,000 increase in depreciation and amortization expense related to general office leasehold improvements associated with the lease on our corporate headquarters and business expansion related to the opening of our new *Charles & Colvard Signature Showroom* also located in our headquarters campus; a \$50,000 increase in travel and expense-related expenditures as we returned to more traditional business travel patterns; a \$30,000 increase in professional services; a \$12,000 increase in insurance expense, principally related to increased premiums; a \$9,000 increase in software-related costs; and a \$5,000 increase in rent expense, primarily related to our corporate headquarters operating lease.

The decrease in compensation expenses for the three months ended December 31, 2022 compared to the same period in 2021 was primarily due to a \$106,000 decrease in employee stock-based compensation expense; and a \$14,000 decrease in bonus expense. These decreases were partially offset by a \$95,000 net increase in salaries and related employee benefits.

Professional services fees increased for the three months ended December 31, 2022 compared to the same period in 2021 primarily due to a \$20,000 increase in fees associated with audit and tax services; a \$19,000 increase in legal fees associated with corporate governance matters; and a \$6,000 increase in broker commissions related to our stock repurchase program. These increases were partially offset by a \$15,000 decrease in investor relations fees.

The decrease in general and administrative expenses for the six months ended December 31, 2022 compared to the same period in 2021 was primarily due to a \$249,000 decrease in compensation expenses; a \$126,000 decrease in bank fees resulting from the revised fee structure associated with different banking arrangements in place in the current period versus those in the year ago period; a \$52,000 decrease in bad debt expense associated with our allowance for doubtful accounts reserve policy; and a \$24,000 decrease in employee-related recruiting and search fees for new hires. These decreases were partially offset by a \$92,000 increase in general business taxes and licenses; a \$69,000 increase in depreciation and amortization expense related to general office leasehold improvements associated with the lease on our corporate headquarters and business expansion related to the opening of our new *Charles & Colvard Signature Showroom* also located in our headquarters campus; a \$65,000 increase in travel and expense related expenditures as we returned to more traditional business travel patterns; a \$17,000 increase in software-related costs; a \$16,000 increase in professional services; a \$15,000 increase in insurance expense, principally related to increased premiums; a \$2,000 increase in rent expense, primarily related to our corporate headquarters operating lease; and a \$3,000 net increase in miscellaneous other general and administrative expenses.

Compensation expenses decreased for the six months ended December 31, 2022 compared to the same period in 2021 principally due to a \$274,000 decrease in employee stock-based compensation expense; and a \$168,000 decrease in bonus expense. These decreases were partially offset by a \$193,000 net increase in salaries and related employee benefits.

Professional services fees increased for the six months ended December 31, 2022 compared to the same period in 2021 primarily due to a \$25,000 increase in broker commissions primarily related to our stock repurchase program and a \$19,000 increase in fees associated with audit and tax services. These increases were partially offset by a \$24,000 decrease in investor relations fees and a \$4,000 decrease in legal fees associated with corporate governance matters.

Interest Income

Interest income for the three and six months ended December 31, 2022 and 2021 is as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2022	2021			2022	2021		
Interest income	\$ 59,574	\$ 490	\$ 59,084	*%	\$ 99,776	\$ 845	\$ 98,931	*%

* Not meaningful

Certain cash balances in excess of operating needs are deposited into and maintained in an interest-bearing account with a federally insured commercial bank. Accordingly, during the three- and six-month periods ended December 31, 2022 and 2021, we earned interest from cash on deposit in this interest-bearing account. The increase in earned interest for the three and six months ended December 31, 2022 reflects movement of invested funds into a higher-yield money market fund in late Fiscal 2022, coupled with the overall increase in interest rates during the first six months of Fiscal 2023 compared with the same period in Fiscal 2022.

Loss on Foreign Currency Exchange

Losses on foreign currency exchange related to foreign sales transacted in functional currencies other than the U.S. dollar for the three and six months ended December 31, 2022 and 2021 are as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2022	2021			2022	2021		
Loss on foreign currency exchange	\$ -	\$ -	\$ -	-%	\$ -	\$ 34	\$ (34)	(100)%

During the six months ended December 31, 2021, we had international sales transactions denominated in currencies other than the U.S. dollar that resulted in foreign currency exchange net losses. There were no such international sales transactions denominated in foreign currencies during the six-month period ended December 31, 2022.

