

**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, 2021

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 28, 2022, there were 30,639,689 shares of the registrant's common stock, no par value per share, outstanding.

FORM 10-Q
For the Quarterly Period Ended December 31, 2021

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

CHARLES & COLVARD, LTD.
CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2021	June 30, 2021
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 16,260,765	\$ 21,302,317
Restricted cash	5,050,000	144,634
Accounts receivable, net	3,647,127	1,662,074
Inventory, net	12,492,151	11,450,141
Note receivable	250,000	250,000
Prepaid expenses and other assets	1,781,448	952,065
Total current assets	<u>39,481,491</u>	<u>35,761,231</u>
Long-term assets:		
Inventory, net	19,348,160	17,722,579
Property and equipment, net	1,417,380	875,897
Intangible assets, net	233,400	209,658
Operating lease right-of-use assets	3,605,817	3,952,146
Deferred income taxes, net	5,945,671	6,350,830
Other assets	49,658	49,658
Total long-term assets	<u>30,600,086</u>	<u>29,160,768</u>
TOTAL ASSETS	<u>\$ 70,081,577</u>	<u>\$ 64,921,999</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 4,870,745	\$ 2,774,373
Operating lease liabilities	774,024	566,083
Accrued expenses and other liabilities	2,487,724	2,281,807
Total current liabilities	<u>8,132,493</u>	<u>5,622,263</u>
Long-term liabilities:		
Noncurrent operating lease liabilities	3,230,281	3,600,842
Accrued income taxes	10,821	9,878
Total long-term liabilities	<u>3,241,102</u>	<u>3,610,720</u>
Total liabilities	<u>11,373,595</u>	<u>9,232,983</u>
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Common stock, no par value; 50,000,000 shares authorized; 30,595,047 and 29,913,095 shares issued and outstanding at December 31, 2021 and June 30, 2021, respectively	56,902,098	56,057,109
Additional paid-in capital	25,787,933	25,608,593
Accumulated deficit	<u>(23,982,049)</u>	<u>(25,976,686)</u>
Total shareholders' equity	<u>58,707,982</u>	<u>55,689,016</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 70,081,577</u>	<u>\$ 64,921,999</u>

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>2021</u>	<u>2020</u>	<u>2021</u>	<u>2020</u>
Net sales	\$ 13,753,135	\$ 12,146,790	\$ 24,033,446	\$ 20,073,083
Costs and expenses:				
Cost of goods sold	7,033,946	6,167,708	12,050,496	10,363,763
Sales and marketing	4,079,035	2,480,571	6,809,187	4,128,503
General and administrative	1,189,559	977,528	2,773,835	2,185,564
Total costs and expenses	<u>12,302,540</u>	<u>9,625,807</u>	<u>21,633,518</u>	<u>16,677,830</u>
Income from operations	1,450,595	2,520,983	2,399,928	3,395,253
Other income (expense):				
Interest income	490	1,126	845	4,586
Interest expense	-	(2,466)	-	(4,905)
Loss on foreign currency exchange	-	(72)	(34)	(603)
Total other income (expense), net	<u>490</u>	<u>(1,412)</u>	<u>811</u>	<u>(922)</u>
Income before income taxes	1,451,085	2,519,571	2,400,739	3,394,331
Income tax expense	(283,473)	(494)	(406,102)	(988)
Net income	<u>\$ 1,167,612</u>	<u>\$ 2,519,077</u>	<u>\$ 1,994,637</u>	<u>\$ 3,393,343</u>
Net income per common share:				
Basic	\$ 0.04	\$ 0.09	\$ 0.07	\$ 0.12
Diluted	\$ 0.04	\$ 0.09	\$ 0.06	\$ 0.12
Weighted average number of shares used in computing net income per common share:				
Basic	30,287,677	28,804,265	30,159,543	28,795,424
Diluted	31,315,488	29,262,702	31,237,948	28,980,009

See Notes to Condensed Consolidated Financial Statements.

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

	Six Months Ended December 31, 2021				
	Common Stock		Additional Paid-in Capital	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>\$ (23,982,049)</u>	<u>\$ 58,707,982</u>
	Six Months Ended December 31, 2020				
	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total Shareholders' Equity
	Number of Shares	Amount			
Balance at June 30, 2020	28,949,410	\$ 54,342,864	\$ 25,880,165	\$ (38,787,452)	\$ 41,435,577
Stock-based compensation	-	-	107,355	-	107,355
Issuance of restricted stock	178,750	-	-	-	-
Retirement of restricted stock	(162,500)	-	-	-	-
Net income	-	-	-	874,266	874,266
Balance at September 30, 2020	28,965,660	\$ 54,342,864	\$ 25,987,520	\$ (37,913,186)	\$ 42,417,198
Stock-based compensation	-	-	87,938	-	87,938
Stock option exercises	126,666	177,325	(62,326)	-	114,999
Net income	-	-	-	2,519,077	2,519,077
Balance at December 31, 2020	<u>29,092,326</u>	<u>\$ 54,520,189</u>	<u>\$ 26,013,132</u>	<u>\$ (35,394,109)</u>	<u>\$ 45,139,212</u>

See Notes to Condensed Consolidated Financial Statements.

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

	Six Months Ended December	
	31,	
	2021	2020
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 1,994,637	\$ 3,393,343
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	238,210	271,061
Stock-based compensation	478,411	195,293
Provision for uncollectible accounts	52,000	5,514
Provision for sales returns	652,000	662,000
Inventory write-off	232,000	105,000
Provision for accounts receivable discounts	29,250	9,581
Deferred income taxes	405,159	-
Changes in operating assets and liabilities:		
Accounts receivable	(2,718,303)	(3,066,219)
Inventory	(2,899,591)	1,862,843
Prepaid expenses and other assets, net	(483,054)	62,095
Accounts payable	2,096,372	(815,659)
Accrued income taxes	943	988
Accrued expenses and other liabilities	43,297	(273,784)
Net cash provided by operating activities	<u>121,331</u>	<u>2,412,056</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(775,705)	(244,688)
Payments for intangible assets	(27,730)	(26,538)
Net cash used in investing activities	<u>(803,435)</u>	<u>(271,226)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Stock option exercises	545,918	114,999
Net cash provided by financing activities	<u>545,918</u>	<u>114,999</u>
NET (DECREASE) INCREASE IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH	(136,186)	2,255,829
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, BEGINNING OF PERIOD	21,446,951	14,617,234
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH, END OF PERIOD	<u>\$ 21,310,765</u>	<u>\$ 16,873,063</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	\$ -	\$ -
Cash paid during the period for income taxes	\$ -	\$ 8,961

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 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 on its own transactional website, moissaniteoutlet.com, through charlesandcolvard.com, LLC.

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, 2021 are not necessarily indicative of the results to be expected for the fiscal year ending June 30, 2022.

The condensed consolidated financial statements as of December 31, 2021 and for the three and six months ended December 31, 2021 and 2020 included in this Quarterly Report on Form 10-Q are unaudited. The balance sheet as of June 30, 2021 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 “2021 Annual Report”) for the fiscal year ended June 30, 2021 filed with the SEC on September 3, 2021.

The accompanying condensed consolidated financial statements as of December 31, 2021, for the three and six months ended December 31, 2021 and 2020, and as of June 30, 2021, include the accounts of the Company and its wholly owned subsidiaries charlesandcolvard.com, LLC; Charles & Colvard Direct, LLC; and Charles & Colvard (HK) Ltd., the Company’s Hong Kong subsidiary, which was entered into dormancy as of September 30, 2020 following its re-activation in December 2017. Charles & Colvard (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, 2021 or 2020. All intercompany accounts have been eliminated.

Significant Accounting Policies – In the opinion of the Company’s management, except as discussed below, the Company’s significant accounting policies used for the three and six months ended December 31, 2021, are consistent with those used for the fiscal year ended June 30, 2021. Accordingly, please refer to Note 2 to the Consolidated Financial Statements in the 2021 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, 2022, 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.”

In accordance with cash management process requirements related to the Company’s asset-based revolving credit facility from White Oak Commercial Finance, LLC (“White Oak”), which the Company had in place prior to obtaining the JPMorgan Chase Credit Facility, there were access and usage restrictions on certain cash deposit balances for periods of up to two business days during which time such deposits were held by White Oak for the benefit of the Company. During the period these cash deposits were held by White Oak, such amounts were classified as restricted cash for reporting purposes on the Company’s condensed consolidated balance sheets. For additional information regarding the Company’s prior asset-based revolving credit facility, see Note 10, “Debt.”

