

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 September 30, 1998

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File Number: 000-23329
C3, Inc.

(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.)

3800 Gateway Boulevard, 310, Morrisville, N.C. 27560

(Address of principal executive offices)

919-468-0399

(Registrant's telephone number,
including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No
--- ---

As of November 9, 1998 there were 6,972,009 shares of the Registrant's Common Stock, no par value per share, outstanding.

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C3, Inc.
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Part I. Financial Information

Item 1. Financial Statements

C3, Inc.
Condensed Balance Sheets

	September 30, 1998	December 31, 1997
	----- (Unaudited)	-----
Assets		
Current Assets:		
Cash and equivalents	\$ 34,401,501	\$ 43,980,385
Accounts receivable, net	524,086	4,298
Interest receivable	159,848	177,654
Inventories	1,812,887	278,602
Prepaid expenses and other assets	300,803	73,274
	-----	-----
Total current assets	37,199,125	44,514,213
Equipment, net	3,655,028	214,990
Patent and license rights, net	207,388	143,886
	-----	-----
Total assets	\$ 41,061,541	\$ 44,873,089
	=====	=====
Liabilities and Shareholders' Equity		
Current Liabilities:		
Accounts payable:		
Cree Research, Inc.	\$ 1,412,483	\$ 567,110
Other	345,206	237,186
Accrued expenses	309,399	
Deferred revenue	71,906	22,512
	-----	-----
Total current liabilities	2,138,994	826,808
Commitments and Contingencies		
Shareholders' Equity:		
Common stock	47,821,538	47,743,431
Additional paid-in capital - stock options	1,855,039	1,632,804
Accumulated deficit	(10,754,030)	(5,329,954)
	-----	-----
Total shareholders' equity	38,922,547	44,046,281
	-----	-----
Total liabilities and shareholders' equity	\$ 41,061,541	\$ 44,873,089
	=====	=====

See notes to Condensed Financial Statements

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C3, Inc.
Condensed Statements Of Operations
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1998	1997	1998	1997
Net sales	\$ 1,326,373	\$ --	\$ 1,778,938	\$ --
Cost of goods	1,089,648	--	1,380,200	--
Gross profit	236,725	--	398,738	--
Operating expenses:				
Marketing and sales	928,598	186,786	2,202,597	233,397
General and administrative	543,018	352,858	1,885,224	675,661
Research and development	785,869	577,347	3,196,711	1,029,918
Total operating expenses	2,257,485	1,116,991	7,284,532	1,938,976
Operating loss	(2,020,760)	(1,116,991)	(6,885,794)	(1,938,976)
Interest income, net	467,532	71,031	1,461,718	184,407
Net loss	\$ (1,553,228)	\$ (1,045,960)	\$ (5,424,076)	\$ (1,754,569)
Basic and diluted net loss per share	\$ (0.22)	\$ (0.46)	\$ (0.78)	\$ (0.78)
Weighted-average common shares, basic and diluted	6,956,071	2,261,102	6,945,356	2,261,102

See notes to Condensed Financial Statements.

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C3, Inc.
Condensed Statements Of Cash Flows
(Unaudited)

	Nine Months Ended September 30,	
	1998	1997
Operating Activities:		
Net loss	\$ (5,424,076)	\$ (1,754,569)
Adjustments:		
Depreciation and amortization	106,345	14,668
Compensation expense related to stock options	276,648	175,000
Change in operating assets and liabilities:		
Net change in assets	(2,263,796)	(130,332)
Net change in liabilities	754,901	457,107
Net cash used by operating activities	(6,549,978)	(1,238,126)
Investing Activities:		
Purchase of equipment	(2,980,066)	(91,317)
Patent costs	(72,534)	(81,527)
Net cash used by investing activities	(3,052,600)	(172,844)
Financing Activities:		
Stock options exercised	23,694	--
Proceeds from preferred stock offerings, net of costs	--	4,981,376

Net cash provided by financing activities	23,694	4,981,376
Net change in cash and equivalents	(9,578,884)	3,570,406
Cash and equivalents, beginning of period	43,980,385	1,167,458
Cash and equivalents, end of period	\$ 34,401,501	\$ 4,737,864

See notes to Condensed Financial Statements.