Provision for Income Taxes

For each of the three and six months ended December 31, 2022, the Company's average effective tax rate was 20.46% which consisted of the federal income tax rate of 21.00% and a blended state income tax rate benefit of 0.54%, net of the federal benefit. For each of the three and six months ended December 31, 2021, our statutory tax rate was 22.24% which consisted of the federal income tax rate of 21% and a blended state income tax rate of 1.24%, net of the federal benefit. Our effective income tax rate reflects the effect of federal and state income taxes on earnings and the impact of differences in book and tax accounting arising primarily from the permanent tax benefits associated with stock compensation transactions during the quarter. For the six months ended December 31, 2022 and 2021, our effective tax rate was 18.37% and 16.92%, respectively.

We recognized a net income tax expense of approximately \$132,000 and \$435,000 for the three and six months ended December 31, 2022, respectively, compared with a net income tax expense of approximately \$283,000 and \$406,000 for the three and six months ended December 31, 2021, respectively.

As of each reporting date, we consider new evidence, both positive and negative, that could impact our view with regard to future realization of deferred tax assets. As of December 31, 2022, we determined that our expectations of future taxable income in upcoming tax years, including estimated growth rates applied to future expected taxable income that includes significant management estimates and assumptions, would continue to be sufficient to result in full utilization of our remaining federal net operating loss carryforwards and certain of the deferred tax assets prior to any statutory expiration. As a result, we determined that sufficient positive evidence existed as of December 31, 2022, to conclude that it is more likely than not deferred tax assets of approximately \$6.29 million remain realizable. Conversely, we further determined that sufficient negative evidence continued to exist to conclude it was uncertain that we would have sufficient future taxable income to utilize certain of our deferred tax assets. Therefore, we continued to maintain a valuation allowance against the deferred tax assets relating to certain state net operating loss carryforwards from our e-commerce subsidiary due to the timing uncertainty of when we will generate positive taxable income to utilize the associated deferred tax assets. In addition, a valuation allowance remains against certain deferred tax assets relating to operating loss carryforwards relating to our dormant subsidiary located in Hong Kong.

Liquidity and Capital Resources

Our business depends on consumer demand for our products and could be adversely impacted by unfavorable general economic conditions, declines in consumer confidence and consumer disposable income, rising energy and fuel prices, increasing freight costs, rising inflation rates, recession and fears of recession, consumer debt levels, increased interest rates, and higher tax rates. The full effect of these factors on the global and domestic economy remains uncertain. In addition, the full impact of the ongoing COVID-19 pandemic on our business remains uncertain as well at this time. Accordingly, we remain increasingly focused on the general macroeconomic conditions outlined herein as well as on the COVID-19 pandemic. We are continually evaluating their potential effect on our business and liquidity and capital resources.

Capital Structure and Long-Term Debt

Short-Term Liquidity and Capital Structure

The Consolidated Appropriations Act, 2021, provides that employers who received a Paycheck Protection Program, or PPP, loan may also qualify for the Employee Retention Credit, or ERC. Previously, pursuant to the Coronavirus Aid, Relief, and Economic Security Act, or CARES Act, taxpayers that received a PPP loan were not eligible for the ERC and this change is retroactive to March 27, 2020. We believe that we may qualify for certain employer-related tax benefits pursuant to the ERC and are currently working with an independent third-party tax credit firm to amend our applicable federal payroll tax returns for such benefit. Any benefit received in connection with available ERC credits will be recognized in the period such credits are received.

