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 March 31, 2017

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	**56-1928817**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
170 Southport Drive **Morrisville, North Carolina**	**27560**
(Address of principal executive offices)	(Zip Code)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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	☐	Accelerated filer	☐
Non-accelerated filer	☐ (Do not check if a smaller reporting company)	Smaller reporting company	☒
Emerging growth company	☐		

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

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

As of May 1, 2017, there were 21,629,685 shares of the registrant's common stock, no par value per share, outstanding.

CHARLES & COLVARD, LTD.

FORM 10-Q
For the Quarterly Period Ended March 31, 2017

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

CHARLES & COLVARD, LTD.
CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2017 (unaudited)	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,629,587	$ 7,427,273
Accounts receivable, net	2,234,486	2,794,626
Inventory, net	9,498,212	9,770,206
Prepaid expenses and other assets	618,570	682,083
Total current assets	18,980,855	20,674,188
Long-term assets:		
Inventory, net	19,426,350	18,360,211
Property and equipment, net	1,481,841	1,391,116
Intangible assets, net	9,372	8,808
Other assets	70,100	71,453
Total long-term assets	20,987,663	19,831,588
TOTAL ASSETS	$ 39,968,518	$ 40,505,776
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,900,663	$ 3,977,149
Accrued cooperative advertising	54,000	50,000
Accrued expenses and other liabilities	660,076	581,107
Total current liabilities	4,614,739	4,608,256
Long-term liabilities:		
Accrued expenses and other liabilities	564,440	594,916
Accrued income taxes	448,071	433,983
Total long-term liabilities	1,012,511	1,028,899
Total liabilities	5,627,250	5,637,155
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Common stock, no par value; 50,000,000 shares authorized; 21,629,685 and 21,369,885 shares issued and outstanding at March 31, 2017 and December 31, 2016, respectively	54,243,816	54,243,816
Additional paid-in capital	14,315,249	14,282,956
Accumulated deficit	(34,217,797)	(33,658,151)
Total shareholders' equity	34,341,268	34,868,621
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 39,968,518	$ 40,505,776

See Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2017	**2016**
Net sales	$ 5,645,382	$ 11,393,271
Costs and expenses:		
Cost of goods sold	3,220,615	9,163,888
Sales and marketing	1,915,335	1,528,585
General and administrative	1,054,171	1,442,695
Research and development	819	1,868
Total costs and expenses	6,190,940	12,137,036
Loss from operations	(545,558)	(743,765)
Other expense:		
Interest expense	-	(1,507)
Total other expense	-	(1,507)
Loss before income taxes from continuing operations	(545,558)	(745,272)
Income tax net expense from continuing operations	(14,088)	(3,243)
Net loss from continuing operations	(559,646)	(748,515)
Discontinued operations:		
Loss from discontinued operations	-	(574,370)
Gain on sale of assets from discontinued operations	-	15,463
Net loss from discontinued operations	-	(558,907)
Net loss	$ (559,646)	$ (1,307,422)
Net loss per common share:		
Basic – continuing operations	$ (0.03)	$ (0.04)
Basic – discontinued operations	-	(0.02)
Basic – total	$ (0.03)	$ (0.06)
Diluted – continuing operations	$ (0.03)	$ (0.04)
Diluted – discontinued operations	-	(0.02)
Diluted – total	$ (0.03)	$ (0.06)
Weighted average number of shares used in computing net loss per common share:		
Basic	21,118,335	20,730,419
Diluted	21,118,335	20,730,419

See Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2017	**2016**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (559,646)	$ (1,307,422)
Net loss from discontinued operations	-	(558,907)
Net loss from continuing operations	(559,646)	(748,515)
Adjustments to reconcile net loss from continuing operations to net cash (used in) provided by operating activities of continuing operations:		
Depreciation and amortization	107,656	146,491
Stock-based compensation	32,293	285,076
Provision for uncollectible accounts	9,000	(93,558)
Provision for sales returns	80,000	(34,000)
Provision for inventory reserves	(266,000)	55,000
Changes in operating assets and liabilities:		
Accounts receivable	471,140	1,340,615
Inventory	(528,145)	7,259,887
Prepaid expenses and other assets, net	64,866	8,698
Accounts payable	(76,486)	(1,310,599)
Accrued cooperative advertising	4,000	7,000
Accrued income taxes	14,088	3,243
Accrued expenses and other liabilities	48,493	(199,136)
Net cash (used in) provided by operating activities of continuing operations	(598,741)	6,720,202
Net cash used in operating activities of discontinued operations	-	(744,511)
Net cash (used in) provided by operating activities	(598,741)	5,975,691
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(197,953)	(38,505)
Intangible assets	(992)	-
Net cash used in investing activities of continuing operations	(198,945)	(38,505)
Net cash provided by investing activities of discontinued operations	-	368,671
Net cash (used in) provided by investing activities	(198,945)	330,166
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(797,686)	6,305,857
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	7,427,273	5,274,305
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 6,629,587	$ 11,580,162
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$ -	$ 1,507

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 founded in 1995, manufactures, markets, and distributes *Charles & Colvard Created Moissanite*® (hereinafter referred to as moissanite or moissanite jewels) and finished jewelry featuring moissanite for sale in the worldwide 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. Leveraging its advantage of being the original and leading worldwide source of created moissanite, the Company's strategy is to establish itself with reputable, high-quality, and sophisticated brands across multiple channels, and to position moissanite as an ethically-sourced, affordable, and luxurious alternative to other gemstones such as diamond. The Company believes this is possible due to moissanite's exceptional brilliance, fire, durability, and rarity like no other jewel available on the market. The Company sells loose moissanite jewels and finished jewelry at wholesale to distributors, manufacturers, retailers, TV shopping networks, and designers, and at retail to end consumers through its wholly owned operating subsidiaries, charlesandcolvard.com, LLC (formerly Moissanite.com, LLC) and Charles & Colvard Direct, LLC (until March 2016), and through third-party marketplaces. As of September 30, 2016, the Company changed the name of its wholly owned subsidiary Moissanite.com, LLC to charlesandcolvard.com, LLC.

In February 2016, the Company made the strategic decision to explore a potential divestiture of its direct-to-consumer home party business previously operated through its Charles & Colvard Direct, LLC (dba *Lulu Avenue*®) subsidiary. After careful analysis of the Company's core competencies, go-to-market strategies, and intent to advance toward profitability, the management team and Board of Directors determined a divestiture of this distribution channel to be in the best interest of the Company and its shareholders. On March 4, 2016, the Company and Charles & Colvard Direct, LLC entered into an asset purchase agreement with Yanbal USA, Inc. ("Yanbal"), under which Yanbal purchased certain assets related to the Company's direct-to-consumer home party business for $500,000 and assumed certain liabilities related to such assets. A more detailed description of this transaction is included in Note 12, "Discontinued Operations."

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 statements in this Quarterly Report on Form 10-Q include all normal and recurring adjustments necessary for the fair statement of the results for the interim periods presented. The results for the three months ended March 31, 2017 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2017.

The condensed consolidated financial statements as of and for the three months ended March 31, 2017 and 2016 included in this Quarterly Report on Form 10-Q are unaudited. The balance sheet as of December 31, 2016 is derived from the audited financial statements as of that date. The accompanying statements should be read in conjunction with the audited financial statements and related notes, together with Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC on March 10, 2017 (the "2016 Annual Report").

The accompanying condensed consolidated financial statements as of and for the three months ended March 31, 2017 and 2016 include the accounts of the Company and its wholly owned subsidiaries charlesandcolvard.com, LLC (formerly Moissanite.com, LLC), formed in 2011; Charles & Colvard Direct, LLC, formed in 2011; and Charles & Colvard (HK) Ltd., the Company's Hong Kong subsidiary that became a dormant entity in the second quarter of 2009 and the operations of which ceased in 2008. All intercompany accounts have been eliminated.

Significant Accounting Policies - In the opinion of the Company's management, the significant accounting policies used for the three months ended March 31, 2017 are consistent with those used for the year ended December 31, 2016. Accordingly, please refer to Note 2 to the Consolidated Financial Statements in the 2016 Annual Report for the Company's significant accounting policies.

Discontinued Operations - The results of operations for businesses that have been disposed of or classified as held-for-sale are segregated from the results of the Company's continuing operations and classified as discontinued operations for each period presented in the Company's condensed consolidated income statement. Similarly, the assets and liabilities of such businesses are presented as discontinued operations for each period presented on the Company's condensed consolidated balance sheet.

Use of Estimates - The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The most significant estimates impacting the Company's condensed consolidated financial statements relate to valuation and classification of inventories, accounts receivable reserves, deferred tax assets, uncertain tax positions, cooperative advertising, and revenue recognition. Actual results could differ materially from those estimates.

Reclassifications - Certain amounts in the prior year's condensed consolidated financial statements have been reclassified to conform to the current year presentation, primarily amounts described in Note 3, "Segment Information and Geographic Data" related to changes in the Company's reportable segments.

Recently Adopted/Issued Accounting Pronouncements - In May 2014, the Financial Accounting Standards Board (the "FASB") issued a new accounting standard that supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of the new standard is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. The new standard defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. The standard is effective for annual periods beginning after December 15, 2017, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting the standard recognized at the date of adoption (which includes additional footnote disclosures). The Company has begun reviewing its significant contracts and continues to assess the impact of adoption of this accounting standard.

In February 2016, the FASB issued new guidance that establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either financing or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company currently expects that upon adoption of this new standard, ROU assets and liabilities will be recognized in the balance sheet in amounts that will be material.

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.

Previously, the Company managed its business through two operating and reportable segments: wholesale distribution transacted through the parent entity, and the direct-to-consumer distribution channel transacted through the Company's wholly owned operating subsidiary, charlesandcolvard.com, LLC (formerly Moissanite.com, LLC). During the three months ended March 31, 2017, the Company began managing its business through two newly defined operating and reportable segments based on its distribution channels to sell its product lines, loose jewels and finished jewelry: its "Traditional" segment, which consists of wholesale, retail, and television customers; and its "Online Channels" segment, which consists of e-commerce customers including charlesandcolvard.com, marketplaces, drop-ship, and other pure-play, exclusively e-commerce customers. The accounting policies of the Traditional segment and Online Channels 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 2016 Annual Report.

The Company evaluates the financial performance of its segments based on net sales; product line gross profit, or the excess of product line sales over product line cost of goods sold; and operating income (loss). 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, rent, utilities, and corporate overhead allocations; freight out; inventory valuation allowance adjustments; and other inventory adjustments, comprising costs of quality issues, damaged goods, and inventory write-offs.

The Company allocates certain general and administrative expenses from its Traditional segment to its Online Channels segment primarily based on net sales and number of employees to arrive at segment operating loss. Unallocated expenses, which also include interest and taxes, remain in its Traditional segment.