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C3, Inc.
Notes To Condensed Financial Statements
(Unaudited)

1. Basis Of Presentation

The accompanying unaudited financial statements have been prepared in conformity with generally accepted accounting principles. However, certain information or footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed, or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the financial statements include all normal recurring adjustments which are necessary for the fair presentation of the results of the interim periods presented. Interim results are not necessarily indicative of results for the fiscal year. Certain reclassifications have been made to prior year's financial statements to conform to the classifications used in fiscal 1998. These financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 1997, as set forth in the Company's Form 10-K, filed with the Securities and Exchange Commission on March 31, 1998.

Prior to July 1, 1998 C3, Inc. was a development stage company which devoted substantially all of its efforts to research and product development and development of its initial markets and did not, through June 30, 1998, generate significant revenues from its planned principal operations.

In preparing financial statements that conform with generally accepted accounting principles, management must 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 amounts of revenues and expenses reflected during the reporting period. Actual results could differ from those estimates.

2. Inventories

Inventories are stated at the lower of cost or market. Inventories consisted of the following:

	September 30, 1998	December 31, 1997
	-----	-----
Raw materials	\$ 37,240	\$ --
Work in process	356,553	278,602
Finished goods	1,419,094	--
	-----	-----
Total inventory	\$1,812,887	\$ 278,602
	=====	=====

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3. Non-Cash Operating Expenses

During the quarter ended September 30, 1998, in accordance with Accounting Principals Board Opinion No. 25, the Company recorded compensation expense of approximately \$130,000 relating to stock options. Cumulatively for the nine months ended September 30, 1998, such compensation expense aggregated approximately \$277,000. Compensation expense related to stock options for the quarter and nine months ended September 30, 1997 was approximately \$109,000. This compensation expense is recorded in general and administrative expense in the statements of operations.

4. Newly Issued Accounting Pronouncements

In June 1997, Statement of Financial Accounting Standards No. 130 ("FAS 130"), Comprehensive Income, was issued. This Statement establishes standards for reporting and display of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. FAS 130 is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods is required. However, this Statement does not currently affect the Company's financial statements since it has no items of other comprehensive income in any period presented.

In June, 1998, Statement of Financial Accounting Standards No. 133 ("FAS 133"), Accounting for Derivative Instruments and Hedging Activities, was issued. This statement establishes standards for valuing and reporting at fair value all derivative instruments as either assets or liabilities. FAS 133 is effective for all fiscal quarters of all fiscal years beginning after June 15, 1999. The Company has not evaluated the impact of the adoption of this Statement on the consolidated financial statements.

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Item 2: Management's Discussion And Analysis Of Financial Condition And Results Of Operations

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that relate to the Company's future plans, objectives, estimates and goals. These statements are subject to numerous risks and uncertainties, including macro and micro economic factors that affect businesses operating in the international economy, the Company's reliance on Cree Research, Inc. ("Cree") as a developer and supplier of silicon carbide crystals, the level of growth in domestic and international gemstone jewelry markets, the level of market acceptance of and demand for the Company's products, and the actions of existing and potential competitors. These and other risks and uncertainties are described under the heading "Business Risks" in the Company's Form 10-K for the year ended December 31, 1997, which was filed with the Securities and Exchange Commission on March 31, 1998. While the Company is no longer a development stage company, it remains subject to the risks and uncertainties described therein. These risks and uncertainties could cause actual results and developments to be materially different from those expressed or implied by any of the forward-looking statements included herein.

Overview

From its inception in June 1995 through June 30, 1998, the Company was a development stage enterprise that devoted its resources to funding research and development of colorless lab-created moissanite gemstones, market research, developing initial consumer marketing themes and assembling a management team. The Company's principal business is the manufacture, marketing and distribution of lab-created moissanite gemstones ("Moissanite"). Moissanite is being marketed as an exclusive new gemstone with properties, including brilliance, fire and hardness that rival other fine gemstones like diamonds, sapphires, rubies and emeralds.

The Company began shipping Moissanite to retailers in Atlanta and Miami/Ft. Lauderdale during the second quarter of 1998, and, in July 1998, launched consumer-focused advertising and promotion activities in those areas. During the third quarter of 1998 the Company expanded the number of retailers in the southeastern states of North Carolina, South Carolina, Georgia and Florida and increased the number of international distributors. Throughout the balance of 1998, the Company will focus on the market introduction of Moissanite throughout the southeastern United States and will continue limited distribution and

promotional activities in domestic locations outside this region. The Company will also continue its efforts to expand the international distribution of Moissanite.