Long-Term Liquidity and Capital Structure

We have an effective shelf registration statement on Form S-3 on file with the SEC that allows us to periodically offer and sell, individually or in any combination, shares of common stock, shares of preferred stock, warrants to purchase shares of common stock or preferred stock, and units consisting of any combination of the foregoing types of securities, up to a total of \$25.00 million, of which all is available. However, we may offer and sell no more than one-third of our public float (which is the aggregate market value of our outstanding common stock held by non-affiliates) in any 12-month period. Our ability to issue equity securities under the shelf registration statement is subject to market conditions, which may be in turn, subject to, among other things, the potential disruption and volatility that may be caused by ongoing macroeconomic effects of the COVID-19 pandemic. Any capital raise is not assured and may not be at terms that would be acceptable to us.

In addition, on December 19, 2022, we received a notification letter from Nasdaq's Listing Qualifications Department indicating that we are not in compliance with applicable Nasdaq Listing Rules because the minimum bid price of our common stock on the Nasdaq Capital Market has closed below \$1.00 per share for 30 consecutive business days. In accordance with further Nasdaq Listing Rules, we have 180 calendar days, or until June 19, 2023, to regain compliance with the minimum \$1.00 bid price per share requirement. To regain compliance, any time before June 19, 2023, the bid price of our common stock must close at \$1.00 per share or more for a minimum of 10 consecutive business days. Under certain circumstances, if we have not regained compliance at that time, we may be provided by Nasdaq with an additional 180 calendar day compliance period to regain compliance. While we intend to engage in efforts to regain compliance, and thus maintain our listing, there can be no assurance that we will be able to regain such compliance during the applicable time periods set forth above. If we fail to continue to meet all applicable listing requirements in the future and Nasdaq determines to delist our common stock, the delisting could substantially decrease trading in our common stock, adversely affect the market liquidity of our common stock, and adversely affect our ability to raise capital under the shelf registration statement, if at all.

Debt

We have no short- or long-term outstanding debt as of December 31, 2022.

Financing Activities

Long-Term Financing Activities

In accordance with authority granted by our Board of Directors on April 29, 2022, we can repurchase up to \$5.00 million in shares outstanding of our common stock over the three-year period ending April 29, 2025. Pursuant to the terms of the repurchase authorization, the common stock share repurchases are generally at the discretion of management. As we repurchase our common shares, which have no par value, we report such shares held as treasury stock on our condensed consolidated balance sheets, with the purchase price recorded within treasury stock.

During the six-month period ended December 31, 2022, we repurchased 358,116 shares of our common stock for an aggregate price of \$451,815 pursuant to the repurchase authorization. We repurchased no shares of our common stock during the three-month period ended December 31, 2022.

Operating Activities and Cash Flows

We require cash to fund our operating expenses and working capital requirements, including outlays for capital expenditures. As of December 31, 2022, our principal sources of liquidity were cash and cash equivalents of \$11.96 million, trade accounts receivable of \$2.09 million, and net current inventory of \$13.09 million, as compared to cash and cash equivalents of \$15.67 million, trade accounts receivable of \$2.22 million, and net current inventory of \$11.02 million as of June 30, 2022. We also had access during the six-month period ended December 31, 2022 to a \$5.00 million cash collateralized line of credit facility, or the JPMorgan Chase Credit Facility, that we obtained effective July 9, 2021, as amended July 28, 2022, from JPMorgan Chase Bank, N.A., or JPMorgan Chase.

During the six months ended December 31, 2022, our working capital decreased by approximately \$2.74 million to \$26.32 million from \$29.06 million at June 30, 2022. As described more fully below, the decrease in working capital at December 31, 2022 is primarily attributable to an increase in our accounts payable, a decrease in our accounts receivables, an increase in our short-term operating lease liabilities, the classification of the note receivable as noncurrent as of December 31, 2022 as compared to current as of June 30, 2022, and a net decrease in our cash, cash equivalents, and restricted cash. These factors were offset partially by a decrease in our accrued expenses and other liabilities, an increase in our allocation of inventory from long-term to short-term due to a higher expected sell through of inventory on hand in the upcoming period, and an increase in our prepaid expenses and other assets. Our cash used for investing activities were principally for construction-in-process expenditures related to our retail expansion program and the construction of our first *Charles & Colvard Signature Showroom* and other leasehold improvements in our corporate offices. Our cash used for financing activities was principally for our share repurchase program.