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

	December 31, 2021	June 30, 2021
Cash and cash equivalents	\$ 16,260,765	\$ 21,302,317
Restricted cash	5,050,000	144,634
Total cash, cash equivalents, and restricted cash	\$ 21,310,765	\$ 21,446,951

Recently Adopted/Issued Accounting Pronouncements – Effective July 1, 2021, the Company adopted the new accounting standard that provides guidance for the simplification of the accounting for income taxes that is intended to reduce the complexity while maintaining or improving the usefulness of tax disclosure information in an entity’s financial statements. The resulting impact of the new guidance did not have a material impact on the Company’s condensed consolidated financial statements.

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 FASB issued new guidance to ease the burden in accounting for or recognizing the effects of referenced interest rate reform on financial reporting. The new guidance is effective as of March 12, 2020 through December 31, 2022. As described in more detail in Note 10, “Debt”, borrowings under the Company’s new line of credit are based on a rate equal to the one-month LIBOR. As of December 31, 2021, the Company had not borrowed against its line of credit, and therefore, is not subject to recognizing or disclosing any effect of referenced rate reform as of December 31, 2021.

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. 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 2021 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, 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

	Three Months Ended December 31, 2020		
	Online Channels	Traditional	Total
Net sales			
Finished jewelry	\$ 6,588,338	\$ 1,676,859	\$ 8,265,197
Loose jewels	997,939	2,883,654	3,881,593
Total	<u>\$ 7,586,277</u>	<u>\$ 4,560,513</u>	<u>\$ 12,146,790</u>
Product line cost of goods sold			
Finished jewelry	\$ 2,863,733	\$ 1,138,413	\$ 4,002,146
Loose jewels	388,426	1,417,177	1,805,603
Total	<u>\$ 3,252,159</u>	<u>\$ 2,555,590</u>	<u>\$ 5,807,749</u>
Product line gross profit			
Finished jewelry	\$ 3,724,605	\$ 538,446	\$ 4,263,051
Loose jewels	609,513	1,466,477	2,075,990
Total	<u>\$ 4,334,118</u>	<u>\$ 2,004,923</u>	<u>\$ 6,339,041</u>
Operating income	\$ 1,494,448	\$ 1,026,535	\$ 2,520,983
Depreciation and amortization	\$ 59,221	\$ 79,384	\$ 138,605
Capital expenditures	\$ 90,852	\$ 52,350	\$ 143,202
	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

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

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,	
	2021	2020	2021	2020
Product line cost of goods sold	\$ 6,138,541	\$ 5,807,749	\$ 10,532,470	\$ 9,305,960
Non-capitalized manufacturing and production control expenses	416,828	395,237	759,229	724,641
Freight out	465,207	316,542	682,712	491,881
Inventory write-off	-	25,000	232,000	105,000
Other inventory adjustments	13,370	(376,820)	(155,915)	(263,719)
Cost of goods sold	<u>\$ 7,033,946</u>	<u>\$ 6,167,708</u>	<u>\$ 12,050,496</u>	<u>\$ 10,363,763</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,	
	2021	2020	2021	2020
Net sales				
United States	\$ 13,021,717	\$ 11,388,680	\$ 22,846,447	\$ 18,888,399
International	731,418	758,110	1,186,999	1,184,684
Total	<u>\$ 13,753,135</u>	<u>\$ 12,146,790</u>	<u>\$ 24,033,446</u>	<u>\$ 20,073,083</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, including but not limited to the note receivable, are reflected in the condensed consolidated balance sheets at carrying value, which approximates fair value due to the short-term nature of these financial instruments.

Assets that are measured at fair value on a non-recurring basis include property and equipment, leasehold improvements, and intangible assets comprising patents, license rights, and trademarks. These items are recognized at fair value when they are considered to be impaired. For the three and six months ended December 31, 2021 and 2020, 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, 2021	June 30, 2021
Finished jewelry:		
Raw materials	\$ 1,728,266	\$ 1,476,514
Work-in-process	1,826,826	779,593
Finished goods	10,089,451	8,025,816
Finished goods on consignment	2,316,408	2,050,372
Total finished jewelry	<u>\$ 15,960,951</u>	<u>\$ 12,332,295</u>
Loose jewels:		
Raw materials	\$ 1,673,194	\$ 1,775,505
Work-in-process	8,604,863	9,893,443
Finished goods	5,153,778	4,942,192
Finished goods on consignment	344,337	154,968
Total loose jewels	<u>15,776,172</u>	<u>16,766,108</u>
Total supplies inventory	103,188	74,317
Total inventory	<u>\$ 31,840,311</u>	<u>\$ 29,172,720</u>

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

	December 31, 2021	June 30, 2021
Short-term portion	\$ 12,492,151	\$ 11,450,141
Long-term portion	19,348,160	17,722,579
Total	<u>\$ 31,840,311</u>	<u>\$ 29,172,720</u>

The Company's work-in-process inventories include raw SiC crystals on which processing costs, such as labor and sawing, have been incurred; and components, such as metal castings and finished good moissanite jewels, that have been issued to jobs in the manufacture of finished jewelry. The Company's moissanite jewel manufacturing process involves the production of intermediary shapes, called "preforms," that vary depending upon the expected size and shape of the finished jewel. To maximize manufacturing efficiencies, preforms may be made in advance of current finished inventory needs but remain in work-in-process inventories. As of December 31, 2021 and June 30, 2021, work-in-process inventories issued to active production jobs approximated \$3.07 million and \$2.23 million, respectively.

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

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

In March 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 matures on March 5, 2022 (the "Maturity Date"). The Company has accounted for the Convertible Promissory Note as a current note receivable within the accompanying consolidated financial statements. Interest is accrued at a simple rate of 0.14% per annum and will 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. Accrued and unpaid interest on the Convertible Promissory Note is classified as a current asset and included in prepaid expenses and other assets in the accompanying consolidated financial statements.

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, 2021	June 30, 2021
Accrued sales tax	\$ 921,828	\$ 555,547
Accrued compensation and related benefits	585,782	866,705
Deferred revenue	548,311	774,891
Accrued cooperative advertising	415,324	68,185
Accrued income taxes	16,478	16,478
Other	1	1
Total accrued expenses and other liabilities	\$ 2,487,724	\$ 2,281,807

8. INCOME TAXES

For each of the three and six months ended December 31, 2021, the Company's statutory tax rate was 22.24% and consisted of the federal income tax rate of 21% and a blended state income tax rate of 1.24%, net of the federal benefit. For each of the three and six months ended December 31, 2020, the Company's statutory tax rate was 22.11% and consisted of the federal income tax rate of 21% and a blended state income tax rate of 1.11%, 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, 2021, the Company's effective tax rate was 16.92%.

As of each reporting date, the Company's management considers new evidence, both positive and negative, that could impact its view with regard to future realization of deferred tax assets. As of June 30, 2021, cumulative positive taxable income over the last three tax years had been generated in the U.S., as compared to the negative evidence of cumulative losses in previous years. The Company's management also determined that its expectations of future taxable income in upcoming tax years, including estimated growth rates applied to future expected taxable income that included significant management estimates and assumptions, would be sufficient to result in full utilization of the Company's federal net operating loss carryforwards and certain of the deferred tax assets prior to any statutory expiration. As a result, the Company's management determined that sufficient positive evidence existed as of June 30, 2021, to conclude that it was more likely than not deferred tax assets of approximately \$6.35 million would be realizable, and it reduced the Company's valuation allowance accordingly.

Accordingly, the Company recognized a net income tax expense of approximately \$283,000 and \$406,000 for the three and six months ended December 31, 2021, respectively, compared with a net income tax expense of approximately \$500 and \$1,000 for the three and six months ended December 31, 2020, respectively. With the reduction of its valuation allowance during the fiscal year ended June 30, 2021, the Company recognized deferred income tax expense during the six months ended December 31, 2021 in the amount of approximately \$405,000. Included in its tax provision, the Company records estimated taxes, penalties, and interest associated with uncertain tax positions as income tax expense and recognized such expense related to these items of approximately \$500 for each of the three months ended December 31, 2021 and 2020, respectively, and approximately \$1,000 for each of the six months ended December 31, 2021 and 2020, respectively.