The Company expects its sales volumes to increase gradually as it increases production capacity and as the market introduction expands geographically. As distribution of Moissanite expands, the Company will incur increasing spending levels as it continues to make investments in development efforts with Cree to increase production volumes of lower cost moissanite, as it makes investments in receivables, inventory and manufacturing equipment, and as it increases advertising, marketing and personnel expenditures. The Company expects to continue operating at a loss through part or all of 1999. Moreover, there can be no assurance that the Company will ever achieve the expected sales increases or profitability or that if profitability is achieved, that such profitability can be sustained.

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Results Of Operations

Three Months ended September 30, 1998 compared with Three Months ended September 30, 1997.

Net sales for the quarter ended September 30, 1998, were \$1,326,373. The Company generated net sales of approximately \$1,200,000 from Moissanite and approximately \$110,000 from the Company's proprietary test instrument. Prior to July 1, 1998 sales of Moissanite were netted against research and development expenses. There were no sales for the third quarter of 1997.

Gross profit was \$236,725 or 18% of net sales for the quarter ended September 30, 1998. These margins decreased from the second quarter of 1998 in which the gross margin was 33% due to the Company's introduction of Moissanite which initially has lower gross margins than the Company's test instrument. The Company will seek to gradually increase gross margins for Moissanite as the Company and Cree work to improve yields from the crystal growth process. Gross margins for test instruments will likely decrease over time as the Company enters into additional volume distribution agreements and if it experiences pricing pressures on its testers anticipated to occur with the introduction of competitive test instruments.

Research and development expenses increased from \$577,347 for the three months ended September 30, 1997 to \$785,869 for the three months ended September 30, 1998. Research and development expenses increased by approximately \$260,000 under the Company's July 1998 Amended and Restated Development Agreement with Cree Research, Inc. The July 1998 agreement replaces the two previous development agreements between C3 and Cree and provides both parties increased flexibility to pursue further color and yield improvements on both 2-inch and 3-inch diameter crystals. This increase was offset by a reduction of internal development costs of approximately \$50,000 primarily due to production personnel costs moving out of research and development expenses as the Company emerged from the development stage.

Marketing and sales expenses increased from \$186,786 for the three months ended September 30, 1997 to \$928,598 for the three months ended September 30, 1998. The increase was primarily due to consumer-focused advertising and marketing expenses associated with the initial launch of Moissanite in the Atlanta and Miami/Ft. Lauderdale areas and compensation expense associated with the expansion of the Company's sales staff.

General and administrative expenses rose from \$352,858 for the three months ended September 30, 1997 to \$543,018 for the three months ended September 30, 1998. The increase primarily reflected compensation and other expenses related to additional staff, occupancy expenses, investor relations and legal expenses associated with business expansion and additional SEC compliance obligations incurred as a public company.

Net interest income increased from \$71,031 for the three months ended September 30, 1997 to \$467,532 for the three months ended September 30, 1998. This increase resulted from higher interest income earned on higher cash balances due primarily to the investment of proceeds from the Company's initial public offering in November 1997.

Nine Months ended September 30, 1998 compared with Nine Months ended September 30, 1997.

Net sales for the nine months ended September 30, 1998, were \$1,778,938. The Company generated net sales of approximately \$1,200,000 from Moissanite and approximately \$560,000 from the Company's proprietary test instrument. In addition, during the first six months of 1998 prior to emerging from the development stage, the Company generated net sales of approximately \$324,000 for gemstones, which have been netted against research and development expenses on the operating statement because many of the gemstones were associated with the Company's research and development program. There were no sales for the nine months ended September 30, 1997.

Gross profit was \$398,738 or 22% of net sales for the nine months ended September 30, 1998. Gross margins decreased compared to the six months ended June 30, 1998 in which the gross margins were 36%, due to the Company's introduction of Moissanite which initially has lower gross margins than the Company's test instrument. The Company will seek to gradually increase gross margins for Moissanite as the Company and Cree work to improve yields from the crystal growth process. Gross margins for test instruments will likely decrease over time as the Company enters into additional volume distribution agreements and if it experiences pricing pressures on its testers anticipated to occur with the introduction of competitive test instruments.