During the six months ended December 31, 2022, approximately \$3.05 million of cash was used by our operations. The primary drivers of our use of cash were a net loss in the amount of approximately \$1.93 million; an increase in inventory of \$1.60 million to build inventory in preparation for the calendar year-end holiday season; a decrease in accrued expenses and other liabilities of \$529,000; and an increase in accounts receivable of \$293,000. These factors were offset partially by an increase in accounts payable of \$460,000; a decrease in prepaid expenses and other assets of \$247,000; and the favorable impact of approximately \$595,000 of non-cash expenses.

Accounts receivable decreased principally due to the decreased level of sales on credit during the three months ended December 31, 2022, as compared with the sales during the period leading up to June 30, 2022. From time to time, we have offered extended Traditional segment customer payment terms beyond 90 days to certain credit-worthy customers. Because of the ongoing impact of the pandemic on the global economy, the extension of these terms may not immediately increase liquidity as a result of ongoing current-period sales, which we expect may continue to be pressured due to the effects of the ongoing pandemic. In addition, we believe our competitors and other vendors in the wholesale jewelry industry have expanded their use of extended payment terms and, in aggregate, we believe that, through our use of extended payment terms, we provide a competitive response in our market during the current global economic environment. We believe that we are unable to estimate the impact of these actions on our net sales, but we believe that if we ceased providing extended payment terms, we would be at a competitive disadvantage for some Traditional segment customers in the marketplace during this economic period and that our net sales and profits would likely be adversely impacted.

We manufactured approximately \$8.77 million in finished jewelry and \$4.89 million in loose jewels, which includes the cost of the loose jewels and the purchase of precious metals and labor in connection with jewelry production, during the six months ended December 31, 2022. We expect our purchases of precious metals and labor to increase as we increase our finished jewelry business. In addition, the price of gold has fluctuated significantly over the past decade, resulting in higher retail price points for gold jewelry. Because the market prices of gold and other precious metals are beyond our control, upward price trends could have a negative impact on our operating cash flow as we manufacture finished jewelry.

Historically, our raw material inventories of SiC crystals had been purchased under exclusive supply agreements with a limited number of suppliers. Because the supply agreements restricted the sale of these crystals exclusively to us, the suppliers negotiated minimum purchase commitments with us that, when combined with reduced sales levels during prior periods in which the purchase commitments were in effect, have resulted in levels of inventories that are higher than we might otherwise maintain. As of December 31, 2022 and June 30, 2022, \$21.90 million and \$22.49 million of our inventories were classified as long-term assets. Loose jewel sales and finished jewelry that we manufacture will utilize both the finished goods loose jewels currently on-hand and, as we deplete certain shapes and sizes, our on-hand raw material SiC crystals of \$1.46 million and new raw material that we purchase pursuant to the Supply Agreement.

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

As of December 31, 2022, all of our remaining federal income tax credits had expired or been utilized, and therefore, are not available to be carried forward to offset future income taxes. As of December 31, 2022, we also had a federal tax net operating loss carryforward of approximately \$16.53 million expiring between 2034 and 2037, or that have no expiration, which can be used to offset against future federal taxable income; North Carolina tax net operating loss carryforwards of approximately \$19.77 million expiring between 2023 and 2035; and various other state tax net operating loss carryforwards expiring between 2023 and 2040, which can be used to offset against future state taxable income.

Short-Term Capital Resources

Line of Credit

Effective July 7, 2021, we obtained from JPMorgan Chase our \$5.00 million cash collateralized JPMorgan Chase Credit Facility. The JPMorgan Chase Credit Facility may be used for general corporate and working capital purposes, including permitted acquisitions and certain additional indebtedness for borrowed money, installment obligations, and obligations under capital and operating leases. The JPMorgan Chase Credit Facility is secured by a cash deposit in the amount of \$5.05 million held by JPMorgan Chase as collateral for the line of credit facility. Effective July 28, 2022, the JPMorgan Chase Credit Facility was amended to, among other things, extend the maturity date to July 31, 2023, and append our obligations under the JPMorgan Chase Credit Facility to be guaranteed by our wholly owned subsidiaries, Charles & Colvard Direct, LLC, charlesandcolvard.com, LLC, and moissaniteoutlet.com, LLC.