As of December 31, 2021, the Company's management determined that its 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, the Company's management determined that sufficient positive evidence existed as of December 31, 2021, to conclude that it is more likely than not deferred tax assets of approximately \$5.95 million remain realizable. Conversely, the Company's 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, the Company continued to maintain a valuation allowance against the deferred tax assets relating to certain state net operating loss carryforwards from the Company's 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 in effect as of December 31, 2021 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 options are exercised, the monthly minimum rent for each of the extended terms will be adjusted to the then prevailing fair market rate.

The Company took possession of the leased property on May 23, 2014, once certain improvements to the leased space were completed and did not have access to the property before this date. 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. Once such costs have been incurred, the Company will be reimbursed for qualified costs by the landlord and the Company will reduce the remaining ROU asset and lease liability by the amount of the reimbursement. Such reductions of the ROU asset and lease liability will be recognized prospectively by the Company 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, 2021, the Company's balance sheet classifications of its leases are as follows:

Operating Leases:

Noncurrent operating lease ROU assets	\$ 3,605,817
Current operating lease liabilities	\$ 774,024
Noncurrent operating lease liabilities	3,230,281
Total operating lease liabilities	<u>\$ 4,004,305</u>

The Company's total operating lease cost was approximately \$214,000 and \$128,000 for the three months ended December 31, 2021 and 2020, respectively. The Company's total operating lease cost was approximately \$413,000 and \$260,000 for the six months ended December 31, 2021 and 2020, respectively.

As of December 31, 2021, 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 4.83 years.

As of December 31, 2021, the Company's remaining future payments under operating leases for each fiscal year ending June 30 are as follows:

2022	\$ 355,868
2023	869,742
2024	893,660
2025	918,236
2026	943,487
2027	317,327
Total lease payments	<u>4,298,320</u>
Less: imputed interest	<u>294,015</u>
Present value of lease payments	4,004,305
Less: current lease obligations	774,024
Total long-term lease obligations	<u>\$ 3,230,281</u>

The Company makes cash payments for amounts included in the measurement of its lease liabilities. During the three months ended December 31, 2021 and 2020, cash paid for operating leases was approximately \$8,000 and \$170,000, respectively. During the six months ended December 31, 2021 and 2020, cash paid for operating leases was approximately \$170,000 and \$340,000, respectively. Upon the execution of the Lease Amendment, the Company recorded additional ROU assets in the amount of approximately \$3.9 million obtained in exchange for the additional operating lease liability during the fiscal year ended June 30, 2021.

Purchase Commitments

On December 12, 2014, the Company entered into an exclusive supply agreement (the “Supply Agreement”) with Cree, Inc., now known as 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 \$29.85 million remains to be purchased as of December 31, 2021. 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, 2021, the Company purchased approximately \$3.00 million of SiC crystals from Wolfspeed pursuant to the terms of the Supply Agreement, as amended. During the six months ended December 31, 2020, the Company purchased approximately \$1.03 million SiC crystals from Wolfspeed pursuant to the terms of the Supply Agreement, as amended.

COVID-19 Update

The evolving COVID-19 pandemic continues to present unprecedented worldwide economic and business challenges in the Company’s fiscal year ending June 30, 2022 (“Fiscal 2022”). The Company’s management has taken measures to protect the health and safety of the Company’s employees, work with its customers and suppliers to minimize disruptions, and support its community in addressing the challenges posed by the ongoing COVID-19 pandemic and its evolving viral variants.

The Company has experienced impacts on its business related to the COVID-19 pandemic, primarily in increased coronavirus-related costs, including at times using accelerated payments in some cases to the Company’s suppliers that are due by their terms in future periods. The Company expects to continue accelerating payments to certain suppliers through at least the remainder of Fiscal 2022. The Company is continuing to see a sharp increase in international and domestic freight costs, with limited availability and long delays causing disruption in the global supply chain. Accordingly, the Company’s management is taking steps where possible to mitigate such potential delays in supplier deliveries by accelerating orders and increasing order quantities.

Following the government mandated shut down during the early days of the pandemic, work in the Company’s production and distribution facilities has continued throughout the pandemic, consistent with guidance from federal, state, and local officials to minimize the spread of COVID-19. The Company’s management continues to take actions to equip its employees with personal protective equipment, establish minimum staffing and social distancing policies, sanitize workspaces, adopt alternate work schedules, and institute other measures aimed to sustain production and related services while minimizing the transmission of COVID-19, including measures to encourage all employees to be fully vaccinated and to provide evidence of vaccination status in line with state and local guidelines. In addition, the Company has maintained a flexible teleworking policy for its employees who can meet customer commitments remotely, and a portion of the Company’s workforce continues teleworking.

Although the COVID-19 pandemic did not have a significant adverse impact on the Company’s financial results in the six months ended December 31, 2021, the ultimate impact of COVID-19 on the Company’s 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 boosters, and related government actions to prevent and manage disease spread, all of which are uncertain and cannot be predicted. The Company cannot at this time predict the full impact of the COVID-19 pandemic, but the Company’s management believes there is a risk that the COVID-19 pandemic could adversely impact the Company’s business, financial condition, results of operations and/or cash flows in Fiscal 2022.

10. DEBT

Line of Credit

Effective July 7, 2021, the Company obtained from JPMorgan Chase Bank, N.A. (“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.

Each advance accrues 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, 2021, the Company had not borrowed against the JPMorgan Chase Credit Facility.

Prior to obtaining the JPMorgan Chase Credit Facility, the Company and its wholly owned subsidiary, charlesandcolvard.com, LLC (collectively, the “Borrowers”), had a \$5.00 million asset-based revolving credit facility (the “White Oak Credit Facility”) from White Oak Commercial Finance, LLC (“White Oak”), which was terminated by the Company in accordance with its terms as of July 9, 2021. The effective date of the White Oak Credit Facility was July 13, 2018, and it was scheduled to mature on July 13, 2021.

Available advances could have been in the form of either revolving or non-revolving. During the first year of the term of the White Oak Credit Facility, any revolving advances would have accrued interest at a rate equal to one-month LIBOR (reset monthly, and subject to a 1.25% floor) plus 3.75%, and any non-revolving advances would have accrued interest at such LIBOR rate plus 4.75%. Thereafter, the interest margins would have been reduced upon the Company’s achievement of a specified fixed charge coverage ratio during the period of any outstanding advances. However, any advances were in all cases subject to a minimum interest rate of 5.50% and interest would have been calculated on an actual/360 basis and payable monthly in arrears. Principal outstanding during an event of default, which did not occur during the term of the White Oak Credit Facility, would have accrued interest at a rate 2% in excess of the rate that would have been otherwise applicable.

The Company had not borrowed against the White Oak Credit Facility as of July 9, 2021, the date upon which the White Oak Credit Facility was terminated by the Company in accordance with its terms.

Paycheck Protection Program Loan

On June 18, 2020, the Company received the proceeds from a loan pursuant to the Paycheck Protection Program under the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), as administered by the U.S. Small Business Administration (the “SBA”). The loan in the principal amount of \$965,000 (the “PPP Loan”) was disbursed by the Lender pursuant to a promissory note issued by the Company (the “Promissory Note”) on June 15, 2020. During the period of time that the principal under the Promissory Note was outstanding, the Company accounted for the Promissory Note as debt within the accompanying consolidated financial statements.

Pursuant to its terms, the Promissory Note was scheduled to mature on June 18, 2022. However, on June 14, 2021, in accordance with applicable provisions of the CARES Act the Company filed its PPP Loan forgiveness application with the Lender for forgiveness of the full amount of the PPP Loan proceeds and the related accrued and unpaid interest. Effective June 23, 2021, the Company’s PPP Loan forgiveness was approved and processed by the SBA for the full principal of the PPP Loan in the amount of \$965,000 and the related accrued and unpaid interest. Accordingly, the full amount of the gain in connection with the extinguishment of this debt was recognized in the fiscal year ended June 30, 2021.

In accordance with the terms of the Promissory Note, during the period of time the principal of the PPP Loan was outstanding, interest was accrued by the Company at a fixed rate of 1% per annum. In connection with the Company’s PPP Loan forgiveness, the SBA also approved forgiveness of accrued interest amounts that would have been otherwise payable by the Company to the Lender. Accordingly, the benefit from the forgiveness of the inception to-date interest expense in the amount of approximately \$9,000 was recognized and included within the gain on extinguishment of debt in the consolidated statement of operations for the fiscal year ended June 30, 2021.

The Company has no outstanding debt as of December 31, 2021.