Research and development expenses increased from \$1,029,918 for the nine months ended September 30, 1997 to \$3,196,711 for the nine months ended September 30, 1998. Approximately 1,960,000 of the increase was attributable to development expenses incurred under the Company's June 1997 Development Agreement, January 1998 Supplemental Development Agreement, and July 1998 Amended and Restated Development Agreement with Cree Research, Inc. The July 1998 agreement replaces the two previous development agreements between C3 and Cree and provides both parties increased flexibility to pursue further color and yield improvements on both 2-inch and 3-inch diameter crystals. The remaining increase was due to increased expenditures for the Company's internal development of prototype gemstone pre-forming and faceting operations and compensation expense for Company research and development staff.

Marketing and sales expenses increased from \$233,397 for the nine months ended September 30, 1997 to \$2,202,597 for the nine months ended September 30, 1998. The increase was primarily due to development and execution of consumer-focused advertising and marketing expenses associated with the initial launch of Moissanite in the Atlanta and Miami/Ft. Lauderdale areas, compensation and travel expense and increased market research expenditures.

General and administrative expenses rose from \$675,661 for the nine months ended September 30, 1997 to \$1,885,224 for the nine months ended September 30, 1998. The increase primarily reflected compensation and other expenses related to additional staff, occupancy expenses, investor relations and legal expenses associated with business expansion and additional SEC compliance obligations incurred as a public company. During the first nine months of 1997, the Company had few paid employees.

Net interest income increased from \$184,407 for the nine months ended September 30, 1997 to \$1,461,718 for the nine months ended September 30, 1998. This increase resulted from higher interest income earned on higher cash balances due primarily to the investment of proceeds from the Company's initial public offering in November 1997.

Liquidity And Capital Resources

The Company has financed its operations primarily from the net proceeds of its initial public offering of common stock in November 1997 and, prior to such offering, from the net proceeds of private equity sales. The net proceeds from the initial public offering were \$41,072,982. During the third quarter of 1998, the Company used \$1,989,600 to fund operations and \$2,702,774 to fund capital expenditures and patent expenses. At September 30, 1998, the Company had approximately \$34.4 million of cash and equivalents and approximately \$35.1 million of working capital. The Company anticipates that its existing capital

resources will be adequate to satisfy its capital requirements for at least the next 12 months.

Due to developments in the Company's business, several balance sheet items changed during the quarter. Accounts receivable and inventories have increased significantly over December 1997 levels due to the introduction of Moissanite and the moissanite/diamond test instrument. In addition, accrued expenses increased over fiscal year-end levels primarily as a result of payroll and benefit expenses. Accounts payable, particularly those to Cree, have also increased significantly as a result of the Company's acquisition of additional crystal growth systems from Cree used to produce silicon carbide crystals, payables for purchases of silicon carbide crystals, and increased expenditures under the Amended and Restated Development Agreement with Cree.

In May 1998, the Company agreed to acquire approximately \$3.4 million of crystal growth systems from Cree to provide additional production capacity for silicon carbide crystals. The Company is paying the purchase price of the systems on a monthly basis as the systems are manufactured. Once completed, the systems will remain at Cree where Cree will use them to produce silicon carbide crystals for the Company. When the systems are fully depreciated, the Company is obligated to transfer title to Cree. The first of these systems came on-line during August 1998 with the balance expected to come on line through the remainder of 1998. Through September 30, 1998, the Company has funded approximately \$2,650,000 of the purchases and will fund the balance of the purchase of these systems from its existing cash and equivalents.

The Company has also entered into a number of agreements with specialty retail jewelry stores in the United States and with international distributors. See Item 5 of Part II of this Quarterly Report. To support this expansion of its distribution network, the Company has begun to build an inventory of moissanite gemstones and intends to significantly increase its advertising and marketing expenditures. The Company intends to fund these development activities, inventories and advertising and marketing expenditures from its existing cash and equivalents.

Year 2000 Compliance

Many currently installed computer systems and software products are coded to accept only two digit entries in the date code field. These date code fields will need to accept entries to distinguish 21st century dates from 20th century dates. The inability to recognize or properly treat dates subsequent to December 31, 1999 may cause a company's systems and applications to process critical financial and operational information incorrectly. The Company has undertaken a program to address the Year 2000 issue with respect to the following: (i) the Company's information technology and operating systems; and (ii) certain systems of the Company's major suppliers, including Cree (insofar as such systems relate to the Company's business activities with such parties).