Summary financial information by reportable segment is as follows:

	Three Months Ended March 31, 2017		
	Traditional	**Online Channels**	**Total**
Net sales			
Loose jewels	$ 3,212,216	$ 717,504	$ 3,929,720
Finished jewelry	276,777	1,438,885	1,715,662
Total	$ 3,488,993	$ 2,156,389	$ 5,645,382
Product line cost of goods sold			
Loose jewels	$ 1,673,661	$ 316,469	$ 1,990,130
Finished jewelry	249,552	564,660	814,212
Total	$ 1,923,213	$ 881,129	$ 2,804,342
Product line gross profit			
Loose jewels	$ 1,538,555	$ 401,035	$ 1,939,590
Finished jewelry	27,225	874,225	901,450
Total	$ 1,565,780	$ 1,275,260	$ 2,841,040
Operating loss	$ (448,998)	$ (96,560)	$ (545,558)
Depreciation and amortization	$ 79,381	$ 28,275	$ 107,656
Capital expenditures	$ 194,332	$ 3,621	$ 197,953

	Three Months Ended March 31, 2016		
	Traditional	Online Channels	Total
Net sales			
Loose jewels	$ 9,083,502	$ 557,096	$ 9,640,598
Finished jewelry	254,630	1,498,043	1,752,673
Total	$ 9,338,132	$ 2,055,139	11,393,271
Product line cost of goods sold			
Loose jewels	$ 7,625,495	$ 188,565	$ 7,814,060
Finished jewelry	91,912	673,195	765,107
Total	$ 7,717,407	$ 861,760	$ 8,579,167
Product line gross profit			
Loose jewels	$ 1,458,007	$ 368,531	$ 1,826,538
Finished jewelry	162,718	824,848	987,566
Total	$ 1,620,725	$ 1,193,379	$ 2,814,104
Operating (loss) income	$ (816,997)	$ 73,232	$ (743,765)
Depreciation and amortization	$ 132,048	$ 14,443	$ 146,491
Capital expenditures	$ 36,903	$ 1,602	$ 38,505

The Company does not allocate any assets to the reportable segments, and, therefore, no asset information is reported to the chief operating decision maker and 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 March 31,	
	2017	2016
Product line cost of goods sold	$ 2,804,342	$ 8,579,167
Non-capitalized manufacturing and production control expenses	367,749	410,750
Freight out	70,797	72,058
Inventory valuation allowances	(266,000)	55,000
Other inventory adjustments	243,727	46,913
Cost of goods sold	$ 3,220,615	$ 9,163,888

The Company recognizes sales by geographic area based on the country in which the customer is based. 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. Sales to international end consumers made by the Company's Online Channels segment are included in U.S. sales because products are shipped and invoiced to a U.S.-based intermediary party that assumes all international shipping and credit risks. All intangible assets as of March 31, 2017 and December 31, 2016 are held in the United States. The following presents certain data by geographic area:

	Three Months Ended March 31,	
	2017	2016
Net sales		
United States	$ 5,242,341	$ 10,641,982
International	403,041	751,289
Total	$ 5,645,382	$ 11,393,271

	March 31, 2017	December 31, 2016
Property and equipment, net		
United States	$ 1,481,841	$ 1,391,116
International	-	-
Total	$ 1,481,841	$ 1,391,116

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

- *Level 3* - unobservable inputs that are not corroborated by market data

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

Assets that are measured at fair value on a non-recurring basis include property and equipment, leasehold improvements, and intangible assets, comprising patents, license rights, and trademarks. These items are recognized at fair value when they are considered to be impaired. For the three months ended March 31, 2017, no impairment was recorded.

5. INVENTORIES

The Company's total inventories, net of reserves, consisted of the following as of March 31, 2017 and December 31, 2016:

	March 31, 2017	December 31, 2016
Raw materials	$ 3,683,641	$ 3,106,617
Work-in-process	10,692,257	11,048,126
Finished goods	15,296,594	15,074,896
Finished goods on consignment	553,070	467,778
Less inventory reserves	(1,301,000)	(1,567,000)
Total	$ 28,924,562	$ 28,130,417
Short-term portion	$ 9,498,212	$ 9,770,206
Long-term portion	19,426,350	18,360,211
Total	$ 28,924,562	$ 28,130,417

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

The Company's work-in-process inventories include raw SiC crystals on which processing costs, such as labor and sawing, have been incurred; and components, such as metal castings and finished good moissanite jewels, that have been issued to jobs in the manufacture of finished jewelry. The Company's moissanite jewel manufacturing process involves the production of intermediary shapes, called "preforms," that vary depending upon the size and shape of the finished jewel. To maximize manufacturing efficiencies, preforms may be made in advance of current finished inventory needs but remain in work-in-process inventories. As of March 31, 2017 and December 31, 2016, work-in-process inventories issued to active production jobs approximated $5.78 million and $7.18 million, respectively.

The Company's jewels do not degrade in quality over time and inventory generally consists of the shapes and sizes most commonly used in the jewelry industry. In addition, the majority of jewel inventory is not mounted in finished jewelry settings and is therefore not subject to fashion trends nor is obsolescence a significant factor. Presently, the Company has very small market penetration in the worldwide jewelry market, and the Company had the exclusive right in the U.S. through August 2015 and the exclusive right in many other countries into the third quarter of 2016 to produce and sell created SiC for use in jewelry applications. During the years ended December 31, 2016 and 2015, management identified an opportunity to sell approximately $6.77 million and $2.28 million, respectively, of legacy loose jewel inventory of less desirable quality. As a result of these sales and feedback from customers on the value of some of these goods, the Company determined a lower of cost or market reserve of $529,000 and $517,000 as of March 31, 2017 and December 31, 2016, respectively, was required on some of the remaining inventory of these lower quality goods.

The Company manufactures finished jewelry featuring moissanite. Relative to loose moissanite jewels, finished jewelry is more fashion oriented and subject to styling trends that could render certain designs obsolete. The majority of the Company's finished jewelry featuring moissanite is held in inventory for resale and consists of such basic designs as stud earrings, solitaire and three-stone rings, pendants, and bracelets that tend not to be subject to significant obsolescence risk due to their classic styling. In addition, the Company manufactures small individual quantities of designer-inspired moissanite fashion jewelry as part of its sample line that are used in the selling process to its Traditional segment customers.

Prior to March 2016, the Company purchased fashion finished jewelry comprising base metals and non-precious gemstones for sale through *Lulu Avenue*®, the Company's former direct-to-consumer home party division of the Company's wholly owned operating subsidiary, Charles & Colvard Direct, LLC. This finished jewelry was fashion oriented and subject to styling trends that could change with each catalog season, of which there are generally two each year. Typically, in the jewelry industry, slow-moving or discontinued lines are sold as closeouts or liquidated in alternative sales channels. Management reviews the finished jewelry inventory on an ongoing basis for any lower of cost or market and obsolescence issues. Management identified certain fashion finished jewelry inventory that could not be sold due to damage or branding issues and established an obsolescence reserve of $49,000 as of March 31, 2017 and $169,000 as of December 31, 2016, for the carrying costs in excess of any estimated scrap values. As of March 31, 2017 and December 31, 2016, management identified certain finished jewelry featuring moissanite that was obsolete due to damage and other factors that indicate the finished jewelry is unsaleable, and established an obsolescence reserve of $22,000 and $258,000, respectively, for the carrying costs in excess of any estimated scrap values.

Periodically, the Company ships finished goods inventory to wholesale customers on consignment terms. Under these terms, the customer assumes the risk of loss and has an absolute right of return for a specified period. Finished goods on consignment at March 31, 2017 and December 31, 2016 are net of shrinkage reserves of $49,000 and $46,000, respectively, to allow for certain loose jewels and finished jewelry on consignment with wholesale customers that may not be returned or may be returned in a condition that does not meet the Company's current grading or quality standards.

The Company's total inventories, net of reserves, consisted of the following as of March 31, 2017 and December 31, 2016:

	March 31, 2017	December 31, 2016
Loose jewels		
Raw materials	$ 3,088,681	$ 2,586,045
Work-in-process	10,054,559	10,589,424
Finished goods	9,695,751	9,455,393
Finished goods on consignment	98,533	5,473
Total loose jewels	$ 22,937,524	$ 22,636,335
Finished jewelry		
Raw materials	$ 594,960	$ 520,572
Work-in-process	637,698	458,702
Finished goods	4,308,333	4,081,275
Finished goods on consignment	405,537	416,305
Total finished jewelry	$ 5,946,528	$ 5,476,854
Total supplies inventory	$ 40,510	$ 17,228
Total inventory	$ 28,924,562	$ 28,130,417

Total net loose jewel inventories at March 31, 2017 and December 31, 2016, including inventory on consignment net of reserves, were $22.94 million and $22.64 million, respectively. The loose jewel inventories at March 31, 2017 and December 31, 2016 include shrinkage reserves of $83,000 and $67,000, respectively, which includes $11,000 and $7,000 of shrinkage reserves on inventory on consignment at March 31, 2017 and December 31, 2016, respectively. Loose jewel inventories at March 31, 2017 and December 31, 2016 also include recut reserves of $438,000 and $425,000, respectively.

Total net jewelry inventories at March 31, 2017 and December 31, 2016, including inventory on consignment net of reserves and finished jewelry featuring moissanite manufactured by the Company, were $5.95 million and $5.48 million, respectively. The finished jewelry inventories at March 31, 2017 and December 31, 2016 also include shrinkage reserves of $114,000 and $102,000, respectively, including shrinkage reserves of $38,000 and $39,000 on inventory on consignment, respectively; and a repairs reserve of $66,000 and $29,000, respectively.

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

6. INCOME TAXES

The Company recognized an income tax net expense for estimated tax, penalties, and interest associated with uncertain tax positions of approximately $14,000 and $3,000 for the three months ended March 31, 2017 and 2016, respectively.

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. Beginning in 2014, management determined that negative evidence outweighed the positive and established a full valuation allowance against its deferred tax assets. The Company maintained a full valuation allowance as of March 31, 2017 and December 31, 2016.

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7. COMMITMENTS AND CONTINGENCIES

Purchase Commitments

On December 12, 2014, the Company entered into a new exclusive supply agreement (the “Supply Agreement”) with Cree, Inc. (“Cree”), which superseded and replaced the exclusive supply agreement that was set to expire in 2015. Under the Supply Agreement, subject to certain terms and conditions, the Company agreed to exclusively purchase from Cree, and Cree agreed to exclusively supply, 100% of the Company’s required SiC materials in quarterly installments that must equal or exceed a set minimum order quantity. The initial term of the Supply Agreement will expire on June 24, 2018, unless extended by the parties. The Company also has one option to unilaterally extend the term of the agreement for an additional two-year period, subject to certain conditions. The Company’s total purchase commitment under the Supply Agreement until June 2018 is dependent upon the size of the SiC material and ranges between approximately $29.60 million and approximately $31.50 million. As of March 31, 2017, the Company’s remaining purchase commitment through June 2018 under the Supply Agreement ranges from approximately $12.33 million to approximately $14.23 million.