11. SHAREHOLDERS' EQUITY AND STOCK-BASED COMPENSATION

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,	
	2021	2020	2021	2020
Employee stock options	\$ 57,448	\$ 50,176	\$ 127,014	\$ 141,216
Restricted stock awards	141,556	37,762	351,397	54,077
Totals	<u>\$ 199,004</u>	<u>\$ 87,938</u>	<u>\$ 478,411</u>	<u>\$ 195,293</u>

No stock-based compensation was capitalized as a cost of inventory during the three and six months ended December 31, 2021 and 2020.

Stock Options

The following is a summary of the stock option activity for the six months ended December 31, 2021:

	Shares	Weighted Average Exercise Price
Outstanding, June 30, 2021	2,235,286	\$ 1.24
Granted	142,793	\$ 2.92
Exercised	(439,227)	\$ 1.24
Forfeited	(14,584)	\$ 0.89
Expired	(60,079)	\$ 1.52
Outstanding, December 31, 2021	<u>1,864,189</u>	\$ 1.36

The total fair value of stock options that vested during the six months ended December 31, 2021 was approximately \$166,000.

The following table summarizes information about stock options outstanding at December 31, 2021:

Options Outstanding			Options Exercisable			Options Vested or Expected to Vest		
Balance as of 12/31/2021	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of 12/31/2021	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of 12/31/2021	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
1,864,189	6.31	\$ 1.36	1,463,550	5.59	\$ 1.29	1,805,494	6.23	\$ 1.36

As of December 31, 2021, the unrecognized stock-based compensation expense related to unvested stock options was approximately \$277,000, 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, 2021 was approximately \$3.04 million. These amounts are before applicable income taxes and represent the closing market price of the Company's common stock at December 31, 2021 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 and 2020, the aggregate intrinsic value of stock options exercised was approximately \$717,000 and \$48,000, respectively. During the six months ended December 31, 2021 and 2020, the total estimated tax benefit associated with certain stock options that were exercised was approximately \$76,000 and \$0, respectively.

Restricted Stock

The following is a summary of the restricted stock activity for the six months ended December 31, 2021:

	Shares	Weighted Average Grant Date Fair Value
Unvested, June 30, 2021	178,750	\$ 0.72
Granted	242,725	\$ 2.75
Vested	(242,725)	\$ 1.25
Unvested, December 31, 2021	<u>178,750</u>	<u>\$ 2.75</u>

The unvested restricted shares as of December 31, 2021 are all performance-based restricted shares that are scheduled to vest, subject to achievement of the underlying performance goals, in July 2022. As of December 31, 2021, the estimated unrecognized stock-based compensation expense related to unvested restricted shares subject to achievement of performance goals was approximately \$326,000, all of which is expected to be recognized over a weighted average period of approximately seven months.

Dividends

The Company has paid no cash dividends during the current fiscal year through December 31, 2021.

12. NET INCOME PER COMMON SHARE

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

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2021	2020	2021	2020
Numerator:				
Net income	\$ 1,167,612	\$ 2,519,077	\$ 1,994,637	\$ 3,393,343
Denominator:				
Weighted average common shares outstanding:				
Basic	30,287,677	28,804,265	30,159,543	28,795,424
Effect of dilutive securities	1,027,811	458,437	1,078,405	184,585
Diluted	<u>31,315,488</u>	<u>29,262,702</u>	<u>31,237,948</u>	<u>28,980,009</u>
Net income per common share:				
Basic	\$ 0.04	\$ 0.09	\$ 0.07	\$ 0.12
Diluted	\$ 0.04	\$ 0.09	\$ 0.06	\$ 0.12

For the three and six months ended December 31, 2021 stock options to purchase approximately 836,000 and 786,000 shares, respectively, and for each of the three and six months ended December 31, 2020, stock options to purchase approximately 2.53 million shares and 2.80 million shares, respectively, were excluded from the computation of diluted net income per common share for each period presented herein. These shares are excluded from the computations of diluted net income per common share because the exercise price of the stock options for each of the periods presented 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 diluted net income per common share for each of the three- and six-month periods ended December 31, 2021 and 2020, because the shares are performance-based and the underlying conditions have not been met as of the periods presented.

13. MAJOR CUSTOMERS AND CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist 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 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.

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, 2021	June 30, 2021
Customer A	45%	30%
Customer B	13%	*%
Customer C	**%	22%
Customer D	**%	14%

* Customer B did not have individual balances that represented 10% or more of total gross accounts receivable as of June 30, 2021.

** Customer C and Customer D did not have individual balances that represented 10% or more of total gross accounts receivable as of December 31, 2021.

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,	
	2021	2020	2021	2020
Customer A	16%	14%	15%	12%
Customer C	*%	*%	11%	10%

* Customer C did not have net sales that represented 10% or more of total net sales for the three months ended December 31, 2021 and 2020.

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, financial condition and results of operations could continue to be adversely affected by an ongoing COVID-19 pandemic and related global economic conditions;
2. Our future financial performance depends upon increased consumer acceptance, growth of sales of our products, and operational execution of our strategic initiatives;
3. Our business and our results of operations could be materially adversely affected as a result of general economic and market conditions;
4. We face intense competition in the worldwide gemstone and jewelry industry;
5. A failure of our information technology infrastructure or a failure to protect confidential information of our customers and our network against security breaches could adversely impact our business and operations;
6. We are subject to certain risks due to our international operations, distribution channels and vendors;
7. 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;
8. We are currently dependent on a limited number of distributor and retail partners in our Traditional segment for the sale of our products;
9. We may experience quality control challenges from time to time that can result in lost revenue and harm to our brands and reputation;
10. Seasonality of our business may adversely affect our net sales and operating income;
11. Our operations could be disrupted by natural disasters;
12. Sales of moissanite and lab grown diamond jewelry could be dependent upon the pricing of precious metals, which is beyond our control;
13. Our current customers may potentially perceive us as a competitor in the finished jewelry business;
14. 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;
15. 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;
16. Governmental regulation and oversight might adversely impact our operations;
17. The execution of our business plans could significantly impact our liquidity;
18. 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;
19. Negative or inaccurate information on social media could adversely impact our brand and reputation;
20. 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;
21. 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;
22. If we fail to evaluate, implement, and integrate strategic acquisition or disposition opportunities successfully, our business may suffer;
23. Our loan, pursuant to the Paycheck Protection Program, or the PPP Loan, under the Coronavirus Aid, Relief, and Economic Security Act, or the CARES Act, as administered by the U.S. Small Business Administration, or the SBA, was forgiven in full and may be subject to review for compliance with applicable SBA requirements for six years from the date the loan was forgiven;
24. Some anti-takeover provisions of our charter documents may delay or prevent a takeover of our Company; and
25. Our failure to maintain compliance with The Nasdaq Stock Market's continued listing requirements could result in the delisting of our common stock.

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, 2021, or the 2021 Annual Report. Historical results and percentage relationships related to any amounts in the condensed consolidated financial statements are not necessarily indicative of trends in operating results for future periods.

Overview

Our Mission

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

About Charles & Colvard

Charles & Colvard, Ltd., a North Carolina corporation founded in 1995 (which may be referred to as Charles & Colvard, we, us, or our), is a globally recognized fine jewelry company specializing in lab grown 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.

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

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

COVID-19 Update

The evolving COVID-19 pandemic continues to present unprecedented worldwide economic and business challenges. During the first six months of the fiscal year ending June 30, 2022, or Fiscal 2022, we have experienced impacts on our business related to the COVID-19 pandemic, primarily in increased coronavirus-related costs, including at times using accelerated payments to our suppliers that are due by their terms in future periods. We expect to continue accelerating payments to certain suppliers through at least the remainder of Fiscal 2022. Moreover, we are also continuing to see a sharp increase in international and domestic freight costs, with limited availability and long delays causing disruption in the global supply chain. Accordingly, we are taking steps where possible to mitigate such potential delays in supplier deliveries by accelerating orders and increasing order quantities. We have also taken measures to protect the health and safety of our employees, work with our customers and suppliers to minimize disruptions, and support our community in addressing the challenges posed by the ongoing COVID-19 pandemic and its evolving viral variants.

Following the government mandated shut down during the early days of the pandemic, work in our production and distribution facilities has continued throughout the pandemic, consistent with guidance from federal, state and local officials to minimize the spread of COVID-19. We continue to take actions to equip employees with personal protective equipment, establish minimum staffing and social distancing policies, sanitize workspaces, adopt alternate work schedules, and institute other measures aimed to sustain production and related services while minimizing the transmission of COVID-19, including measures to encourage all employees to be fully vaccinated and to provide evidence of vaccination status in line with state and local guidelines. In addition, we have maintained a flexible teleworking policy for our employees who can meet customer commitments remotely, and a portion of our workforce continues teleworking.