As part of its evolution to an operating company, the Company has selected and is in the process of implementing an enterprise-wide information technology system to support the long-term information needs of the Company. The Company has received written confirmation from the software vendor that the information technology system selected by the Company is fully Year 2000 compliant. The Company anticipates that the implementation of this system and testing of the Year 2000 compliance of the system will be completed by December 31, 1998 and that the Year 2000 issue will not pose significant operational problems for its computer systems. The Company is in the process of reviewing its non-information technology systems for Year 2000 compliance and expects this review to be complete by mid 1999. The Company believes the Year 2000 exposure with respect to those systems is insignificant.

The Company has also initiated communications with its significant suppliers and vendors, including Cree. The Company is coordinating efforts with these parties to minimize the extent to which its business will be vulnerable to their failure to remediate their own Year 2000 issues. The Company has received confirmation from its significant suppliers and vendors that they have developed plans to address the Year 2000 compliance issues of their systems prior to December 31, 1999.

The crystal growth systems which Cree uses to produce silicon carbide crystals for the Company are dependent upon microprocessors. Although Cree has confirmed

to the Company that it is addressing the Year 2000 issues with respect to all of its systems including the crystal growth systems, the Company has not yet been informed that compliance has been achieved for the growth systems. Any loss or delay in the receipt of silicon carbide crystals could indefinitely delay deliveries of Moissanite to the Company's customers which would have a material adverse impact on the Company's business, operating results and financial condition. The Company will continue to monitor this issue with Cree.

There can be no assurance that the systems of such third parties on which the Company's business relies will be modified on a timely basis. The Company's business, financial condition or results of operations could be materially adversely affected by the failure of its systems or those operated by other parties to operate properly beyond December 31, 1999. To the extent possible, the Company will be developing and executing contingency plans designed to allow continued operation in the event of failure of the Company's or third parties' systems.

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Part II - Other Information

Item 2: Changes In Securities And Use Of Proceeds

On November 14, 1997, the Securities and Exchange Commission declared the Company's Registration Statement on Form S-1 (File No. 333-36809) to be effective. The net proceeds of this offering were \$41,072,982. As of September 30, 1998, the Company had approximately \$28,884,100 of the remaining net proceeds of the offering invested in money market accounts, debt instruments having an original maturity of three months or less and other highly liquid investments. Approximately \$3,986,700 of the proceeds have been used in research and development, of which \$130,325 was paid to officers, directors or shareholders owning more than ten percent of the Common Stock outstanding. The Company has also used approximately \$3,453,200 to fund sales, marketing and administrative expenses, of which \$205,000 was paid to officers, directors or shareholders owning more than ten percent of the Common Stock outstanding. The Company also expended approximately \$1,718,900 to build inventory of its products. In addition, the Company acquired \$3,030,100 of production equipment, including \$2,650,000 of crystal growth systems from Cree, certain computerized wafering and preform development equipment, and other equipment.

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Item 5: Other Information

On October 15, 1998, the Company's board of directors increased its size to nine members and elected Barbara Kotlikoff as a director. Ms. Kotlikoff has more than 20 years experience in the jewelry, fashion and advertising industries. Since 1995, Ms. Kotlikoff has been a senior executive with Monet Group, Inc., a privately held manufacturer and distributor of jewelry, and currently serves as Monet's president and managing director - international. Upon the election of Ms. Kotlikoff, the board of directors was classified into three groups of three directors each. The first group, consisting of Jeff N. Hunter, Barbara Kotlikoff and Kurt Leutzinger, will serve until the 1999 annual meeting of shareholders, the second group, consisting of Howard Rubin, Joel N. Levy and Ollin B. Sykes, will serve until the 2000 annual meeting of shareholders and the third group, consisting of Richard G. Hartigan, Jr., Kurt Nassau and Frederick A. Russ, will serve until the 2001 annual meeting of shareholders. Beginning with the 1999 annual meeting of the shareholders, directors will be elected for an initial term of three years.

The Company has entered into a number of agreements with specialty retail jewelry stores in 47 cities, primarily in the initial launch area of the Southeastern United States. The initial consumer launch activities in the Southeastern United States began in mid-July 1998. Additionally, the Company has entered into 8 international agreements for distribution of moissanite gemstones in 16 countries and various areas in the Caribbean. The international agreements require the purchase of an aggregate of approximately \$19 million of moissanite gemstones through the year 2000, with approximately \$1.4 million of those purchases during calendar 1998.