During the three months ended March 31, 2017 and 2016, the Company purchased approximately $2.21 million and $1.91 million, respectively, of SiC crystals from Cree.

8. LINE OF CREDIT

On June 25, 2014, the Company and its wholly owned subsidiaries, Charles & Colvard Direct, LLC, and Moissanite.com, LLC (now charlesandcolvard.com LLC) (collectively, the “Borrowers”), obtained a $10,000,000 asset-based revolving credit facility (the “Credit Facility”) from Wells Fargo Bank, National Association (“Wells Fargo”). The Credit Facility will be used for general corporate and working capital purposes, including transaction fees and expenses incurred in connection therewith and the issuance of letters of credit up to a $1,000,000 sublimit. The Credit Facility will mature on June 25, 2017. Accordingly, the Company is currently reviewing various credit facility alternatives.

The Credit Facility includes a $5,000,000 sublimit for advances that are supported by a 90% guaranty provided by the U.S. Export-Import Bank. Advances under the Credit Facility are limited to a borrowing base, which is computed by applying specified advance rates to the value of the Borrowers’ eligible accounts and inventory, less reserves. Advances against inventory are further subject to an initial $3,000,000 maximum. The Borrowers must maintain a minimum of $1,000,000 in excess availability at all times. There are no other financial covenants.

Each advance accrues interest at a rate equal to Wells Fargo’s 3-month LIBOR rate plus 2.50%, calculated on an actual/360 basis and payable monthly in arrears. Principal outstanding during an event of default accrues interest at a rate of 3% in excess of the above rate. Any advance may be prepaid in whole or in part at any time. In addition, the maximum line amount may be reduced by the Company in whole or part at any time, subject to a fee equal to 2% of any reduction in the first year after closing, 1% of any reduction in the second year after closing, and 0% thereafter. There are no mandatory prepayments or line reductions.

The Credit Facility is secured by a lien on substantially all assets of the Borrowers, each of which is jointly and severally liable for all obligations thereunder. Wells Fargo’s security interest in certain SiC materials is subordinate to Cree’s security interest in such materials pursuant to the Supply Agreement and an Intercreditor Agreement with Wells Fargo.

The Credit Facility is evidenced by a credit and security agreement, dated as of June 25, 2014, as amended (the “Credit Agreement”), and customary ancillary documents. The Credit Agreement contains customary covenants, representations and cash dominion provisions, including a financial reporting covenant and limitations on dividends, distributions, debt, contingent obligations, liens, loans, investments, mergers, acquisitions, divestitures, subsidiaries, affiliate transactions, and changes in control.

Events of default under the Credit Facility include, without limitation, (1) any impairment of the Export-Import Bank guaranty, unless the guaranteed advances are repaid within two business days, (2) an event of default under any other indebtedness of the Borrowers in excess of $200,000, and (3) a material adverse change in the ability of the Borrowers to perform their obligations under the Credit Agreement or in the Borrowers' assets, liabilities, businesses or prospects, or other circumstances that Wells Fargo believes may impair the prospect of repayment. If an event of default occurs, Wells Fargo is entitled to take enforcement action, including acceleration of amounts due under the Credit Agreement and foreclosure upon collateral.

The Credit Agreement contains other customary terms, including indemnity, expense reimbursement, yield protection, and confidentiality provisions. Wells Fargo is permitted to assign the Credit Facility.

As of March 31, 2017, the Company had not borrowed against the Credit Facility.

9. STOCK-BASED COMPENSATION

The following table summarizes the components of the Company's stock-based compensation included in net loss:

	Three Months Ended March 31,	
	2017	2016
Employee stock options	$ 71,323	$ 139,183
Consultant stock options	-	50,248
Restricted stock awards	(39,030)	144,591
Totals	$ 32,293	$ 334,022

No stock-based compensation was capitalized as a cost of inventory during the three months ended March 31, 2017 or 2016.

Included in total stock-based compensation is approximately $0 and $49,000 for the three months ended March 31, 2017 and 2016, respectively, related to discontinued operations.

Stock Options - The following is a summary of the stock option activity for the three months ended March 31, 2017:

	Shares	Weighted Average Exercise Price
Outstanding, December 31, 2016	2,134,898	$ 1.99
Granted	125,454	$ 1.04
Forfeited	(23,625)	$ 1.86
Expired	(417,002)	$ 3.08
Outstanding, March 31, 2017	1,819,725	$ 1.68

The weighted average grant date fair value of stock options granted during the three months ended March 31, 2017 was $0.59. The total fair value of stock options that vested during the three months ended March 31, 2017 was approximately $127,000. The fair value of each stock option is estimated on the date of grant using the Black-Scholes-Merton option pricing model with the following weighted average assumptions for stock options granted during the three months ended March 31, 2017:

Dividend yield	0.0%
Expected volatility	63.3%
Risk-free interest rate	1.96%
Expected lives (years)	5.51

Although the Company issued dividends in prior years, a dividend yield of zero was used due to the uncertainty of future dividend payments. Volatility is a measure of the amount by which a financial variable such as share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The Company estimates expected volatility giving primary consideration to the historical volatility of its common stock. The risk-free interest rate is based on the published yield available on U.S. Treasury issues with an equivalent term remaining equal to the expected life of the stock option. The expected lives of the stock options issued since 2014 represent the estimated period of time until exercise or forfeiture and are based on the simplified method of using the mid-point between the vesting term and the original contractual term. Stock options issued prior to 2014 were expensed using expected lives that represented the time until exercise or forfeiture using historical information. Expected forfeitures are based on the historical forfeiture rates by employee class.

The following table summarizes information about stock options outstanding at March 31, 2017:

Options Outstanding			Options Exercisable			Options Vested or Expected to Vest		
Balance as of 3/31/2017	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of 3/31/2017	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of 3/31/2017	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
1,819,725	7.48	$ 1.68	1,170,784	6.58	$ 1.95	1,736,717	7.40	$ 1.70

As of March 31, 2017, the unrecognized stock-based compensation expense related to unvested stock options was approximately $281,000, which is expected to be recognized over a weighted average period of approximately 22 months.

The aggregate intrinsic value of stock options outstanding, exercisable, and vested or expected to vest at March 31, 2017 was approximately $11,000. This amount is before applicable income taxes and represents the closing market price of the Company's common stock at March 31, 2017 less the grant price, multiplied by the number of stock options that had a grant price that is less than the closing market price. This amount represents the amount that would have been received by the optionees had these stock options been exercised on that date. During the three months ended March 31, 2017, no stock options were exercised.

Restricted Stock - The following is a summary of the restricted stock activity for the three months ended March 31, 2017:

	Shares	Weighted Average Grant Date Fair Value
Unvested, December 31, 2016	359,400	$ 0.91
Granted	420,000	$ 1.11
Vested	(202,953)	$ 0.91
Canceled	(160,200)	$ 0.91
Unvested, March 31, 2017	416,247	$ 1.11

As of March 31, 2017, the estimated unrecognized stock-based compensation expense related to unvested restricted shares subject to achievement of performance goals was approximately $427,000, all of which is expected to be recognized over a weighted average period of approximately 11 months.

Dividends - The Company has not paid any cash dividends in the current year through March 31, 2017.

10. NET LOSS PER COMMON SHARE

Basic net loss from continuing and discontinued operations per common share is computed by dividing net loss by the weighted average number of common shares outstanding during the periods. Diluted net loss from continuing and discontinued operations per common share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the periods. Common equivalent shares consist of stock options that are computed using the treasury stock method. Antidilutive stock awards consist of stock options and unvested restricted shares that would have been antidilutive in the application of the treasury stock method in accordance with the "Earnings Per Share" topic of the FASB Accounting Standards Codification.

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

	Three Months Ended March 31,	
	2017	2016
Numerator:		
Net loss from continuing operations	$ (559,646)	$ (748,515)
Net loss from discontinued operations	-	(558,907)
Net loss	$ (559,646)	$ (1,307,422)
Denominator:		
Weighted average common shares outstanding:		
Basic and Diluted	21,118,335	20,730,419
Net loss per common share:		
Basic – continuing operations	$ (0.03)	$ (0.04)
Basic – discontinued operations	-	(0.02)
Basic – total	$ (0.03)	$ (0.06)
Diluted – continuing operations	$ (0.03)	$ (0.04)
Diluted – discontinued operations	-	(0.02)
Diluted – total	$ (0.03)	$ (0.06)

For the three months ended March 31, 2017 and 2016, stock options to purchase approximately 1.82 and 2.37 million shares, respectively, were excluded from the computation of diluted net loss per common share because the exercise price of the stock options was greater than the average market price of the common shares or the effect of inclusion of such amounts would be anti-dilutive to net loss per common share. For the three months ended March 31, 2017 and 2016, approximately 416,000 and 564,000, respectively, of restricted shares that have been issued but not yet vested have been excluded from the computation of diluted net loss per common share.

11. MAJOR CUSTOMERS AND CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and trade accounts receivable. At times, cash balances may exceed the Federal Deposit Insurance Corporation ("FDIC") insurable limits of $250,000 per depositor at each financial institution. The Company has never experienced any losses related to these balances. Non-interest-bearing amounts on deposit in excess of FDIC insurable limits at March 31, 2017 approximated $6.31 million.

Trade receivables potentially subject the Company to credit risk. The Company's standard wholesale customer payment terms on trade receivables are generally between 30 and 90 days, though it may offer extended terms with specific customers and on significant orders from time to time. The Company believes its competitors and other vendors in the wholesale jewelry industry have also expanded their use of extended payment terms and, in aggregate, the Company believes that by expanding its use of extended payment terms, it has provided a competitive response in its market and that its net sales have been favorably impacted. The Company is unable to estimate the impact of this program on its net sales, but if it ceased providing extended payment terms in select instances, the Company believes it would not be competitive for some wholesale customers in the marketplace and that its net sales and profits would likely decrease. The Company extends credit to its customers based upon a number of factors, including an evaluation of the customer's financial condition and credit history 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. During the year ended December 31, 2016, the Company wrote off $815,000 in accounts receivable related to one international customer that was past due on its payment arrangement as it determined that the benefits of continued collections efforts did not outweigh the cost of legal proceedings. The Company does not believe its commercial terms were a factor with this customer's non-payment. The Company's allowance for doubtful accounts previously included an allowance for this accounts receivable, and therefore, this write-off did not have an impact on net loss for the year ended December 31, 2016. The Company has not experienced any other significant accounts receivable write-offs related to revenue arrangements with extended payment terms.

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:

	March 31, 2017	December 31, 2016
Customer A	23%	**%
Customer B	*%	13%

*Customer B did not have a balance that represented 10% or more of the total gross accounts receivable as of March 31, 2017.
**Customer A did not have a balance that represented 10% or more of the total gross accounts receivable as of December 31, 2016.