Although the COVID-19 pandemic did not have a significant adverse impact on our financial results during the six month period ended December 31, 2021, the ultimate impact of COVID-19 on our operations and financial performance in future periods, including our ability to execute our 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 boosters, 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 believe the risk exists that the COVID-19 pandemic, including changes in consumer-level spending as a result of the pandemic, could adversely impact our business, financial condition, results of operations and/or cash flows in Fiscal 2022.

For additional risks to the Company related to the COVID-19 pandemic, see “Part I, Item 1A. Risk Factors”, contained in our 2021 Annual Report.

Fiscal 2022 Financial Outlook

Our key strategic initiatives during Fiscal 2022 continue to be designed to increase brand awareness and to drive expansion of our favorable brand equity. We believe that we remain on a strong trajectory toward accomplishing our goal for continued and sustained top line growth and are poised to broaden our consumer reach and maximize product value through our brand- and performance-based marketing strategy. We have made significant investments to strengthen the Charles & Colvard brand through our marketing strategy, which includes brand marketing campaigns across multiple digital platforms, social media outlets, earned media, and media placements as well as placements with key consumer-based influencers. We believe that to continue the growth of our business, we must continue to acquire new customers and retain existing customers in a cost-effective manner. During the quarter ended December 31, 2021, we made significant progress toward completion of our first Charles & Colvard Signature Showroom, which we believe will complement and expand our omnichannel brand strategy in the fine jewelry space. This showroom, which we expect to open during Fiscal 2022, will be the first location of our retail showroom expansion program and is located in our corporate headquarters in North Carolina’s Research Triangle Park. We believe that our retail showroom expansion program will allow us to develop a nationwide footprint to showcase our exclusive *Signature Collection* designs as well as a wide assortment of Forever One™ moissanite and Caydia® lab grown diamond fine jewelry. We are also nearing completion of the construction of an innovative broadcast studio at our corporate headquarters, which will expand our content production capabilities and provide us a platform to live-stream consumer-based broadcasts on our websites and through other online media channels, including those of our business partners. We believe this digital marketing capability will continue to further position and define our brand in what we believe is a rapidly evolving consumer landscape and better meet the consumer’s current appetite for digital content. We believe these capabilities will provide incremental sales channels for our direct-to-consumer business and allow us to compete more effectively and to increase our market share within the fine jewelry space. We continually develop our dynamic marketing strategies to optimize our messaging and advertising spend across multiple channels in an effort to drive strategic customer acquisition and to increase fine jewelry sales from new customers and repeat orders from existing customers. In December, we kicked off our out-of-home marketing strategy and began a digital billboard advertising program in New York City that allowed us to present a collection of our fine jewelry and lab grown gemstones to live consumers in the New York City mass media market. While we are in the early stages of seeking to expand our geographic footprint, we believe these strategies will combine to help drive future and sustained growth and to present our brand and gemstone product lines to a broader range of consumers in the fine jewelry space. We further believe that we are well-positioned to meet current marketing-level trends within the jewelry industry, where consumers are increasingly more aware of the products they purchase and seek brands that stand for sustainability and social and environmental responsibility.

We discuss our strategic outlook and key strategies for Fiscal 2022 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 2021 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 future effects of the COVID-19 pandemic on our results of operations, cash flows, and financial position remain unclear. 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, including the impact of the COVID-19 pandemic and the related responses, 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 2021 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 2022.

Results of Operations

The following table sets forth certain consolidated statements of operations data for the three and six months ended December 31, 2021 and 2020:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2021	2020	2021	2020
Net sales	\$ 13,753,135	\$ 12,146,790	\$ 24,033,446	\$ 20,073,083
Costs and expenses:				
Cost of goods sold	7,033,946	6,167,708	12,050,496	10,363,763
Sales and marketing	4,079,035	2,480,571	6,809,187	4,128,503
General and administrative	1,189,559	977,528	2,773,835	2,185,564
Total costs and expenses	12,302,540	9,625,807	21,633,518	16,677,830
Income from operations	1,450,595	2,520,983	2,399,928	3,395,253
Other income (expense):				
Interest income	490	1,126	845	4,586
Interest expense	-	(2,466)	-	(4,905)
Loss on foreign currency exchange	-	(72)	(34)	(603)
Total other income (expense), net	490	(1,412)	811	(922)
Income before income taxes	1,451,085	2,519,571	2,400,739	3,394,331
Income tax expense	(283,473)	(494)	(406,102)	(988)
Net income	\$ 1,167,612	\$ 2,519,077	\$ 1,994,637	\$ 3,393,343

Consolidated Net Sales

Consolidated net sales for the three and six months ended December 31, 2021 and 2020 comprise the following:

	Three Months Ended December 31,		Change		Six Months Ended December 31,		Change	
	2021	2020	Dollars	Percent	2021	2020	Dollars	Percent
Finished jewelry	\$ 10,539,166	\$ 8,265,197	\$ 2,273,969	28%	\$ 16,225,453	\$ 12,600,534	\$ 3,624,919	29%
Loose jewels	3,213,969	3,881,593	(667,624)	(17)%	7,807,993	7,472,549	335,444	4%
Total consolidated net sales	\$ 13,753,135	\$ 12,146,790	\$ 1,606,345	13%	\$ 24,033,446	\$ 20,073,083	\$ 3,960,363	20%

Consolidated net sales were \$13.75 million for the three months ended December 31, 2021 compared to \$12.15 million for the three months ended December 31, 2020, an increase of approximately \$1.61 million, or 13%. Consolidated net sales were \$24.03 million for the six months ended December 31, 2021 compared to \$20.07 million for the six months ended December 31, 2020, an increase of approximately \$3.96 million, or 20%. The increase in consolidated net sales for the three and six months ended December 31, 2021 was due primarily to strong calendar year-end holiday sales and increased consumer awareness and strong demand for our moissanite jewels, lab grown diamonds, and finished jewelry featuring both moissanite and lab grown diamonds. These increases resulted in higher finished jewelry product net sales during the three and six months ended December 31, 2021 in our Online Channels segment and Traditional segment. The increases in our Online Channels segment net sales in the three months ended December 31, 2021 were partially offset by lower net sales in our Traditional segment driven by lower loose jewels sales and decreased international sales during the three months ended December 31, 2021.

Sales of finished jewelry represented 77% and 68% of total consolidated net sales for the three and six months ended December 31, 2021, respectively, compared to 68% and 63%, respectively, of total consolidated net sales for the corresponding periods of the prior year. For the three months ended December 31, 2021, finished jewelry sales were \$10.54 million compared to \$8.27 million for the corresponding period of the prior year, an increase of approximately \$2.27 million, or 28%. For the six months ended December 31, 2021, finished jewelry sales were \$16.23 million compared to \$12.60 million for the corresponding period of the prior fiscal year, an increase of approximately \$3.62 million, or 29%. The increase in finished jewelry sales for the three- and six-month periods ended December 31, 2021 was due primarily to higher finished jewelry sales of *Forever One™*, *Moissanite by Charles & Colvard®*, and *Signature Collection* in our Online Channels segment as well as in our Traditional segment.

Sales of loose jewels represented 23% and 32% of total consolidated net sales for the three and six months ended December 31, 2021, respectively, compared to 32% and 37%, respectively, of total consolidated net sales for the corresponding periods of the prior fiscal year. For the three months ended December 31, 2021, loose jewel sales were \$3.21 million compared to \$3.88 million for the corresponding period of the prior year, a decrease of \$668,000, or 17%. For the six months ended December 31, 2021, loose jewel sales were \$7.81 million compared to \$7.47 million for the corresponding period of the prior fiscal year, an increase of \$335,000, or 4%. The decrease in loose jewel sales for the three-month period ended December 31, 2021 was principally due to lower sales of loose jewels through our distribution network in our Online Channels segment and Traditional segment, which reflected activity from many of our distributors that pulled forward calendar year-end holiday purchases into our first quarter during the current fiscal year to preclude potential holiday shipping delays. The increase in loose jewels sales for the six-month period ended December 31, 2021 was primarily a result of higher sales of loose jewels through our domestic distributors.