Each advance under the JPMorgan Chase Credit Facility, as amended, accrues interest at a rate equal to the sum of JPMorgan Chase's monthly secured overnight financing rate, or the SOFR rate, to which JPMorgan Chase is subject with respect to the adjusted SOFR rate as established by the U.S. Federal Reserve Board, plus a margin of 1.25% per annum and an unsecured to secured interest rate adjustment of 0.10% per annum. Prior to its amendment, each advance under the JPMorgan Chase Credit Facility would have accrued interest at a rate equal to JPMorgan Chase's monthly LIBOR rate multiplied by a statutory reserve rate for eurocurrency funding to which JPMorgan Chase is subject with respect to the adjusted LIBOR rate as established by the U.S. Federal Reserve Board, plus a margin of 1.25% per annum. Interest is calculated monthly on an actual/360-day basis and payable monthly in arrears. Principal outstanding during an event of default, at JPMorgan Chase's option, accrues interest at a rate of 3% per annum in excess of the above rate. Any advance may be prepaid in whole or in part at any time.

As of December 31, 2022, we had not borrowed against the JPMorgan Chase Credit Facility.

Long-Term Capital Commitment

Contractual Agreement

On December 12, 2014, we entered into the Supply Agreement with Cree, Inc., now known as Wolfspeed, Inc., or Wolfspeed. Under the Supply Agreement, subject to certain terms and conditions, we agreed to exclusively purchase from Wolfspeed, and Wolfspeed agreed to exclusively supply, 100% of our required SiC materials in quarterly installments that must equal or exceed a set minimum order quantity. The initial term of the Supply Agreement was scheduled to expire on June 24, 2018, unless extended by the parties. Effective June 22, 2018, the Supply Agreement was amended to extend the expiration date to June 25, 2023. The Supply Agreement, as amended, also provides for the exclusive production of the raw materials used in our premium moissanite product, Forever One™ and provided us with one option, subject to certain conditions, to unilaterally extend the term of the Supply Agreement for an additional two-year period following the expiration of the initial term. In addition, the amendment to the Supply Agreement established a process by which Wolfspeed may begin producing alternate SiC material based on our specifications that will give us the flexibility to use the materials in a broader variety of our products, as well as to permit us to purchase certain amounts of SiC materials from third parties under limited conditions. On August 26, 2020, the Supply Agreement was further amended, effective June 30, 2020, to extend the expiration date to June 29, 2025, which may be further extended by mutual agreement of the parties. The Supply Agreement was also amended to, among other things, (i) spread our total purchase commitment under the Supply Agreement in the amount of approximately \$52.95 million over the term of the Supply Agreement, as amended; (ii) establish a process by which Wolfspeed has agreed to accept purchase orders in excess of the agreed-upon minimum purchase commitment, subject to certain conditions; and (iii) permit us to purchase revised amounts of SiC materials from third parties under limited conditions. Our total purchase commitment under the Supply Agreement, as amended, until June 2025 is approximately \$52.95 million, of which approximately \$24.75 million remains to be purchased as of December 31, 2022.

During the six months ended December 31, 2022 and 2021, we purchased approximately \$1.80 million and \$3.00 million, respectively, of SiC crystals from Wolfspeed pursuant to the terms of the Supply Agreement, as amended. Going forward, we expect to use existing cash and cash equivalents and access to other working capital resources, including but not limited to the potential issuance of equity securities, together with future cash expected to be provided by our operating activities to make purchases in accordance with the terms of the Supply Agreement, as amended.

Liquidity and Capital Trends

We believe that our existing cash and cash equivalents and cash expected to be provided by operating activities combined will be sufficient to meet our working capital and capital expenditure needs over the next twelve months.

From a long-term perspective, we believe that our ongoing access to capital markets, including but not limited to the issuance of equity securities or even potential debt securities, coupled with cash provided by operating activities in future periods beyond the next twelve months, will continue to provide us with the necessary liquidity to meet our long-term working capital and capital expenditure requirements.