On October 20, 1998, Cree Research, Inc., the Company's exclusive supplier of

silicon carbide crystals, achieved the first milestone for 3-inch diameter crystals under the Amended and Restated Development Agreement with Cree entered into in July 1998 by producing, in development, a 3-inch crystal meeting mutually agreed upon yields of useable material. A 3-inch crystal can produce approximately twice as many moissanite gemstones as a 2-inch crystal with the same percentage of useable material. Future activities under the development program will be focused on moving this initial achievement to a repeatable process and then into a manufacturing process. The Agreement establishes performance milestones for 1999 and contemplates that the Company and Cree will revise the performance milestones annually to provide both parties with more flexibility to pursue further color and yield improvements on both 2-inch and 3-inch diameter crystals.

In March and September 1998, the Company entered into a first and second amendment, respectively, to its agreement with John M. Bachman, Inc. ("JMB"). These amendments provide for the Company to advance JMB additional funds to expand the production facilities of its affiliate which facets the Company's Moissanite gemstone preforms. These funds will be repaid through reductions to future cutting charges, which have been increased on a per stone basis to reflect additional services to be provided by JMB. The amendments also grant the Company a right of first refusal to acquire any excess gemstone cutting capacity that occurs at JMB's affiliate and any equity securities offered by JMB or its affiliate. The amendments extend the term of the Company's agreement with JMB to December 31, 2000. The Company has the right to terminate the agreement at any time after January 1, 2000 upon 90 days written notice.

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Item 6: Exhibits And Reports On Form 8-K

(a) Exhibits

- Exhibit 10.27 Employment Agreement, dated April 6, 1998, between Mark Kellam and C3, Inc.
- Exhibit 10.28 First Amendment to Agreement dated March 23, 1998, between John M. Bachman, Inc. and C3, Inc.*
- Exhibit 10.29 Second Amendment to Agreement, dated September 28, 1998 between John M. Bachman, Inc. and C3, Inc.*
- Exhibit 27.1 Financial Data Schedule

* The Company has requested that certain portions of this Exhibit be given confidential treatment. An unredacted version of this Exhibit has been filed with the Commission.

(b) Report on Form 8-K

The Company did not file any reports on 8-K during the three months ended September 30, 1998.

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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.

C3, Inc.

Dated: November 9, 1998

/s/ Jeff N. Hunter

Jeff N. Hunter
Chief Executive Officer and Chairman of the
Board and Director
(Principal Executive Officer)

Dated: November 9, 1998

/s/ Mark W. Hahn

Mark W. Hahn
Chief Financial Officer
(Principal Financial and
Accounting Officer)

EMPLOYMENT AGREEMENT
DATED APRIL 6, 1998
BETWEEN C3, INC. AND MARK KELLAM

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (the "Agreement") is made and entered into effective as of April 6, 1998 by and between C3, Inc., a North Carolina company with its principal office at 3800 Gateway Boulevard, Suite 310, Morrisville, North Carolina, 27560 (the "Company"), and Mark Kellam, an individual currently residing at 709 River Forest Road, Pittsboro, North Carolina, 27312 ("Employee").

Statement of Purpose

The Company wishes to obtain the services of Employee on the terms and conditions and with the benefits set forth in this Agreement. Employee desires to be employed by the Company on such terms and conditions and to receive such additional consideration as set out herein.

Therefore, in consideration of the mutual covenants contained in this Agreement, the grant of certain options to purchase common stock of the Company and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Company and Employee agree as follows:

1. Employment. The Company hereby agrees to employ Employee, and Employee hereby accepts such employment, on the terms and conditions set forth in this Agreement.

2. Term of Employment. The term of Employee's employment under this Agreement shall commence as of the date of this Agreement and shall continue on and through December 31, 1998. Termination of employment shall be governed by Paragraph 7 of this Agreement, and unless terminated by either party as provided in Paragraph 7, this Agreement shall automatically, at the expiration of each then existing term, renew for successive one year terms.