U.S. net sales accounted for approximately 95% of total consolidated net sales for each of the three- and six-month periods ended December 31, 2021, compared to 94% of total consolidated net sales for each of the corresponding periods of the prior year. U.S. net sales increased to \$13.02 million, or 14%, during the three months ended December 31, 2021 from the corresponding period of the prior fiscal year. U.S. net sales increased to \$22.85 million, or 21%, during the six months ended December 31, 2021 from the corresponding period of the prior year. U.S. net sales increased during the three and six months ended December 31, 2021 primarily as a result of increased sales to U.S. customers in both our Online Channels segment and Traditional segment.

Our largest U.S. customer during the three and six months ended December 31, 2021 accounted for 16% and 15% 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, 2020 when this customer accounted for 14% and 12% 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 and 2020, accounted for 11% and 10% of total consolidated net sales during each of the respective six-month periods. Other than our U.S. customers noted above during the three- and six-month periods ended December 31, 2021 and 2020, 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 5% of total consolidated net sales for each of the three- and six-month periods ended December 31, 2021, respectively, compared to 6% of total consolidated net sales for each of the corresponding periods of the prior year. International net sales decreased 4% and less than 1% during the three and six months ended December 31, 2021, respectively, from the corresponding periods of the prior fiscal year due to somewhat lower demand in our international distributor market coupled with flat demand in our direct-to-consumer international sales from our Online Channels segment in international markets. In light of the effects of ongoing global economic conditions and as the world continues to adapt to the COVID-19 pandemic, we continue to evaluate these and other potential distributors in international markets to determine the best long-term partners. As a result, and in light of the ongoing worldwide pandemic and international trade challenges, we expect our sales in these markets 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, 2021 or 2020. 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, 2021 and 2020 are as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2021	2020			2021	2020		
Product line cost of goods sold:								
Finished jewelry	\$ 4,703,976	\$ 4,002,146	\$ 701,830	18%	\$ 7,038,459	\$ 5,756,435	\$ 1,282,024	22%
Loose jewels	1,434,565	1,805,603	(371,038)	(21)%	3,494,011	3,549,525	(55,514)	(2)%
Total product line cost of goods sold	6,138,541	5,807,749	330,792	6%	10,532,470	9,305,960	1,226,510	13%
Non-product line cost of goods sold	895,405	359,959	535,446	149%	1,518,026	1,057,803	460,223	44%
Total cost of goods sold	\$ 7,033,946	\$ 6,167,708	\$ 866,238	14%	\$ 12,050,496	\$ 10,363,763	\$ 1,686,733	16%

Total cost of goods sold was \$7.03 million for the three months ended December 31, 2021 compared to \$6.17 million for the three months ended December 31, 2020, a net increase of approximately \$866,000, or 14%. Total cost of goods sold was \$12.05 million for the six months ended December 31, 2021 compared to \$10.36 million for the six months ended December 31, 2020, an increase of approximately \$1.69 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 increase in total cost of goods sold for the three months ended December 31, 2021 compared to the same period in 2020 was primarily driven by increased sales of finished jewelry, which reflect higher material and labor costs, in our Online Channels segment as a result of strong demand during the calendar year-end 2021 holiday season. Our finished jewelry products cost more to produce due to higher material and labor costs when compared to the production of loose jewels.

The net increase in non-product line cost of goods sold for the three months ended December 31, 2021, comprises a \$390,000 higher change in other inventory adjustments principally related to unfavorable changes in production standard cost variances compared to the three months ended December 31, 2020. The net increase in non-product line cost of goods sold was also related to an approximate \$149,000 increase in freight out principally from increased shipments resulting from Online Channels segment sales growth during the three months ended December 31, 2021, as well as a reflection of the rising costs of freight overall during the period, and an approximate \$22,000 increase in non-capitalized manufacturing and production control expenses principally due to the timing of when work-in-process goods are received into inventory and overhead costs are allocated. These increases in non-product line cost of goods sold were offset in part by an approximate \$25,000 decrease in inventory write-offs primarily related to fewer additional reserves being required in the three months ended December 31, 2021, compared to those in the comparable prior year period.

The increase in cost of goods sold for the six months ended December 31, 2021 compared to the same period in 2020 was also primarily driven by the increased finished jewelry sales in both our Online Channels segment and Traditional segment as a result of strong sales throughout the six-month period, and moreover, during the calendar year-end 2021 holiday season.

The increase in non-product line cost of goods sold for the six months ended December 31, 2021, comprises a \$108,000 higher change in other inventory adjustments principally related to unfavorable changes in production standard cost variances compared to those in the six months ended December 31, 2020. The increase in non-product line cost of goods sold was also related to an approximate \$191,000 increase in freight out principally from increased shipments resulting from Online Channels segment sales growth during the six months ended December 31, 2021, as well as a reflection of the rising costs of freight overall during the period; an approximate \$127,000 increase in inventory write-offs primarily related to increases in obsolescence reserves in the first three months of the six month-period ended December 31, 2021, compared to those in the comparable prior year period; and an approximate \$35,000 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.

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, 2021 and 2020 are as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2021	2020			2021	2020		
Sales and marketing	\$ 4,079,035	\$ 2,480,571	\$ 1,598,464	64%	\$ 6,809,187	\$ 4,128,503	\$ 2,680,684	65%

Sales and marketing expenses were \$4.08 million for the three months ended December 31, 2021 compared to \$2.48 million for the three months ended December 31, 2020, an increase of approximately \$1.60 million, or 64%. Sales and marketing expenses were \$6.81 million for the six months ended December 31, 2021 compared to \$4.13 million for the six months ended December 31, 2020, an increase of approximately \$2.68 million, or 65%.

The increase in sales and marketing expenses for the three months ended December 31, 2021 compared to the same period in 2020 was primarily due to a \$1.41 million increase in advertising and digital marketing expenses; a \$72,000 increase in professional services principally comprising consulting services for marketing support in the current year period; a \$49,000 increase in bank fees, which are principally related to higher credit card transaction fees from increased online sales levels; a \$32,000 increase in compensation expenses; a \$23,000 increase in rent expense, primarily related to our corporate headquarters operating lease amendment that was executed in January 2021; and a \$14,000 increase in travel expenses as we returned to more traditional business travel patterns following cut-backs relating to the COVID-19 pandemic and related cost-control measures in the prior year period. These increases were offset partially by a \$4,000 decrease in software-related costs incurred primarily in connection with new software-related agreements associated with upgraded operating and cybersecurity systems in the prior year and a \$1,000 net decrease in general office-related expenses.

The increase in advertising and digital marketing expenses for the three months ended December 31, 2021 compared to the same period in 2020 comprises a \$1.11 million increase in digital advertising spend; a \$196,000 increase in cooperative advertising; an \$80,000 increase in brand awareness marketing campaigns; a \$21,000 increase in print media expenses; and an \$8,000 increase in outside agency fees. During the comparable prior year period, advertising and digital marketing expenses were lower due to cost reductions we imposed in response to the COVID-19 pandemic.

Compensation expenses for the three months ended December 31, 2021 compared to the same period in 2020 increased primarily due to an \$11,000 increase in salaries, commissions, and related employee benefits in the aggregate; an \$11,000 increase in bonus expense; and a \$10,000 increase in employee stock-based compensation expense. The increases in bonus and employee stock-based compensation expenses reflect the impact of our performance-based bonus plans and stock compensation-related benefits.

The increase in sales and marketing expenses for the six months ended December 31, 2021 compared to the same period in 2020 was primarily due to a \$2.21 million increase in advertising and digital marketing expenses; a \$145,000 increase in compensation expenses; a \$107,000 increase in professional services principally comprising consulting services for marketing support in the current year period; an \$81,000 increase in bank fees expenses, which are principally related to higher credit card transaction fees from increased online sales levels; a \$44,000 increase in software-related costs incurred primarily in connection with new software-related agreements associated with upgraded operating and cybersecurity systems; a \$42,000 increase in rent expense, primarily related to our corporate headquarters operating lease amendment that was executed in January 2021; a \$25,000 increase in travel expenses as we returned to more traditional business travel patterns following cut-backs relating to the COVID-19 pandemic and related cost-control measures in the prior year period; a \$19,000 increase in depreciation and amortization expense relating to capitalized costs associated with information technology-related upgrades; and a \$9,000 net increase in general office-related expenses.

The increase in advertising and digital marketing expenses for the six months ended December 31, 2021 compared to the same period in 2020 comprises a \$1.84 million increase in digital advertising spend; a \$211,000 increase in cooperative advertising; a \$137,000 increase in expenses relating to our participation in the 2021 JCK Trade Show (the JCK Trade Show organization did not hold an event in the prior year due to restrictions related to the COVID-19 pandemic); a \$29,000 increase in print media expenses; and a \$10,000 increase in outside agency fees. These increases were offset partially by an \$18,000 decrease in brand awareness marketing campaign expenditures in the current year period.