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 gross sales:

	Three Months Ended March 31,	
	2017	2016
Customer A	25%	**%
Customer C	10%	**%
Customer D	*%	59%

*Customer D did not have a balance that represented 10% or more of total gross sales for the three months ended March 31, 2017.
**Customers A and C did not have individual balances that represented 10% or more of total gross sales for the three months ended March 31, 2016.

12. DISCONTINUED OPERATIONS

On March 4, 2016, the Company and Charles & Colvard Direct, LLC ("Direct") a wholly-owned subsidiary of the Company, entered into an asset purchase agreement (the "Purchase Agreement") with Yanbal, pursuant to which Yanbal agreed to purchase certain assets of Direct (the "Transferred Assets"). The transactions contemplated by the Purchase Agreement also closed on March 4, 2016 (the "Closing Date"). The Company determined that the sale of these assets represented a strategic shift that will have a major effect on the Company's operations and financial results. The Company made the decision to divest of these assets after careful analysis of the Company's core competencies, go-to-market strategies, and intent to advance toward profitability.

Pursuant to the terms of the Purchase Agreement, the Transferred Assets included, among other things, (i) an inventory credit to be used towards $250,000 in existing non-moissanite and moissanite inventory as of the Closing Date, consisting of Direct's current jewelry offered under the "Lulu Avenue" trademarks, (ii) all existing marketing collateral such as packaging and catalogs for Direct's current jewelry offered under the "Lulu Avenue" trademarks as of the Closing Date, (iii) certain assigned contracts, (iv) style advisor and customer lists, and (v) all intellectual property rights owned by the Company and Direct and used solely in connection with the operation of Direct's direct-to-consumer home party business for the sale of fashion jewelry and related products and services in the United States, excluding the "Lulu Avenue" and "Love Knot" trademarks and other "Lulu Avenue" specific intellectual property such as the domain name www.luluavenue.com and all content located on such website (the "Lulu Intellectual Property"). The inventory credit and an exclusive, nontransferable license to use the Lulu Intellectual Property that was also granted to Yanbal on the Closing Date expired on July 31, 2016. After the Closing Date, the Company and Direct may not engage in the direct-to-consumer home party business and may not solicit style advisors or customers of the direct-to-consumer home party business. The Company had also agreed to provide to Yanbal certain transition services, which services ended August 31, 2016.

The purchase price for the Transferred Assets was $500,000 with selling expenses of approximately $131,000, resulting in a net purchase price of approximately $369,000. The Company recorded a liability associated with $35,000 of expense related to certain style advisor incentives and reduced prepaid expenses by $60,000 related to contracts acquired by Yanbal.

There were no assets or liabilities related to discontinued operations at March 31, 2017 or December 31, 2016.

The following table presents the major classes of line items constituting pretax loss from discontinued operations:

	Three Months Ended March 31,	
	2017	**2016**
Net sales	$ -	$ 717,073
Costs and expenses:		
Cost of goods sold	-	259,089
Sales and marketing	-	863,808
General and administrative	-	168,535
Interest expense	-	11
Total costs and expenses	-	1,291,443
Loss from discontinued operations	-	(574,370)
Other income:		
Gain on sale of long-term assets	-	15,463
Total other income, net	-	15,463
Pretax loss from discontinued operations	$ -	$ (558,907)

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

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

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

- *Our future financial performance depends upon increased consumer awareness and acceptance, growth of sales of our products, and operational execution of our strategic initiatives.*
- *We are currently substantially dependent on a limited number of distributors, jewelry manufacturers, and retailers for the sale of our products.*
- *The execution of our business plans could significantly impact our liquidity.*
- *Our business and our results of operations could be materially adversely affected as a result of our inability to fulfill orders on a timely basis.*
- *The financial difficulties or insolvency of one or more of our major customers or their lack of willingness and ability to market our products could adversely affect results.*
- *We expect to remain dependent upon our exclusive supply agreement, or the Supply Agreement, with Cree, Inc., or Cree, which we entered into on December 12, 2014, for the sole supply of our silicon carbide, or SiC, crystals for the foreseeable future.*
- *We face intense competition in the worldwide jewelry industry.*
- *The resignation of our Chief Financial Officer and the departure of our Chief Revenue Officer create uncertainties and could impact our business.*
- *Our failure to maintain compliance with NASDAQ's continued listing requirements could result in the delisting of our common stock.*
- *Our current wholesale customers may potentially perceive us as a competitor in the finished jewelry business.*
- *We may experience quality control challenges from time to time that can result in lost revenue and harm to our brands and reputation.*
- *Our business and our results of operations could be materially adversely affected as a result of general economic and market conditions.*
- *We are subject to certain risks due to our international distribution channels and vendors.*
- *Our operations could be disrupted by natural disasters.*
- *Sales of moissanite jewelry could be dependent upon the pricing of precious metals, which is beyond our control.*
- *Seasonality of our business may adversely affect our net sales and operating income.*
- *We may not be able to adequately protect our intellectual property, which could harm the value of our products and brands and adversely affect our business.*
- *A failure of our information technology infrastructure or a failure to protect confidential information of our customers and our network against security breaches could adversely impact our business and operations.*
- *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.*
- *If we fail to evaluate, implement, and integrate strategic acquisition or disposition opportunities successfully, our business may suffer.*
- *Governmental regulation and oversight might adversely impact our operations.*
- *Some anti-takeover provisions of our charter documents may delay or prevent a takeover of our company.*

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

The following discussion is designed to provide a better understanding of our unaudited condensed consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance, and a summary of our operating results. This information should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q and the condensed consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2016. Historical results and percentage relationships among any amounts in the condensed consolidated financial statements are not necessarily indicative of trends in operating results for future periods.

Overview

We manufacture, market and distribute *Charles & Colvard Created Moissanite*® (which we refer to as moissanite or moissanite jewels) and finished jewelry featuring moissanite for sale in the worldwide jewelry market. Moissanite, also known by its chemical name silicon carbide, or 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. Leveraging our advantage of being the original and leading worldwide source of created moissanite jewels, our strategy is to establish Charles & Colvard with reputable, high-quality, and sophisticated brands across multiple channels, and to position moissanite as an ethically-sourced, affordable, and luxurious alternative to other gemstones such as diamond. We believe this is possible due to moissanite's exceptional brilliance, fire, durability, and rarity like no other jewel available on the market. We sell loose moissanite jewels and finished jewelry at wholesale to distributors, manufacturers, retailers, TV shopping networks, and designers, and at retail to end consumers through our wholly owned operating subsidiaries, charlesandcolvard.com, LLC (formerly Moissanite.com, LLC) and Charles & Colvard Direct, LLC (until March 2016), and through third-party marketplaces. As of September 30, 2016, we changed the name of our wholly owned subsidiary Moissanite.com, LLC to charlesandcolvard.com, LLC.

In February 2016, we made the strategic decision to explore a potential divestiture of our direct-to-consumer home party business previously operated through our Charles & Colvard Direct, LLC (dba *Lulu Avenue*®) subsidiary. After careful analysis of our core competencies, go-to-market strategies, and intent to advance toward profitability, the management team and Board of Directors determined a divestiture of this distribution channel to be in our best interest and our shareholders' best interest. On March 4, 2016, we and Charles & Colvard Direct, LLC entered into an asset purchase agreement with Yanbal USA, Inc., or Yanbal, under which Yanbal purchased certain assets related to our direct-to-consumer home party business for $500,000 and assumed certain liabilities related to such assets. The operating results of Charles & Colvard Direct, LLC are being presented as a discontinued operation. A more detailed description of this transaction is included in Note 12, "Discontinued Operations", in the Notes to Condensed Consolidated Financial Statements.

Previously, we managed our business through two operating and reportable segments: wholesale distribution transacted through the parent entity, and the direct-to-consumer distribution channel transacted through our wholly owned operating subsidiary, charlesandcolvard.com, LLC (formerly Moissanite.com, LLC). During the three months ended March 31, 2017, we began managing our business through two newly defined operating and reportable segments based on our distribution channels to sell our product lines, loose jewels and finished jewelry: our "Traditional" segment, which consists of wholesale, retail, and television customers; and our "Online Channels" segment, which consists of e-commerce customers including charlesandcolvard.com, marketplaces, drop-ship, and other pure-play, exclusively e-commerce customers.

We sell our loose moissanite jewels at wholesale to some of the largest distributors and jewelry manufacturers in the world, which mount them into fine jewelry to be sold at retail outlets and via the Internet. We also sell loose moissanite jewels and finished jewelry featuring moissanite at wholesale to retailers, TV shopping networks, and designers to be sold to end consumers and directly to consumers through our e-commerce sales channel charlesandcolvard.com, third-party marketplaces, and other third-party e-commerce channels. We believe our continued and expanding use of multiple sales channels to the jewelry trade and the end consumer with branded finished jewelry featuring moissanite positions Charles & Colvard goods at the many touchpoints where consumers are when they are making their buying decisions – thereby creating greater exposure for our brand and increasing consumer demand.

Our go-forward strategy is one of optimization and growth. Our future success will be measured on our ability to expand existing channels while discovering new channel partners and new markets through calculated sales and marketing efforts. Our key strategies for 2017 are as follows:

- *Innovate the Forever One™ product line.* We plan to invest research and development funds and efforts into the continued expansion of the *Forever One™* offering including new jewel shapes and sizes.

- *Expand our finished jewelry line.* We plan to collaborate with key designers and jewelry suppliers to expand our product line and introduce new collections of fashion, fine, and bridal jewelry.

- *Invest in key retail and wholesale partnerships.* We plan to leverage significant groundwork laid with existing partners whose brands and customers align with ours to amplify our reach into these established markets.

- *Explore new traditional and non-traditional sales channels.* We plan to discover unexplored channels as green field opportunities that may open new and innovative ways to reach the consumer where they are shopping.

- *Convey e-commerce learning to new channels.* We plan to leverage our experience and significant underpinnings in e-commerce to expand our footprint into new channels and regions.

- *Evolve our customer service function.* We plan to continually improve our customer service function with the intention of delivering world-class service to our wholesale partners and direct consumers.

- *Amplify our global marketing efforts.* We plan to carefully measure the return on our marketing investments, and focus our efforts on profitable endeavors that drive interest in the Charles & Colvard brand, pull consumers to our many sales and educational outlets, and drive conversions.

- *Advance toward profitability.* We plan to make calculated investments in our growth while continually striving to reach profitability.

As we execute our strategy to build and reinvest in our businesses, significant expenses and investment of cash will be required ahead of the revenue streams we expect in the future, and this will likely result in some unprofitable reporting periods in 2017. Despite this, we have maintained as one of our primary goals to generate positive cash flow from continuing operations to protect our cash position. We will continue to monitor our cash burn rate and collection efforts as we grow the business.