In connection with our short- and long-term capital resources, we have an effective shelf registration statement on Form S-3 on file with the SEC that allows us to periodically offer and sell, individually or in any combination, shares of common stock, shares of preferred stock, warrants to purchase shares of common stock or preferred stock, and units consisting of any combination of the foregoing types of securities, up to a total of \$25.00 million, of which all is available. However, we may offer and sell no more than one-third of our public float (which is the aggregate market value of our outstanding common stock held by non-affiliates) in any 12-month period. As outlined above under the caption, *Long-Term Liquidity and Capital Structure*, our ability to issue equity securities under the shelf registration statement is subject to market conditions, which may be in turn, subject to, among other things, the potential disruption and volatility that may be caused by ongoing macroeconomic effects of the COVID-19 pandemic and the risks associated with the potential delisting of our common stock on the Nasdaq Capital Market if we fail to regain compliance with applicable Nasdaq Listing Rules within the periods of time described therein. Accordingly, any capital raise is not assured and these conditions may adversely affect our ability to raise capital under the shelf registration statement, if at all.

Our future capital requirements and the adequacy of available funds will depend on many factors, including the ongoing uncertainty surrounding COVID-19 that could lead to further disruption and volatility in the global capital markets as well as its impact on our rate of sales growth; the expansion of our sales and marketing activities; the timing and extent of raw materials and labor purchases in connection with loose jewel production to support our moissanite jewels and lab grown diamond business and precious metals and labor purchases in connection with jewelry production to support our finished jewelry business; the timing of capital expenditures; and the risk factors described in more detail in “Risk Factors” in Part II, Item 1A, of this Quarterly Report on Form 10-Q and in Part I, Item 1A, of our 2022 Annual Report on Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control Over Financial Reporting

We routinely review our internal control over financial reporting and from time to time make changes intended to enhance the effectiveness of our internal control over financial reporting. We will continue to evaluate the effectiveness of our disclosure controls and procedures and internal control over financial reporting on an ongoing basis and will take action as appropriate. During the three months ended December 31, 2022, we made no changes to our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, that we believe materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

We discuss in our Annual Report on Form 10-K for the fiscal year ended June 30, 2022 and our Quarterly Reports on Form 10-Q for the quarter ended September 30, 2022 various risks that may materially affect our business. There have been no material changes to such risks, except as set forth below.

Our business and our results of operations could be materially adversely affected as a result of general economic and market conditions. Our business, including our sales volumes and overall profitability, depends on consumer demand for our products and could be adversely impacted further by unfavorable general economic conditions, declines in consumer confidence and consumer disposable income, rising energy and fuel prices, increasing freight costs, rising inflation rates, recession and fears of recession, consumer debt levels, increased interest rates, and higher tax rates. Our business could also be adversely impacted by possible disruptions in global financial markets, including severely diminished liquidity and credit availability, declines in economic growth, increased unemployment levels, and uncertainty about economic stability, including the increased risk of global trade tensions and geopolitical unrest such as the ongoing conflict between Russia and Ukraine, and domestic political and geopolitical instability. We are unable to predict the likely duration and severity of the effects of these disruptions in the financial markets and the adverse domestic and global economic conditions, and if these economic conditions deteriorate, our business and results of operations could be materially and adversely affected.

Ongoing unfavorable economic conditions may continue to lead consumers to further delay or reduce purchases of our products and services and projected consumer demand for our products and services may not grow as we expect. The consequences of such adverse effects could also include interruptions or delays in our suppliers' performance of our contracts, reductions and delays in customer purchases, delays in or the inability of customers to obtain financing to purchase our products, and bankruptcy of customers or suppliers. Prolonged or pervasive economic downturns could also slow the pace of any planned future showroom openings that we may have going forward.

Luxury products, such as fine jewelry, are discretionary purchases for consumers. Recessionary economic cycles, higher interest rates, higher tax rates, higher fuel and energy costs, higher freight costs, higher inflation rates, higher levels of unemployment, adverse conditions in the residential real estate and mortgage markets, tighter access to consumer credit, increased consumer debt levels, unsettled financial markets, and other economic factors that may affect consumer spending or buying habits could materially and adversely affect demand for our products. In addition, volatility in the financial markets has had and may continue to have a negative impact on consumer spending patterns. A reduction in consumer spending or disposable income may affect us more significantly than companies in other industries and could have a material adverse effect on our business, results of operations, and financial condition.