Compensation expenses for the six months ended December 31, 2021 compared to the same period in 2020 increased primarily as a result of an \$85,000 increase in salaries, commissions, and related employee benefits in the aggregate; a \$47,000 increase in employee stock-based compensation expense; and a \$15,000 increase in bonus expense. The increases in employee stock-based compensation and bonus expenses reflect improved operating results that impact these performance-based compensation-related benefits. These increases were partially offset by a \$2,000 decrease in employee-related severance costs from the prior year.

General and Administrative

General and administrative expenses for the three and six months ended December 31, 2021 and 2020 are as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2021	2020			2021	2020		
General and administrative	\$ 1,189,559	\$ 977,528	\$ 212,031	22%	\$ 2,773,835	\$ 2,185,564	\$ 588,271	27%

General and administrative expenses were \$1.19 million for the three months ended December 31, 2021 compared to \$978,000 for the three months ended December 31, 2020, an increase of approximately \$212,000, or 22%. General and administrative expenses were \$2.77 million for the six months ended December 31, 2021 compared to \$2.19 million for the six months ended December 31, 2020, an increase of approximately \$588,000, or 27%.

The increase in general and administrative expenses for the three months ended December 31, 2021 compared to the same period in 2020 was primarily due to an \$89,000 increase in compensation expenses; a \$47,000 increase in bad debt expense associated with our allowance for doubtful accounts reserve policy in connection with the increase in accounts receivable, compared with the prior period; a \$42,000 increase in housing allowances and travel-related expenditures as we returned to more normal business travel patterns following cut-backs relating to the COVID-19 pandemic in the prior year period; a \$32,000 increase in rent expense, primarily related to our corporate headquarters operating lease amendment that was executed in January 2021; a \$28,000 increase in employee-related recruiting and search fees for new hires; a \$22,000 increase in business taxes and licenses; a \$10,000 increase in insurance expenses principally related to higher renewal premiums; and a \$6,000 net increase in miscellaneous other general and administrative expenses. These increases were partially offset by a \$26,000 decrease in bank-related fees principally in connection with the Company's prior credit facility that was terminated in accordance with its terms in July 2021; a \$23,000 decrease in depreciation and amortization expense, principally related to fully depreciated assets when compared to those in prior periods; and a \$15,000 decrease in professional services.

The increase in compensation expenses for the three months ended December 31, 2021 compared to the same period in 2020 comprises a \$90,000 increase in employee stock-based compensation expense and an \$11,000 increase in bonus expense. Both increases reflect improved operating results compared with those of prior periods that impact these performance-based compensation-related benefits. These increases were partially offset by a \$12,000 net decrease in salaries and related employee benefits in the aggregate as a result of lower headcount in the current period.

Professional services fees decreased for the three months ended December 31, 2021 compared to the same period in 2020 primarily due to a \$25,000 decrease in legal fees associated with corporate governance matters in the prior year period. This decrease was partially offset by a \$7,000 net increase in consulting and other professional services in the current year period; and a \$3,000 increase in fees associated with audit and tax services.

The increase in general and administrative expenses for the six months ended December 31, 2021 compared to the same period in 2020 was primarily due to a \$384,000 increase in compensation expenses; a \$67,000 increase in housing allowances and travel-related expenditures as we returned to more normal business travel patterns following cut-backs relating to the COVID-19 pandemic in the prior year period; a \$55,000 increase in rent expense, primarily related to our corporate headquarters operating lease amendment that was executed in January 2021; a \$47,000 increase in professional services; a \$46,000 increase in bad debt expense associated with our allowance for doubtful accounts reserve policy in connection with the increase in accounts receivable, compared with the prior period; a \$39,000 increase in employee-related recruiting and search fees for new hires; a \$20,000 increase in insurance expenses principally related to higher renewal premiums; a \$9,000 increase in business taxes and licenses; and a \$1,000 net increase in miscellaneous other general and administrative expenses. These increases were partially offset by a \$46,000 decrease in depreciation and amortization expense, principally related to fully depreciated assets when compared to those in prior periods and a \$34,000 decrease in bank-related fees principally in connection with the Company's prior credit facility that was terminated in accordance with its terms in July 2021.

Compensation expenses increased for the six months ended December 31, 2021 compared to the same period in 2020 principally due to a \$213,000 increase in employee stock-based compensation expense and a \$183,000 increase in bonus expense. Both increases reflect improved operating results compared with those of prior periods that impact these performance-based compensation-related benefits. These increases were partially offset by a \$12,000 net decrease in salaries and related employee benefits in the aggregate as a result of lower headcount in the current period.

Professional services fees increased for the six months ended December 31, 2021 compared to the same period in 2020 primarily due to a \$38,000 increase in fees associated with audit and tax services, principally related to a discrete income tax-related project; a \$7,000 net increase in consulting and other professional services principally related to a benefits consulting arrangement in the current year period; and a \$2,000 increase in legal fees associated with corporate governance matters.

Interest Income

Interest income for the three and six months ended December 31, 2021 and 2020 is as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2021	2020			2021	2020		
Interest income	\$ 490	\$ 1,126	\$ (636)	(56)%	\$ 845	\$ 4,586	\$ (3,741)	(82)%

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 months ended December 31, 2021 and 2020, we earned interest from cash on deposit in this interest-bearing account. The decrease in earned interest reflects adverse changes in interest rates during Fiscal 2022 compared with Fiscal 2021.

Interest Expense

Interest expense for the three and six months ended December 31, 2021 and 2020 is as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2021	2020			2021	2020		
Interest expense	\$ -	\$ 2,466	\$ (2,466)	(100)%	\$ -	\$ 4,905	\$ (4,905)	(100)%

During the period of time the principal of the PPP Loan was outstanding, we accrued interest at a fixed rate of 1% per annum. Our accrual for interest expense associated with the PPP Loan began June 18, 2020, the date we received the proceeds for the PPP Loan from our Lender, through June 23, 2021, the date our PPP Loan, including the related accrued and unpaid interest, was forgiven by the U.S. Small Business Administration.

We had no outstanding debt during the six months ended December 31, 2021.

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, 2021 and 2020 are as follows:

	Three Months Ended		Change		Six Months Ended		Change	
	December 31,		Dollars	Percent	December 31,		Dollars	Percent
	2021	2020			2021	2020		
Loss on foreign currency exchange	\$ -	\$ 72	\$ (72)	(100)%	\$ 34	\$ 603	\$ (569)	(94)%

During the three and six months ended December 31, 2021 and 2020, we had international sales transactions denominated in currencies other than the U.S. dollar that resulted in foreign currency exchange net losses. The decrease in these losses reflects the lower level of international sales denominated in foreign currencies during the three months ended December 31, 2021, compared with the same period in the prior year, coupled with fluctuations in foreign currency exchange rates during the six months ended December 31, 2021.

Provision for Income Taxes

For each of the three and six months ended December 31, 2021, our statutory tax rate was 22.24% and consisted of the federal income tax rate of 21% and a blended state income tax rate of 1.24%, net of the federal benefit. For each of the three and six months ended December 31, 2020, our statutory tax rate was 22.11% and consisted of the federal income tax rate of 21% and a blended state income tax rate of 1.11%, 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-based compensation transactions during the quarter. For the six months ended December 31, 2021, our effective tax rate was 16.92%.

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 June 30, 2021, cumulative positive taxable income over the last three tax years had been generated in the U.S., as compared to the negative evidence of cumulative losses in previous years. We also determined that our expectations of future taxable income in upcoming tax years, including estimated growth rates applied to future expected taxable income that included significant management estimates and assumptions, would be sufficient to result in full utilization of our 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 June 30, 2021, to conclude that it was more likely than not deferred tax assets of approximately \$6.35 million would be realizable, and we reduced our valuation allowance accordingly.

Accordingly, we recognized a net income tax expense of approximately \$283,000 and \$406,000 for the three and six months ended December 31, 2021, respectively, compared with a net income tax expense of \$500 and \$1,000 for the three and six months ended December 31, 2020, respectively. With the reduction of our valuation allowance during the fiscal year ended June 30, 2021, we recognized deferred income tax expense during the six months ended December 31, 2021 in the amount of approximately \$405,000. Included in our tax provision, we record estimated taxes, penalties, and interest associated with uncertain tax positions as income tax expense and recognized such expense related to these items of approximately \$500 for each of the three months ended December 31, 2021 and 2020, respectively, and approximately \$1,000 for each of the six months ended December 31, 2021 and 2020, respectively.