In the three months ended March 31, 2017, we began to see positive momentum as the outcomes of our re-branding effort took hold. Our Online Channels segment, including charlesandcolvard.com, marketplaces, drop-ship and other pure-play, exclusively e-commerce customers, generated a 5% increase in net sales over the same period in 2016. We believe this growth was fueled by our ongoing digital marketing efforts, driving strong Valentine's Day sales and overall increased traffic to our many e-commerce outlets. We remain on track with our strategic programs, including the expansion of our Online Channels segment, continued growth within our Traditional segment, and our move up-market with our Forever One gemstone leading the charge. Continued demand from both channel partners and consumers for Forever One products drove substantial improvement in our gross margins – to 43% for the three months ended March 31, 2017, compared with 20% in the same period in 2016, with Forever One representing 86% of our overall loose gemstone and finished jewelry sales. In the three months ended March 31, 2017, we announced the availability of Forever One in four new, sought-after shapes – emerald, hearts & arrows, pear, and radiant. With the appointment of our new Senior Merchandising Director, we are now focused on our expanded jewelry line, leveraging our new gemstone shapes into additional fashion, bridal and fine jewelry selections.

Our total consolidated net sales for the three months ended March 31, 2017 of $5.65 million were 50% less than total consolidated net sales during the three months ended March 31, 2016. The decrease in consolidated net sales for the three months ended March 31, 2017 was due primarily to the sale, in a single transaction, during the three months ended March 31, 2016 of approximately $6.77 million of legacy loose gemstone inventory, or the Legacy Inventory Sale, at low margins, as a result of our efforts to reduce inventories. Traditional segment net sales for the three months ended March 31, 2017 of $3.49 million were 63% lower than Traditional segment net sales during the three months ended March 31, 2016, primarily due to the Legacy Inventory Sale. Online Channels segment net sales for the three months ended March 31, 2017 of $2.16 million were 5% higher than Online Channels segment net sales during the three months ended March 31, 2016, primarily due to the increase in marketplaces, drop-ship, and other pure-play, exclusively ecommerce customers.

Loose jewel sales comprised 70% of our total consolidated net sales for the three months ended March 31, 2017 and decreased 59% to $3.93 million, compared with $9.64 million in the same period of 2016. Finished jewelry sales for the three months ended March 31, 2017 comprised 30% of our total consolidated net sales and decreased 2% to $1.72 million, compared with $1.75 million in the same period of 2016.

Operating expenses from continuing operations were $2.97 million for the three months ended March 31, 2017, compared with $2.97 million in the same period of 2016. Sales and marketing expenses increased $387,000, or 25%, to $1.92 million, primarily as a result of an increase in compensation expenses related to severance in connection with the departure of our former Chief Revenue Officer. General and administrative expenses decreased $388,000, or 27%, to $1.05 million primarily as a result of a decrease in compensation expenses and professional services, partially offset by an increase in bad debt expense associated with our allowance for doubtful accounts reserve policy.

We recorded a net loss of $560,000, or $0.03 per diluted share, for the three months ended March 31, 2017, compared to a net loss of $1.31 million, or $0.06 per diluted share, in the same period of 2016. The decreased net loss was primarily due to the discontinuance of our direct-to-consumer home party business and an increased gross profit margin. We recorded a net loss from continuing operations of $560,000 for the three months ended March 31, 2017, compared to a net loss from continuing operations of $749,000 in the same period of 2016.

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

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which we prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses and related disclosures of contingent assets and liabilities. “Critical accounting policies and estimates” are defined as those most important to the financial statement presentation and that require the most difficult, subjective, or complex judgments. We base our estimates on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Under different assumptions and/or conditions, actual results of operations may materially differ. We have disclosed our critical accounting policies and estimates in our Annual Report on Form 10-K for the year ended December 31, 2016, and that disclosure should be read in conjunction with this Quarterly Report on Form 10-Q.

Results of Operations

The following table sets forth certain consolidated statements of operations data for the three months ended March 31, 2017 and 2016:

	Three Months Ended March 31,	
	2017	2016
Net sales	$ 5,645,382	$ 11,393,271
Costs and expenses:		
Cost of goods sold	3,220,615	9,163,888
Sales and marketing	1,915,335	1,528,585
General and administrative	1,054,171	1,442,695
Research and development	819	1,868
Total costs and expenses	6,190,940	12,137,036
Loss from operations	(545,558)	(743,765)
Other expense:		
Interest expense	-	(1,507)
Total other expense	-	(1,507)
Loss before income taxes from continuing operations	(545,558)	(745,272)
Income tax net expense from continuing operations	(14,088)	(3,243)
Net loss from continuing operations	(559,646)	(748,515)
Discontinued Operations:		
Loss from discontinued operations	-	(574,370)
Gain on sale of assets from discontinued operations	-	15,463
Net loss from discontinued operations	-	(558,907)
Net loss	$ (559,646)	$ (1,307,422)

Consolidated Net Sales

Consolidated net sales for the three months ended March 31, 2017 and 2016 comprise the following:

	Three Months Ended March 31,		Change	
	2017	2016	Dollars	Percent
Loose jewels	$ 3,929,720	$ 9,640,598	$ (5,710,878)	-59%
Finished jewelry	1,715,662	1,752,673	(37,011)	-2%
Total consolidated net sales	$ 5,645,382	$ 11,393,271	$ (5,747,889)	-50%

Consolidated net sales were $5.65 million for the three months ended March 31, 2017 compared to $11.39 million for the three months ended March 31, 2016, a decrease of $5.75 million, or 50%. The decrease in consolidated net sales for the three months ended March 31, 2017 was due primarily to the Legacy Inventory Sale during the three months ended March 31, 2016.

Sales of loose jewels represented 70% of total consolidated net sales for the three months ended March 31, 2017, compared to 85% of total consolidated net sales for the corresponding period of the prior year. For the three months ended March 31, 2017, loose jewel sales were $3.93 million compared to $9.64 million for the corresponding period of the prior year, a decrease of $5.71 million, or 59%. The decrease for the three months ended March 31, 2017 was primarily due to the Legacy Inventory Sale during the three months ended March 31, 2016.

Sales of finished jewelry represented 30% of total consolidated net sales for the three months ended March 31, 2017, compared to 15% of total consolidated net sales for the corresponding period of the prior year. For the three months ended March 31, 2017, finished jewelry sales were $1.72 million compared to $1.75 million for the corresponding period of the prior year, a decrease of $37,000, or 2%.

U.S. net sales accounted for approximately 93% of total consolidated net sales for the three months ended March 31, 2017, compared to 93% of total consolidated net sales for the corresponding period of the prior year. U.S. net sales decreased to $5.24 million, or 51%, during the three months ended March 31, 2017 from the corresponding period of the prior year primarily as a result of the Legacy Inventory Sale during the three months ended March 31, 2016.

Our two largest U.S. customers during the three months ended March 31, 2017 accounted for 25% and 10%, respectively of total consolidated sales, but neither accounted for a significant portion of our total consolidated sales during the same period of 2016. Our largest U.S. customer during the three months ended March 31, 2016 accounted for 59% of total consolidated sales, but did not account for a significant portion of our consolidated sales during the same portion of 2017. We expect that we will remain dependent on our ability, and that of our largest customers, to maintain and enhance retail programs. A change in or loss of any of these customer or retailer relationships could have a material adverse effect on our results of operations.

International net sales accounted for approximately 7% of total consolidated net sales for the three months ended March 31, 2017, compared to 7% of total consolidated net sales for the corresponding period of the prior year. International sales decreased 46% during the three months ended March 31, 2017, from the corresponding period of the prior year as we serve distributors in the Hong Kong and India markets and demand for loose jewels in these markets was down compared to the corresponding period of the prior year. We have been evaluating each of the distributors in these international markets to determine the best long-term partner. As a result, our sales in these markets may continue to fluctuate significantly each reporting period.

We did not have an international customer account for more than 10% of total consolidated sales during the three months ended March 31, 2017 or 2016. A portion of our international consolidated sales represents jewels sold internationally that may be re-imported to U.S. retailers. Our top three international distributors by sales volume during the three months ended March 31, 2017 were located in Hong Kong, Canada, and Hong Kong.

Costs and Expenses

Cost of Goods Sold

Cost of goods sold for the three months ended March 31, 2017 and 2016 are as follows:

	Three Months Ended March 31,		Change	
	2017	**2016**	**Dollars**	**Percent**
Product line cost of goods sold				
Loose jewels	$ 1,990,130	$ 7,814,060	$ (5,823,930)	-75%
Finished jewelry	814,212	765,107	49,105	6%
Total product line cost of goods sold	2,804,342	8,579,167	(5,774,825)	-67%
Non-product line cost of goods sold	416,273	584,721	(168,448)	-29%
Total cost of goods sold	$ 3,220,615	$ 9,163,888	$ (5,943,2735)	-65%

Total cost of goods sold was $3.22 million for the three months ended March 31, 2017 compared to $9.16 million for the three months ended March 31, 2016, a decrease of $5.94 million, or 65%. Product line cost of goods sold is defined as product cost of goods sold in each of our Traditional segment and Online Channels 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 valuation allowance adjustments; and other inventory adjustments, comprising costs of quality issues, damaged goods, and inventory write-offs.

The decrease in cost of goods sold for the three months ended March 31, 2017 compared to the same period in 2016 was primarily due to the Legacy Inventory Sale during the three months ended March 31, 2016. The net decrease in non-product line cost of goods sold comprises a $321,000 decrease in the change in inventory valuation allowances, a $43,000 decrease in non-capitalized manufacturing and production control expenses, and a $1,000 decrease in freight out. These decreases were offset in part by a $197,000 increase in other inventory adjustments. See Note 3, “Segment Information and Geographic Data”, in the Notes to Condensed Consolidated Financial Statements for further discussion of non-product line cost of goods sold.

Sales and Marketing

Sales and marketing expenses for the three months ended March 31, 2017 and 2016 are as follows:

	Three Months Ended March 31,		Change	
	2017	2016	Dollars	Percent
Sales and marketing	$ 1,915,335	$ 1,528,585	$ 386,750	25%

Sales and marketing expenses were $1.92 million for the three months ended March 31, 2017 compared to $1.53 million for the three months ended March 31, 2016, an increase of $387,000, or 25%.

The increase in sales and marketing expenses for the three months ended March 31, 2017 compared to the same period in 2016 was primarily due to a $375,000 increase in compensation expenses; a $53,000 increase in travel expenses; a $43,000 increase in professional services; a $39,000 increase in office-related and other expenses; and a $3,000 increase in depreciation expenses. These increases were partially offset by a $168,000 decrease in advertising expenses and a $19,000 decrease in recruiting expenses.

The increase in compensation expenses for the three months ended March 31, 2017 compared to the same period in 2016 was primarily due to a $246,000 increase in severance expense primarily related to the departure of our former Chief Revenue Officer; a $77,000 increase in salaries, commissions, and related employee benefits; a $42,000 increase in bonus expense; and a $10,000 increase in relocation expense.

The decrease in advertising expenses for the three months ended March 31, 2017 compared to the same period in 2016 was primarily due to a $121,000 decrease in internet marketing; a $44,000 decrease in cooperative advertising; a $37,000 decrease in outside agency fees; a $26,000 decrease in print media expenses; and a $6,000 decrease in trade show related expenses. These decreases were partially offset by a $54,000 increase in social media expense and a $12,000 increase in other advertising expenses.