3. Position and Duties. The Employee shall serve as Director of Technology of the Company. Employee will, under the direction of the President and CEO of the Company, faithfully and to the best of his ability perform the duties as set out on Exhibit A hereto and such additional duties as may be reasonably assigned by the President and Board of Directors. Employee agrees to devote his entire working time, energy and skills to the Company while so employed.

4. Compensation and Benefits. Employee shall receive compensation and benefits for the services performed for the Company under this Agreement as follows:

(a) Base Salary. Employee shall receive a base salary of \$104,000 per year, payable in regular and equal monthly installments ("Base Salary").

(b) Employee Benefits. Employee shall receive such benefits as are made available to the other employees of the Company, including, but not limited to, life, medical and disability insurance, retirement benefits and such vacation as is provided to the other employees of the Company (the "Employee Benefits").

(c) Incentive Compensation. Employee shall participate in such incentive plans as may be approved by the Board of Directors from time-to-time.

The specific incentive compensation plans for 1998 are as set out on Exhibit B hereto.

5. Reimbursement of Expenses. The Company shall reimburse Employee for all reasonable out-of-pocket expenses incurred by Employee specifically and directly related to the performance by Employee of the services under this Agreement.

6. Withholding. The Company may withhold from any payments or benefits under this Agreement all federal, state or local taxes or other amounts as may be required pursuant to applicable law, government regulation or ruling.

7. Termination of Employment.

(a) Death of Employee. If the Employee shall die during the Term, this Agreement and the employment relationship hereunder will automatically terminate on the date of death, which date shall be the last day of the Term.

(b) Termination of Just Cause. The Company shall have the right to terminate the Employee's employment under this Agreement at any time for Just Cause, which termination shall be effective immediately. Termination for "Just Cause" shall include termination for the Employee's personal dishonesty, gross incompetence, willful misconduct, breach of a fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, regulation (other than traffic violations or similar offenses), written Company policy or final cease-and-desist order, conviction of a felony or of a misdemeanor involving moral turpitude, unethical business practices in connection with the Company's business, misappropriation of the Company's assets (determined on a reasonable basis), disability or material breach of any other provision of this Agreement, provided that the Employee has received written notice from the Company of such material breach and such breach remains uncured thirty days after the delivery of such notice. For purposes of this subsection, the term "disability" means the inability of Employee, due to the condition of his physical, mental or emotional health, to satisfactorily perform the duties of his employment hereunder for a continuous three month period; provided further that if the Company furnishes long term disability insurance for the Employee, the term "disability" shall mean that continuous period sufficient to allow for the long term disability payments to commence pursuant to the Company's long term disability insurance policy. In the event the Employee's employment under this Agreement is terminated for Just Cause, the Employee shall have no right to receive compensation or other benefits under this Agreement for any period after such termination.

(c) Termination Without Cause. The Company may terminate the Employee's employment other than for "Just Cause," as described in Subsection (b) above, at any time upon written notice to the Employee, which termination shall be effective immediately. In the event the Company terminates Employee pursuant to this Subsection (c), (i) the Employee will receive the Base Salary for the remainder of the then existing term ("Termination Compensation"), so long as the Employee complies with Sections 8, 9 and 10 of the Agreement and (ii) the Company shall take such action as may be required to vest any unvested benefits of the Employee under any employee stock-based or other benefit plan or arrangement for those options which are scheduled to vest within 180 of the termination date. Such amounts shall be payable at the times such amounts would have been paid in accordance with Section 4. In addition, Employee shall continue to participate in the same group hospitalization plan, health care plan, dental care plan, life or other insurance or death benefit plan, and any other present or

future similar group employee benefit plan or program for which officers of the Company generally are eligible, on the same terms as were in effect prior to Employee's termination, either under the Company's plans or comparable coverage, for all periods Employee receives Termination Compensation. Notwithstanding anything in this Agreement to the contrary, if Employee breaches Sections 8, 9 or 10 of this Agreement, the Employee will not be entitled to receive any further compensation or benefits pursuant to this Section 7(c).