Our future financial performance depends upon increased consumer acceptance, growth of sales of our products, and operational execution of our strategic initiatives. We believe that most consumers are not generally aware of the existence and attributes of moissanite jewels and lab grown diamonds and that the consumer market for moissanite jewels, lab grown diamonds, and finished jewelry featuring both moissanite and lab grown diamonds remains in the early stages of development and consumer acceptance. The degree of future market acceptance and demand is subject to a significant amount of uncertainty. Our future financial performance will depend, in part, upon greater consumer acceptance of moissanite jewels and lab grown diamonds as an ethically sourced, affordable, luxurious alternative to other gemstones, such as a mined diamond, and our ability to develop brands and execute strategic initiatives, particularly in our Online Channels segment, to grow our sales and operating income. As we execute our strategy to build and reinvest in our business, significant expenses and investment of cash will be required going forward and this may adversely affect our operating income. If we are unable to execute and achieve desired revenue levels, we may adjust our strategic initiatives in response to the results of our investments.

In addition, consumer acceptance may be affected by retail jewelers' and jewelry manufacturers' acceptance of moissanite jewels, lab grown diamonds, and finished jewelry featuring both moissanite and lab grown diamonds. The quality, design, and workmanship of the jewelry settings, whether manufactured by us or other manufacturers, could affect both consumers' perception and acceptance of our products and costs incurred by returns and markdowns.

Therefore, as other competitors enter the moissanite and lab grown diamond market, we could face market share and pricing pressures for our own products. In addition, the lower quality of competitors' gemstones could negatively impact consumer perception of moissanite jewels and lab grown diamonds, and in turn, acceptance of our jewels.

Thus, our future financial performance may be affected by:

- Our ability to develop and promote the Charles & Colvard brands, such as *Forever One*[™], *Moissanite by Charles & Colvard*[®], and *Caydia*[®], all of which are used in finished jewelry featuring moissanite and lab grown diamonds, which may in part drive interest and demand for moissanite and lab grown diamond jewelry at the consumer level;
- Our ability to differentiate *Charles & Colvard Created Moissanite*[®] and *Caydia*[®] from competing products, including competitive moissanite and the rapidly emerging lab grown diamond industry;
- Our ability to operationally execute our digital marketing strategy for our Online Channels segment;
- Our continued ability and the ability of manufacturers, designers, and retail jewelers to select jewelry settings that encourage consumer acceptance of and demand for our moissanite jewels, lab grown diamonds, and finished jewelry;
- Our ability to understand our consumer market segment and effectively market to them a compelling value proposition that leads to converted customers;
- Our ability to continue our relationship with Wolfspeed in order to sustain our supply of high-quality SiC crystals;
- The continued willingness and ability of our jewelry distributors and other jewelry suppliers, manufacturers, and designers to market and promote *Charles & Colvard Created Moissanite*[®] and *Caydia*[®] to the retail jewelry trade;
- The continued willingness of distributors, retailers, and others in our distribution channels to purchase loose *Forever One*[™], *Moissanite by Charles & Colvard*[®], and *Caydia*[®] as well as their continued willingness of manufacturers, designers, and retail jewelers to undertake setting of the loose jewels;
- Our continued ability and the ability of jewelry manufacturers and retail jewelers to set loose moissanite jewels and lab grown diamonds in finished jewelry with high-quality workmanship; and
- Our continued ability and the ability of retail jewelers, including that of our internal retail jewelry marketing team in connection with the *Charles & Colvard Signature Showroom*, which is our first retail jewelry brick-and-mortar location that we opened in October 2022, to effectively market and sell finished jewelry featuring moissanite and lab grown diamonds to consumers.