Sales and marketing expenses are allocated across our Traditional segment and Online Channels segment, which in 2016 included allocations to Charles & Colvard Direct, LLC, a segment we are reporting as discontinued operations. See Note 12, "Discontinued Operations", in the Notes to the Consolidated Financial Statements for further discussion of discontinued operations. Approximately $61,000 of sales and marketing expenses for the three months ended March 31, 2016 is attributable to sales and marketing expenses that are now being allocated to our remaining two continuing operations segments that were previously allocated to Charles & Colvard Direct, LLC.

General and Administrative

General and administrative expenses for the three months ended March 31, 2017 and 2016 are as follows:

	Three Months Ended March 31,		Change	
	2017	2016	Dollars	Percent
General and administrative	$ 1,054,171	$ 1,442,695	$ (388,524)	-27%

General and administrative expenses were $1.05 million for the three months ended March 31, 2017 compared to $1.44 million for the three months ended March 31, 2016, a decrease of $389,000, or 27%.

The decrease in general and administrative expenses for the three months ended March 31, 2017 compared to the same period in 2016 was primarily due to a $432,000 decrease in compensation expenses; a $199,000 decrease in professional services; a $21,000 decrease in depreciation and amortization expense; and a $10,000 decrease in travel expense. These decreases were partially offset by a $103,000 increase in bad debt expense associated with our allowance for doubtful accounts reserve policy.

The decrease in compensation expenses for the three months ended March 31, 2017 compared to the same period in 2016 was primarily due to a $209,000 decrease in stock-based compensation expense related primarily to the valuation of performance based restricted stock; a $201,000 decrease in salaries and related employee benefits; and a decrease of $29,000 in bonuses. These decreases were partially offset by a $7,000 increase in severance expense.

Professional services decreased for the three months ended March 31, 2017 compared to the same period in 2016 primarily due to a $130,000 decrease in legal fees primarily related to the divestiture of our direct-to-consumer home party business in the prior year; a $77,000 decrease in audit and tax services; and a $2,000 decrease in investor and public relations expenses. These decreases were partially offset by a $10,000 increase in other professional services.

General and administrative expenses are allocated across our Traditional segment and Online Channels segment, which in 2016 included allocations to Charles & Colvard Direct, LLC, a segment we are reporting as discontinued operations. See Note 12, “Discontinued Operations”, in the Notes to the Consolidated Financial Statements for further discussion of discontinued operations. Approximately $170,000 of general and administrative expenses for the three months ended March 31, 2016 is attributable to general and administrative expenses that are now being allocated to our remaining two continuing operations segments that were previously allocated to Charles & Colvard Direct, LLC.

Provision for Income Taxes

We recognized an income tax net expense for estimated tax, penalties, and interest associated with uncertain tax positions of approximately $14,000 and $3,000 for the three-month periods ended March 31, 2017 and 2016, respectively.

As of each reporting date, management considers new evidence, both positive and negative, that could impact its view with regard to future realization of deferred tax assets. Beginning in 2014, management determined that negative evidence outweighed the positive and established a full valuation allowance against our deferred tax assets. We maintained a full valuation allowance as of March 31, 2017 and December 31, 2016.

Liquidity and Capital Resources

We require cash to fund our operating expenses and working capital requirements, including outlays for capital expenditures. As of March 31, 2017, our principal sources of liquidity were cash and cash equivalents totaling $6.63 million, trade accounts receivable of $2.23 million, and current inventory of $9.50 million, as compared to cash and cash equivalents totaling $7.43 million, trade accounts receivable of $2.80 million, and current inventory of $9.77 million as of December 31, 2016. As described more fully below, we also have access to a $10 million credit facility.

During the three months ended March 31, 2017, our working capital decreased by approximately $1.70 million to $14.37 million from $16.07 million at December 31, 2016. As described more fully below, the decrease in working capital at March 31, 2017 is primarily attributable to a decrease in our cash and cash equivalents due to our decreased cash from operations, a decrease in accounts receivable, and a decreased allocation of inventory to short-term from long-term.

During the three months ended March 31, 2017, $599,000 of cash was used in continuing operations. The primary drivers of the use of cash were our loss of $560,000 that included a decrease of $37,000 of non-cash expenses, an increase in inventory of $528,000, and a decrease in accounts payable of $76,000. These factors were partially offset by a decrease in accounts receivable of $471,000, a decrease in prepaid expenses and other assets of $65,000, and an increase in accrued expenses of $67,000. Inventory increased in part due to the purchase of new raw material SiC crystals during the quarter pursuant to the Supply Agreement; production of moissanite jewels; and purchases of jewelry castings and other jewelry components due to increased demand in certain channels. Accounts receivable decreased primarily due to collections efforts. We did not offer any extended wholesale customer payment terms during the three months ended March 31, 2017; however, we may offer these terms from time to time, which may not immediately increase liquidity as a result of current-period sales. We believe our competitors and other vendors in the wholesale jewelry industry have expanded their use of extended payment terms and, in aggregate, we believe that through our use of extended payment terms, we have provided a competitive response in our market and that our net sales have been favorably impacted. We are unable to estimate the impact of this program on our net sales, but if we ceased providing extended payment terms in select instances, we believe we would not be competitive for some wholesale customers in the marketplace and that our net sales and profits would likely decrease.

We manufactured approximately $3.17 million in loose jewels and $1.08 million in finished jewelry, which includes the cost of the loose jewels and the purchase of precious metals and labor in connection with jewelry production, during the three months ended March 31, 2017. We expect our purchases of precious metals and labor to increase as we increase our finished jewelry business. In addition, the price of gold has increased significantly over the past decade, 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 our reduced sales during the periods when the purchase commitments were in effect, have resulted in levels of inventories that are higher than we might otherwise maintain. As of March 31, 2017, $19.43 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 $3.09 million and new raw material that we are purchasing pursuant to the Supply Agreement.

On December 12, 2014, we entered into the Supply Agreement with Cree, our long-time SiC raw materials supplier. Under the Supply Agreement, subject to certain terms and conditions, we agreed to exclusively purchase from Cree, and Cree agreed to exclusively supply, 100% of our required SiC materials in quarterly installments that must equal or exceed a set minimum order quantity. The initial term of the Supply Agreement will expire on June 24, 2018, unless extended by the parties. We also have one option to unilaterally extend the term of the agreement for an additional two-year period, subject to certain conditions. Our total purchase commitment under the Supply Agreement until June 2018 is dependent upon the size of the SiC material and ranges between approximately $29.60 million and approximately $31.50 million. As of March 31, 2017, our remaining purchase commitment through June 2018 under the Supply Agreement ranges from approximately $12.33 million to approximately $14.23 million.

During the three months ended March 31, 2017, we purchased approximately $2.21 million of SiC crystals from Cree. We expect to use existing cash and cash equivalents and other working capital, together with future cash expected to be provided by operating activities and, if necessary, our Credit Facility, to finance our purchase commitment under the Supply Agreement.

We made no income tax payments during the three months ended March 31, 2017. As of March 31, 2017, we had approximately $882,000 of remaining federal income tax credits, $533,000 of which expire between 2018 and 2021 and the balance without an expiration, which can be carried forward to offset future income taxes. As of March 31, 2017, we also had a federal tax net operating loss carryforward of approximately $25.03 million expiring between 2020 and 2036, which can be used to offset against future federal taxable income, a North Carolina tax net operating loss carryforward of approximately $20.26 million expiring between 2023 and 2031, and various other state tax net operating loss carryforwards expiring between 2021 and 2036, which can be used to offset against future state taxable income.

On June 25, 2014, we and our wholly owned subsidiaries, Charles & Colvard Direct, LLC and Moissanite.com, LLC (now charlesandcolvard.com LLC), collectively referred to as the Borrowers, obtained the Credit Facility from Wells Fargo. The Credit Facility will be used for general corporate and working capital purposes, including transaction fees and expenses incurred in connection therewith and the issuance of letters of credit up to a $1,000,000 sublimit. The Credit Facility will mature on June 25, 2017. Accordingly, we are currently reviewing various credit facility alternatives.

The Credit Facility includes a $5,000,000 sublimit for advances that are supported by a 90% guaranty provided by the U.S. Export-Import Bank. Advances under the Credit Facility are limited to a borrowing base, which is computed by applying specified advance rates to the value of the Borrowers' eligible accounts and inventory, less reserves. Advances against inventory are further subject to an initial $3,000,000 maximum. We must maintain a minimum of $1,000,000 in excess availability at all times. There are no other financial covenants.

Each advance accrues interest at a rate equal to Wells Fargo's 3-month LIBOR rate plus 2.50%, calculated on an actual/360 basis and payable monthly in arrears. Principal outstanding during an event of default accrues interest at a rate of 3% in excess of the above rate. Any advance may be prepaid in whole or in part at any time. In addition, the maximum line amount may be reduced by us in whole or part at any time, subject to a fee equal to 2% of any reduction in the first year after closing, 1% of any reduction in the second year after closing, and 0% thereafter. There are no mandatory prepayments or line reductions.

The Credit Facility is secured by a lien on substantially all assets of the Borrowers, each of which is jointly and severally liable for all obligations thereunder. Wells Fargo's security interest in certain SiC materials is subordinate to Cree's security interest in such materials pursuant to the Supply Agreement and an Intercreditor Agreement with Wells Fargo.

The Credit Facility is evidenced by a credit and security agreement dated as of June 25, 2014, as amended, or the Credit Agreement, and customary ancillary documents. The Credit Agreement contains customary covenants, representations and cash dominion provisions, including a financial reporting covenant and limitations on dividends, distributions, debt, contingent obligations, liens, loans, investments, mergers, acquisitions, divestitures, subsidiaries, affiliate transactions, and changes in control.

Events of default under the Credit Facility include, without limitation, (1) any impairment of the Export-Import Bank guaranty, unless the guaranteed advances are repaid within two business days, (2) an event of default under any other indebtedness of the Borrowers in excess of $200,000, and (3) a material adverse change in the ability of the Borrowers to perform their obligations under the Credit Agreement or in the Borrowers' assets, liabilities, businesses or prospects, or other circumstances that Wells Fargo believes may impair the prospect of repayment. If an event of default occurs, Wells Fargo is entitled to take enforcement action, including acceleration of amounts due under the Credit Agreement and foreclosure upon collateral.

The Credit Agreement contains other customary terms, including indemnity, expense reimbursement, yield protection, and confidentiality provisions. Wells Fargo is permitted to assign the Credit Facility.

As of March 31, 2017, we had not borrowed against the Credit Facility.