As of December 31, 2021, 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, 2021, to conclude that it is more likely than not deferred tax assets of approximately \$5.95 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

The full impact of the COVID-19 pandemic on the global and domestic economy remains uncertain and the world continues adapting to the ongoing pandemic and evolving viral variants and its adverse effects on global economics and worldwide business operations. The impact of the COVID-19 pandemic continues to place unprecedented pressures on global and U.S. businesses including our own. Depending on future developments, including the success of the global vaccine efforts to control the spread of the underlying virus and evolving variants, the pandemic could materially adversely impact our capital resources and liquidity in the future. We remain increasingly focused on the COVID-19 pandemic and are continually evaluating its potential effect on our business and liquidity and capital resources.

Capital Structure and Long-Term Debt

As a component of our 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 effects of the COVID-19 pandemic. Any capital raise is not assured and may not be at terms that would be acceptable to us.

Our weighted average shares outstanding on a diluted basis were 31.32 million shares and 31.24 million shares for the three and six months ended December 31, 2021, respectively, compared to 29.26 million shares and 28.98 million shares for the three and six months ended December 31, 2020, respectively. The increases in our weighted average shares outstanding in the current year periods were driven by an increase in option exercises since the prior year periods presented herein.

We have no outstanding debt as of December 31, 2021.

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, 2021, our principal sources of liquidity were cash, cash equivalents and restricted cash totaling \$21.31 million, trade accounts receivable of \$3.65 million, and net current inventory of \$12.49 million, as compared to cash, cash equivalents, and restricted cash totaling \$21.45 million, trade accounts receivable of \$1.66 million, and net current inventory of \$11.45 million as of June 30, 2021. As described more fully herein, we also have access to a \$5.00 million cash collateralized line of credit facility with JPMorgan Chase Bank, N.A., or JPMorgan Chase.

During the six months ended December 31, 2021, our working capital increased by approximately \$1.21 million to \$31.35 million from \$30.14 million at June 30, 2021. As described more fully below, the increase in working capital at December 31, 2021 is primarily attributable to an increase in our accounts receivable, 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. These factors were offset partially by an increase in our accounts payable, an increase in our short-term operating lease liabilities, an increase in our accrued expenses and other liabilities, and a net decrease in our cash, cash equivalents, and restricted cash, principally resulting from cash used in our investing activities for construction in-process expenditures related to our retail expansion program and the construction of our first Charles & Colvard Signature Showroom, or Signature Showroom, and other leasehold improvements in our corporate offices. Our cash used for investing activities was offset partially by cash provided by financing and operating activities.

In accordance with the terms of the lease agreement for our corporate headquarters, or Lease Agreement, and the location for our first Signature Showroom, the Lease Agreement includes an allowance for leasehold improvements offered by the landlord in an amount not to exceed approximately \$545,000. We believe that once such qualified costs for the Signature Showroom and other leasehold improvements in our corporate offices have been incurred, we expect to be reimbursed by the landlord for a portion of the construction in-process expenditures related to our Signature Showroom and other corporate office related improvements in an amount not to exceed the above-referenced allowance as provided in the Lease Agreement. For more detailed information about the allowance for leasehold improvements contained within the Lease Agreement, see Note 9 to our condensed consolidated financial statements in Item 1, "Financial Statements", of this Quarterly Report on Form 10-Q.

During the six months ended December 31, 2021, approximately \$121,000 of cash was provided by our operations. The primary drivers of our cash flows from operations were the favorable effect of net income in the amount of \$1.99 million; an increase in accounts payable of \$2.10 million; an increase in accrued expenses and other liabilities of \$43,000; and an increase in accrued income taxes of \$1,000. In addition, the net effect of non-cash items included in net income totaling \$2.09 million also favorably impacted net cash provided by operating activities during the six month-period ended December 31, 2021. These factors were offset partially by an increase in inventory of \$2.90 million; an increase in accounts receivable of \$2.72 million; and an increase in prepaid expenses and other assets of \$483,000.

Accounts receivable increased principally due to the increased level of sales during the three months ended December 31, 2021, as compared with the sales during the period leading up to June 30, 2021. Throughout the course of the COVID-19 pandemic and through the current period ended December 31, 2021, 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 \$9.50 million in finished jewelry and \$5.15 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, 2021. 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 price of gold and other precious metals is beyond our control, the upward price trends could continue and have a negative impact on our operating cash flow as we manufacture finished jewelry.

Historically, our raw material inventories of SiC crystals had been purchased under exclusive supply agreements with a limited number of suppliers. Because the supply agreements restricted the sale of these crystals exclusively to us, the suppliers negotiated minimum purchase commitments with us that, when combined with reduced sales levels during prior periods in which the purchase commitments were in effect, have resulted in levels of inventories that are higher than we might otherwise maintain. As of December 31, 2021, \$19.35 million of our inventories were classified as long-term assets. Loose jewel sales and finished jewelry that we manufacture will utilize both the finished goods loose jewels currently on-hand and, as we deplete certain shapes and sizes, our on-hand raw material SiC crystals of \$1.67 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, 2021, 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, 2021, we also had a federal tax net operating loss carryforward of approximately \$19.00 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 \$19.87 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.

Contractual Commitment

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 \$29.85 million remains to be purchased as of December 31, 2021.

During the six months ended December 31, 2021 and 2020, we purchased approximately \$3.00 million and \$1.03 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 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.

Line of Credit

Effective July 7, 2021, we obtained from JPMorgan Chase our \$5.00 million cash collateralized line of credit facility, or 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.

Each advance accrues interest at a rate equal to JPMorgan Chase's monthly London Interbank Offered Rate, or LIBOR, 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, 2021, we had not borrowed against the JPMorgan Chase Credit Facility.

Prior to obtaining the JPMorgan Chase Credit Facility, we and our wholly owned subsidiary, charlesandcolvard.com, LLC, collectively referred to as the Borrowers, had a \$5.00 million asset-based revolving credit facility, or the White Oak Credit Facility, from White Oak Commercial Finance, LLC, or White Oak, which we terminated in accordance with its terms as of July 9, 2021. The effective date of the White Oak Credit Facility was July 13, 2018, and it was scheduled to mature on July 13, 2021.

The White Oak Credit Facility was available for general corporate and working capital purposes, including permitted acquisitions and was guaranteed by the Borrowers. Under the terms of the White Oak Credit Facility, the Borrowers were required to maintain at least \$500,000 in excess availability at all times. The White Oak Credit Facility contained no other financial covenants.

Advances under the White Oak Credit Facility could have been either revolving or non-revolving. During the first year of the term of the White Oak Credit Facility, any revolving advances would have accrued interest at a rate equal to one-month LIBOR (reset monthly, and subject to a 1.25% floor) plus 3.75%, and any non-revolving advances would have accrued interest at such LIBOR rate plus 4.75%. Thereafter, the interest margins would have been reduced upon our achievement of a specified fixed charge coverage ratio. However, any advances were in all cases subject to a minimum interest rate of 5.50%. Interest would have been calculated on an actual/360 basis and payable monthly in arrears. Principal outstanding during an event of default, which did not occur during the term of the White Oak Credit Facility, would have accrued interest at a rate 2% in excess of the rate that would have been otherwise applicable.

We had not borrowed against the White Oak Credit Facility as of July 9, 2021, the date upon which we terminated the White Oak Credit Facility in accordance with its terms.

Liquidity and Capital Trends

Notwithstanding the adverse impact that the COVID-19 pandemic has had on the global economy and on our own business operations, we believe that it has not materially adversely impacted our liquidity position and we continue to generate operating cash flows to meet our short-term liquidity needs. We further believe that our existing cash, cash equivalents, and restricted cash and access to other working capital resources, including but not limited to, the issuance of equity securities, and future cash expected to be provided by operating activities combined will be sufficient to meet our working capital and capital expenditure needs over the next twelve months.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

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, 2021, 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, 2021 and our Quarterly Report on Form 10-Q for the quarter ended September 30, 2021 various risks that may materially affect our business. There have been no material changes to such risks.

Item 6. Exhibits

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

<u>Exhibit No.</u>	<u>Description</u>
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

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 3, 2022

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

February 3, 2022

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, 2021 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 3, 2022

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, 2021 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 3, 2022

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, 2021, 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 3, 2022

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, 2021, 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 3, 2022

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.