Our failure to maintain compliance with Nasdaq's continued listing requirements could result in the delisting of our common stock. Our common stock is currently listed on The Nasdaq Capital Market. In order to maintain this listing, we must satisfy minimum financial and other requirements. On December 19, 2022, we received a notification letter from Nasdaq's Listing Qualifications Department indicating that we are not in compliance with Nasdaq Listing Rule 5550(a)(2), because the minimum bid price of our common stock on the Nasdaq Capital Market has closed below \$1.00 per share for 30 consecutive business days. The notification letter has no immediate effect on the Nasdaq listing or trading in our common stock. In accordance with Nasdaq Listing Rule 5810(c)(3)(A), we have 180 calendar days, or until June 19, 2023, to regain compliance with the minimum \$1.00 bid price per share requirement. To regain compliance, any time before June 19, 2023, the bid price of our common stock must close at \$1.00 per share or more for a minimum of 10 consecutive business days. On June 19, 2023, if we meet the continued listing requirement for market value of publicly held shares and all other initial listing standards for The Nasdaq Capital Market (except for the minimum bid price requirement), and we notify Nasdaq of our intent to cure the deficiency, we may be provided with an additional 180 calendar day compliance period to regain compliance. If we are not eligible for an additional compliance period at that time, Nasdaq will provide us with written notification that our common stock will be subject to delisting. Upon such notice, we may appeal Nasdaq's delisting determination to a Nasdaq hearing panel. There can be no assurance that, if we appeal Nasdaq's determination, such appeal would be successful.

While we intend to engage in efforts to regain compliance, and thus maintain our listing, there can be no assurance that we will be able to regain compliance during the applicable time periods set forth above. If we fail to continue to meet all applicable listing requirements in the future and Nasdaq determines to delist our common stock, the delisting could substantially decrease trading in our common stock and adversely affect the market liquidity of our common stock; adversely affect our ability to obtain financing on acceptable terms, if at all; and may result in the potential loss of confidence by investors, suppliers, customers, employees, and fewer business development opportunities. Additionally, the market price of our common stock may decline further and shareholders may lose some or all of their investment.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per share	Total Number of shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs
October 1, 2022 – October 31, 2022	-	\$ -	-	\$ -
November 1, 2022 – November 30, 2022	-	\$ -	-	\$ -
December 1, 2022 – December 31, 2022	-	\$ -	-	\$ -
Total	-	\$ -	-	\$ 4,510,021

- ⁽¹⁾ On May 5, 2022, we announced that our Board of Directors had approved a share repurchase program to permit us to repurchase up to \$5.00 million worth of our issued and outstanding common stock over the three-year period ending April 29, 2025.

Item 6. Exhibits

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

<u>Exhibit No.</u>	<u>Description</u>
10.1+	Charles & Colvard, Ltd. Fiscal 2023 Senior Management Equity Incentive Program, effective July 1, 2022 (incorporated herein by reference to Exhibit 10.1 to our Current Report on Form 8-K, as filed with the SEC on November 9, 2022)
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.INS	Inline XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase document
104	Cover Page Interactive Data File – the cover page XBRL tags are embedded within the Inline XBRL document contained in Exhibit 101

+ Denotes management contract or compensatory plan or arrangement

SIGNATURES

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

CHARLES & COLVARD, LTD.

February 2, 2023

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

February 2, 2023

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

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

I, Don O'Connell, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2022 of Charles & Colvard, Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 2, 2023

By: /s/ Don O'Connell

Don O'Connell

President and Chief Executive Officer

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

I, Clint J. Pete, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2022 of Charles & Colvard, Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 2, 2023

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

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

In connection with the Quarterly Report of Charles & Colvard, Ltd. (the "Company") on Form 10-Q for the quarterly period ended December 31, 2022, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Don O'Connell, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

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

By: /s/ Don O'Connell
Don O'Connell
President and Chief Executive Officer
February 2, 2023

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

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

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

In connection with the Quarterly Report of Charles & Colvard, Ltd. (the "Company") on Form 10-Q for the quarterly period ended December 31, 2022, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Clint J. Pete, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

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

By: /s/ Clint J. Pete
Clint J. Pete
Chief Financial Officer
February 2, 2023

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

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