We believe that our existing cash and cash equivalents and other working capital, together with future cash expected to be provided by operating activities, will be sufficient to meet our working capital and capital expenditure needs over the next 12 months. Our future capital requirements and the adequacy of available funds will depend on many factors, including our rate of sales growth; the expansion of our sales and marketing activities, the timing and extent of raw materials and labor purchases in connection with loose jewel production to support our moissanite jewels business and precious metals and labor purchases in connection with jewelry production to support our finished jewelry business; the timing of capital expenditures; and risk factors described in more detail in "Risk Factors" in this report, in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016. We obtained the Credit Facility to mitigate these risks to our cash and liquidity position. Also, we may make investments in, or acquisitions of, complementary businesses, which could also require us to seek additional equity or debt financing.

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 Interim 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 Interim 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 March 31, 2017, we made no changes to our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, that we believe materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

We discuss in our Annual Report on Form 10-K for the year ended December 31, 2016 various risks that may materially affect our business. There have been no material changes to such risks.

Item 6. Exhibits

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

Exhibit No.	Description
10.1	Charles & Colvard, Ltd. 2017 Senior Management Equity Incentive Program, effective January 1, 2017 (incorporated herein by reference to Exhibit 10.1 to our Current Report on Form 8-K, as filed with the SEC on February 24, 2017)
10.2	Separation of Employment Agreement, dated March 9, 2017, between Charles & Colvard, Ltd. and Steve Larkin
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from Charles & Colvard, Ltd.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2017 formatted in XBRL (eXtensible Business Reporting Language) and furnished electronically herewith: (i) Condensed Consolidated Balance Sheets; (ii) Condensed Consolidated Statements of Operations; (iii) Condensed Consolidated Statements of Cash Flows; and (iv) Notes to Condensed Consolidated Financial Statements.

SIGNATURES

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

		CHARLES & COLVARD, LTD.
	By:	/s/ Suzanne Miglucci
May 4, 2017		Suzanne Miglucci President and Chief Executive Officer
	By:	/s/ Clint J. Pete
May 4, 2017		Clint J. Pete Interim Chief Financial Officer (Principal Financial Officer and Chief Accounting Officer)

EXHIBIT INDEX

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Exhibit 10.2

SEPARATION OF EMPLOYMENT AGREEMENT

This **SEPARATION OF EMPLOYMENT AGREEMENT (**"Agreement") is made and entered into by Steve Larkin ("Employee") and Charles & Colvard, Ltd. (the "Company").

Employee was employed by the Company as its Chief Revenue Officer pursuant to an employment agreement between Employee and the Company dated May 6, 2013, as amended by the First Amendment to Employment Agreement dated March 8, 2016 (the "Employment Agreement"). The employment relationship between the Company and Employee terminated as of the Effective Resignation Date defined herein.

The Company is willing to provide Employee the severance benefits described herein in exchange for his entering into this Agreement, and the parties desire to terminate their employment relationship on mutually agreeable terms and avoid all litigation relating to the employment relationship and its termination.

Employee represents that he has carefully read this entire Agreement, understands its consequences, and voluntarily enters into it.

In consideration of the above and the mutual promises set forth below, Employee and the Company agree as follows:

1. RESIGNATION. Employee tenders, and the Company accepts, Employee's voluntary resignation from all positions with the Company and its affiliates, such voluntary resignation to be effective January 10, 2017 ("Effective Resignation Date"). After the Effective Resignation Date, the Employee will not represent himself as being a current employee, representative or agent of the Company or any affiliate thereof for any purpose and will immediately remove all such representations from social media sites.

As of the Effective Resignation Date, the Employment Agreement shall terminate and neither party shall have any further obligations thereunder except that Employee specifically acknowledges and agrees that his obligations under paragraphs 8 (Definitions), 9 (Covenant Not to Compete), 10 (Confidentiality), 11 (Proprietary Information) and 21 (Publication) of the Employment Agreement shall continue after the termination of that Employment Agreement in accordance with their terms; provided, however, that the references to "fashion jewelry" in subparagraph 8 (e) of the Employment Agreement shall be deleted and Employee agrees that unless the Company expressly consents otherwise, he will be restricted from working for any organization that currently sells moissanite gemstones or jewelry, including any such organizations that are Company competitors or partners.

By signing this Agreement, Employee represents that he has been fully paid for all time worked and received all salary and all other amounts of any kind due to him from the Company with the sole exception of (a) the payments payable under this Agreement, and (b) any accrued and vested benefits payable pursuant to the Company's employee benefit plans.

2. SEVERANCE BENEFITS.

A. Severance Pay**.** The Company will pay Employee severance pay in a gross amount of One Hundred Ninety Thousand Dollars ($190,000) (less applicable taxes and withholdings), payable as follows: (i) one installment of One Hundred Twenty-Five Thousand Dollars ($125,000) (less applicable withholdings) on the first regular payroll date following the fourth day after this Agreement becomes effective as stated in paragraph 5 below and (ii) the remaining Sixty-Five Thousand Dollars ($65,000) (less applicable withholdings) paid in three substantially equal installments one each on April 21, 2017, May 19, 2017, and June 30, 2017, unless otherwise required pursuant to paragraph 10.

B. COBRA Premium Assistance. If Employee timely and properly elects continuation coverage under the Company's group health plan pursuant to the Consolidated Omnibus Budget Reconciliation Act ("COBRA"), then the Company will provide Employee with an additional sum of Four Thousand Six Hundred Eight Dollars and Eighteen Cents ($4,608.18), an amount equal to the COBRA premiums for coverage for him and his eligible dependents (less an amount equal to the active employee contribution, if any) for the 6-month period immediately following the Effective Resignation Date, payable in a lump sum at the time the first installment provided in subparagraph A above is paid.

Payment under this subparagraph 2B shall be made in a lump sum but in no event later than the last day of the calendar year following the year in which the expenses were incurred. Under no circumstances will Employee be entitled to a cash payment or other benefit in lieu of the payment of the actual COBRA premium cost. The amount of expenses eligible for payment during any calendar year shall not be affected by the amount of expenses eligible for payment in any other calendar year.

C. Equity Award Acceleration. The Company has agreed to accelerate vesting as to 25,000 options granted under the Company's 2008 Stock Incentive Plan. Those options and all options granted during Employee's employment including 125,000 options previously granted and currently held by Employee shall be exercisable as set forth in the applicable option agreement, except that such options shall be exercisable through January 10, 2022. Employee understands that, as a result of such extension, any options not exercised by Employee on or before April 10, 2017 may no longer qualify as incentive stock options within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended. The Company has also agreed to waive the forfeiture of 75,000 shares of restricted stock granted under the Company's 2008 Stock Incentive Plan, and the restrictions on such restricted stock shall lapse effective January 10, 2017.

The severance and other benefits afforded under this Agreement are in lieu of any other compensation or benefits, excluding vested retirement benefits, to which Employee otherwise might be entitled, and payment of the severance and other benefits is conditioned upon Employee's compliance with the terms of this Agreement and all surviving terms of the Employment Agreement (including but not limited to paragraphs 8, 9, 10, 11 and 21).

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3. RELEASE.

A. In consideration of the benefits conferred by this Agreement, **EMPLOYEE (ON BEHALF OF HIMSELF AND HIS ASSIGNS, HEIRS AND OTHER REPRESENTATIVES) RELEASES THE COMPANY AND ITS RELATED PARTIES (DEFINED BELOW) ("RELEASEES") FROM ALL CLAIMS AND WAIVES ALL RIGHTS KNOWN OR UNKNOWN, HE MAY HAVE OR CLAIM TO HAVE AGAINST THE COMPANY, ITS PREDECESSORS, SUBSIDIARIES OR AFFILIATES** relating to his employment with the Company and separation therefrom arising before the execution of the Agreement to the fullest extent permitted by law, including but not limited to claims:

(i) for discrimination, harassment or retaliation arising under federal, state or local laws prohibiting age (including but not limited to claims under the Age Discrimination in Employment Act of 1967 ("ADEA"), as amended), sex, national origin, race, religion, disability, veteran status or other protected class discrimination, harassment or retaliation for protected activity;

(ii) for compensation and benefits (including but not limited to claims under the Employee Retirement Income Security Act of 1974 ("ERISA"), Fair Labor Standards Act of 1938 ("FLSA"), Family and Medical Leave Act of 1993 ("FMLA"), all as amended, and similar federal, state, and local laws and claims under any other Company policy, plan or program, including the Charles & Colvard, Ltd. 2008 Stock Incentive Plan and the incentive plans and programs thereunder;

(iii) under federal, state or local law of any nature whatsoever (including but not limited to constitutional, statutory, tort, express or implied contract or other common law); and

(iv) for attorneys' fees.

Provided, however, the release of claims set forth in this Agreement does NOT:

(v) apply to claims for workers' compensation benefits, vested retirement benefits or unemployment benefits filed with the applicable state agencies or where otherwise prohibited by law;

(vi) bar a challenge under the Older Workers Benefit Protection Act of 1990 (OWBPA) to the enforceability of the waiver and release of ADEA claims set forth in this Agreement; or

(vii) prohibit Employee from filing a charge with or participating in an investigation by the U.S. Equal Employment Opportunity Commission, Securities and Exchange Commission (SEC), Financial Industry Regulatory Authority (FINRA) or other self-regulatory or governmental agency with jurisdiction concerning the terms, conditions and privileges of employment or jurisdiction over the Company's business or assisting with an investigation conducted internally by the Company; provided, however, that by signing this Agreement, Employee waives the right to, and shall not seek or accept, any monetary or other relief of any nature whatsoever in connection with any such charges, investigations or proceedings except as follows: This Agreement does not limit Employee's right to receive an award for information provided to the SEC, FINRA, or any other securities regulatory agency or authority.

B. Employee will not sue the Releasees on any matters relating to his employment or separation therefrom arising before the execution of this Agreement (with the sole exception of claims and challenges set forth in subparagraph A (v) through (vi) above), or join as a party with others who may sue on any such claims, or opt-in to an action brought by others asserting such claims, and in the event that Employee is made a member of any class asserting such claims without his knowledge or consent, Employee shall opt out of such action at the first opportunity.

C. The Releasees which Employee is releasing by signing this Agreement include: the Company and its predecessors, successors, and assigns and its and/or their past, present and future owners, parents, subsidiaries, affiliates, predecessors, successors, assigns, officers, directors, employees, employee benefit plans (together with all plan administrators, trustees, fiduciaries and insurers) and agents.

4. COMPANY INFORMATION AND PROPERTY.

A. Employee shall not at any time after his employment terminates disclose, use or aid third parties in obtaining or using any confidential or proprietary Company information nor access or attempt to access any Company computer systems, networks or any resources or data that resides thereon.

Confidential or proprietary information is information relating to the Company or any aspect of its business which is not generally available to the public, the Company's competitors, or other third parties, or ascertainable through common sense or general business or technical knowledge; however, nothing in this paragraph or in this Agreement or in the agreements referenced in subparagraph C below is intended, nor shall be construed, to (i) prohibit Employee from any communications to, or participation in any investigation or proceeding conducted by, any governmental agency referenced in paragraph 3, (ii) interfere with, restrain, or prevent Employee communications regarding wages, hours, or other terms and conditions of employment, or (iii) prevent Employee from otherwise engaging in any legally protected activity. Moreover, notwithstanding the foregoing or any other provision in this Agreement, Employee cannot be held criminally or civilly liable under any federal or state trade secret law if he discloses a trade secret (iv) to federal, state, or local government officials, to his attorneys, or in a sealed court document, for the purpose of reporting or investigating a suspected violation of the law, or (v) to his attorneys or in a sealed court document in connection with a lawsuit for retaliation by an employer for reporting a suspected violation of the law.

B. All records, files or other materials maintained by or under the control, custody or possession of the Company or its agents in their capacity as such shall be and remain the Company's property and Employee shall return all such property. By signing this Agreement, Employee represents that:

(i) Employee has returned all the Company property (including, but not limited to, jewelry issued by the Company to Employee under open memo orders dated September 24, 2015 and November 19, 2015 (except for item 377201); credit cards; keys; company car; cell phone; air card; access cards; thumb drive(s), laptop(s), personal digital devices and all other computer hardware and software; records, files, documents, manuals, and other documents in whatever form they exist, whether electronic, hard copy or otherwise and all copies, notes or summaries thereof and turned over all passwords or access codes which he created, received or otherwise obtained in connection with his employment);

(ii) Employee has not deleted any emails, files or other information from any Company computer or device prior to his return of the property; and

(iii) Employee has permanently deleted any Company information that may reside on his personal computer(s), other devices or accounts and, if requested by the Company, has submitted all personal computers, phones and other devices which he used for Company business, and has identified all personal accounts on which Company information has been placed and related passwords, to a third party vendor, as may be designated by the Company, for inspection and removal of any Company-related information.

C. Nothing in this Agreement shall relieve Employee from any obligations under any other previously executed confidentiality, proprietary information or secrecy agreements. All such agreements shall continue to be in full force and effect upon the execution of this Agreement subject to the clarification set forth in subparagraph A above.

5. RIGHT TO REVIEW AND REVOKE. The Company delivered this Agreement to Employee on March 8, 2017 by email delivery to his counsel and desires that he have adequate time and opportunity to review and understand the consequences of entering into it. Accordingly, the Company advises him to consult with his attorney prior to executing it and that he has twenty-one (21) days within which to consider it. In the event that Employee does not return an executed copy of this Agreement to Kimberly J. Korando, Smith Anderson Blount Dorsett Mitchell & Jernigan, L.L.P., 150 Fayetteville Street, Suite 2300, Raleigh, North Carolina 27601 by no later than the twenty-second (22nd) calendar day after receiving it, this Agreement and the obligations of the Company herein shall become null and void. Employee may revoke this Agreement during the seven (7) day period immediately following his execution of it. The Agreement will not become effective or enforceable until the revocation period has expired. To revoke the Agreement, a written notice of revocation must be delivered to Kimberly J. Korando at the above address.

6. CONFIDENTIALITY AND NONDISPARAGEMENT. Employee shall keep the terms and provisions of this Agreement confidential, and ***Employee represents and warrants that since receiving this Agreement he has not disclosed,*** and going forward will not disclose, the terms and conditions of this Agreement to third parties, except as follows: (i) he may reveal the terms and provisions of this Agreement to members of his immediate family or to an attorney whom he may consult for legal advice, or representatives of any governmental agency referenced in paragraph 3A, provided that such persons agree to maintain the confidentiality of the Agreement, (ii) he may disclose the terms and provisions of this Agreement to the extent such disclosure is required by law, and (iii) he may state that his separation from employment with the Company was voluntary and it would not be appropriate to make further comment. Employee shall not comment about the circumstances leading to his voluntary resignation, except as expressly permitted by paragraphs 3 and 4 of this Agreement.

Employee represents and warrants that since receiving this Agreement, he (i) has not made, and going forward will not make, disparaging, defaming or derogatory remarks about the Company or its products, services, business practices, directors, officers, managers or employees to anyone; nor (ii) taken, and going forward will not take, any action that may impair the relations between the Company and its vendors, customers, employees, or agents or that may be detrimental to or interfere with, the Company or its business. Nothing in this section nor in this Agreement is intended, nor shall be construed, to prohibit Employee from any communications to, or participation in any investigation or proceeding conducted by, any governmental agency referenced in paragraph 3A.

The Company's Board of Directors members and officers will not disparage Employee to third parties. Nothing in this section is intended, nor shall be construed, to prohibit these individuals from any communications to, or participation in any investigation or proceeding conducted by, any governmental agency referenced in paragraph 3A, or complying with terms of a lawfully issued subpoena or sworn testimony in litigation.

7. COOPERATION. The parties agree that certain matters in which Employee has been involved during his employment may necessitate his cooperation with the Company in the future. Accordingly, to the extent reasonably requested by the Company, Employee shall cooperate with the Company in connection with such matters. The Company shall reimburse Employee for reasonable expenses incurred in connection with such cooperation as well as the approved time incurred by Employee at a rate of $200/hour. Such reimbursement shall be made as soon as administratively feasible after substantiation of the expenses, which normally occurs within sixty (60) days of receipt, but in no event later than the last day of the calendar year following the year in which the expenses were incurred. Under no circumstances will Employee be entitled to any payment or other benefit in lieu of such reimbursement. The amount of expenses eligible for reimbursement during any calendar year shall not be affected by the amount of expenses eligible for reimbursement in any other calendar year.

8. INJUNCTIVE RELIEF. Because of the unique nature of the confidential information, Employee understands and agrees that the Company will suffer irreparable harm in the event that Employee fails to comply with any of Employee's obligations under paragraph 4 of this Agreement and that monetary damages will be inadequate to compensate the Company for such breach. Accordingly, Employee agrees that the Company will, in addition to any other remedies available to it at law or in equity, be entitled to injunctive relief to enforce the terms of paragraph 4 of this Agreement.

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9. OTHER. Except as expressly provided in this Agreement, (a) this Agreement supersedes all other understandings and agreements, oral or written, between the parties and constitutes the sole agreement between the parties with respect to its subject matter, (b) no representations, inducements, promises or agreements, oral or written, have been made by any party or by anyone acting on behalf of any party, which are not embodied in this Agreement, and (c) no agreement, statement or promise not contained in the Agreement shall be valid or binding on the parties. No change or modification of this Agreement shall be valid or binding on the parties unless such change or modification is in writing and is signed by the parties. Employee's or the Company's waiver of any breach of a provision of this Agreement shall not waive any subsequent breach by the other party. If a court of competent jurisdiction holds that any provision or sub-part thereof contained in this Agreement is invalid, illegal or unenforceable, that invalidity, illegality or unenforceability shall not affect any other provision in this Agreement.

This Agreement is intended to avoid all litigation relating to Employee's employment with the Company and his separation therefrom; therefore, it is not to be construed as the Company's admission of any liability to him, liability which the Company denies.

This Agreement shall apply to, be binding upon and inure to the benefit of the parties' successors, assigns, heirs and other representatives and be governed by North Carolina law (without regard to its conflicts of laws provisions) and the applicable provisions of federal law, including but not limited to ADEA.

10. SECTION 409A OF THE INTERNAL REVENUE CODE.

(a) Parties' Intent. The parties intend that the provisions of this Agreement comply with Section 409A of the Code and the regulations thereunder (collectively, "Section 409A") and all provisions of this Agreement shall be construed in a manner consistent with the requirements for avoiding taxes or penalties under Section 409A. If any provision of this Agreement (or of any award of compensation, including equity compensation or benefits) would cause Employee to incur any additional tax or interest under Section 409A, the Company shall, upon the specific request of Employee, use its reasonable business efforts to in good faith reform such provision to comply with Code Section 409A; provided, that to the maximum extent practicable, the original intent and economic benefit to Employee and the Company of the applicable provision shall be maintained, and the Company shall have no obligation to make any changes that could create any additional economic cost or loss of benefit to the Company. The Company shall timely use its reasonable business efforts to amend any plan or program in which Employee participates to bring it in compliance with Section 409A.

(b) Separation from Service. A termination of employment shall not be deemed to have occurred for purposes of any provision of this Agreement relating to the payment of any amounts or benefits upon or following a termination of employment unless such termination also constitutes a "Separation from Service" within the meaning of Section 409A and, for purposes of any such provision of this Agreement, references to a "termination," "termination of employment," "separation from service" or like terms shall mean Separation from Service.

(c) Separate Payments. Each installment payment required under this Agreement shall be considered a separate payment for purposes of Section 409A.

(d) Delayed Distribution to Key Employees. If the Company determines in accordance with Sections 409A and 416(i) of the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder, in the Company's sole discretion, that Employee is a Key Employee of the Company on the date Employee's employment with the Company terminates and that a delay in benefits provided under this Agreement is necessary to comply with Code Section 409A(A)(2)(B)(i), then any severance payments and any continuation of benefits or reimbursement of benefit costs provided by this Agreement, and not otherwise exempt from Section 409A, shall be delayed for a period of six (6) months following the date of termination of Employee's employment (the "409A Delay Period"). In such event, any severance payments and the cost of any continuation of benefits provided under this Agreement that would otherwise be due and payable to Employee during the 409A Delay Period shall be paid to Employee in a lump sum cash amount in the month following the end of the 409A Delay Period. For purposes of this Agreement, "Key Employee" shall mean an employee who, on an Identification Date ("Identification Date" shall mean each December 31) is a key employee as defined in Section 416(i) of the Code without regard to paragraph (5) thereof. If Employee is identified as a Key Employee on an Identification Date, then Employee shall be considered a Key Employee for purposes of this Agreement during the period beginning on the first April 1 following the Identification Date and ending on the following March 31.

IN WITNESS WHEREOF, the parties have entered into this Agreement on the day and year written below.

EMPLOYEE REPRESENTS THAT HE HAS CAREFULLY READ THE ENTIRE AGREEMENT, UNDERSTANDS ITS CONSEQUENCES, AND VOLUNTARILY ENTERS INTO IT.

/s/ Steve Larkin 3/9/2017
Steve Larkin Date

CHARLES & COLVARD, LTD.

By: /s/ Suzanne Miglucci 3/9/2017
Name: Suzanne Miglucci Date
Title: President and Chief Executive Officer

Exhibit 31.1

**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, Suzanne Miglucci, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2017 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.

May 4, 2017

By: /s/ Suzanne Miglucci
Suzanne Miglucci
President and Chief Executive Officer

Exhibit 31.2

**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 March 31, 2017 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.

May 4, 2017

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

Exhibit 32.1

**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 March 31, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Suzanne Miglucci, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Suzanne Miglucci
Suzanne Miglucci
President and Chief Executive Officer
May 4, 2017

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.

Exhibit 32.2

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 March 31, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Clint J. Pete, Interim Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Clint J. Pete
Clint J. Pete
Interim Chief Financial Officer
May 4, 2017

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.