(d) Change of Control Situations. In the event of a Change of Control of Company at any time after the date hereof, Employee may voluntarily terminate employment with Company up until twelve (12) months after the Change of Control for "Good Reason" and, subject to Section 7(f), (y) be entitled to receive in a lump sum (i) any compensation due but not yet paid through the date of

termination and (ii) in lieu of any further salary payments from the date of termination to the end of the then existing term, an amount equal to the Termination Compensation times 2, and (z) shall continue to participate in the same group hospitalization plan, health care plan, dental care plan, life or other insurance or death benefit plan, and any other present or future similar group employee benefit plan or program for which officers of the Company generally are eligible, or comparable plans or coverage, for a period of two years following termination of employment by the Employee, on the same terms as were in effect either (A) at the date of such termination, or (B) if such plans and programs in effect prior to the Change of Control of Company are, considered together as a whole, materially more generous to the officers of Company, then at the date of the Change of Control. Any equity based incentive compensation (including but not limited to stock options, SARs, etc.) shall fully vest and be immediately exercisable in full upon a Change in Control, notwithstanding any provision in any applicable plan. Any such benefits shall be paid by the Company to the same extent as they were so paid prior to the termination or the Change of Control of Company.

"Good Reason" shall mean the occurrence of any of the following events without the Employee's express written consent:

(i) the assignment to the Employee of duties inconsistent with the position and status of the Employee with the Company immediately prior to the Change of Control;

(ii) a reduction by the Company in the Employee's pay grade or base salary as then in effect, or the exclusion of Employee from participation in Company's benefit plans in which he previously participated as in effect at the date hereof or as the same may be increased from time to time during the Term, or Company's failure to increase (within twelve (12) months of the Employee's last increase in base salary) the Employee's base salary in an amount which at least equals, on a percentage basis, the average percentage increase in base salary for all executives entitled to participate in Company's executive incentive plans for which Employee was eligible in the preceding 12 months; or

(iii) an involuntary relocation of the Employee more than 50 miles from the location where the Employee worked immediately prior to the Change in Control or the breach by the Company of any material provision of this Agreement; or

(iv) any purported termination of the employment of Employee by Company which is not effected in accordance with this Agreement.

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A "Change of Control" shall be deemed to have occurred if (i) any person or group of persons (as defined in Section 13(d) and 14(d) of the Securities Exchange Act of 1934) together with its affiliates, excluding employee benefit plans of Company, becomes, directly or indirectly, the "beneficial owner" (as defined in Rule 13d-3 promulgated under the Securities Exchange Act of 1934) of securities of Company representing 20% or more of the combined voting power of Company's then outstanding securities; or (ii) during the then existing term of the Agreement, as a result of a tender offer or exchange offer for the purchase of securities of Company (other than such an offer by the Company for its own securities), or as a result of a proxy contest, merger, consolidation or sale of assets, or as a result of any combination of the foregoing, individuals who at the beginning of any year period during such term constitute the Company's Board of Directors, plus new directors whose election by Company's shareholders is approved by a vote of at least two thirds of the outstanding voting shares of the Company, cease for any reason during such year period to constitute at least two-thirds of the members of such Board of Directors; or (iii) the shareholders of the Company approve a merger or consolidation of the Company with any other corporation or entity regardless of which entity is the survivor, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or being converted into voting securities of the surviving entity) at least 60% of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation; or (iv) the shareholders of the Company approve a plan of complete liquidation or winding-up of the Company or an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets; or (v) any event which the

Company's Board of Directors determines should constitute a Change of Control.

(e) Employee's Right to Payment. In receiving any payments pursuant to this Section 7, Employee shall not be obligated to seek other employment or take any other action by way of mitigation of the amounts payable to the Employee hereunder, and such amounts shall not be reduced or terminated whether or not the Employee obtains other employment.

(f) Reduction in Agreement Payment. Notwithstanding anything in this Agreement to the contrary, if any of the payments provided for under this Agreement (the "Agreement Payments"), together with any other payments that the Employee has the right to receive (such other payments together with the Agreement Payments are referred to as the "Total Payments"), would constitute a "parachute payment" as defined in Section 280G(b)(2) of the Internal Revenue Code of 1986, as amended (the "Code") (a "Parachute Payment"), the Agreement Payments shall be reduced by the smallest amount necessary so that no portion of such Total Payments would be Parachute Payments. In the event the Company shall make an Agreement Payment to the Employee that would constitute a Parachute Payment, the Employee shall return such payment to the Company (together with interest at the rate set forth in Section 1274(b)(2)(B) of the Code). For purposes of determining whether and the extent to which the Total Payments constitute Parachute Payments, no portion of the Total Payments the receipt of which Employee has effectively waived in writing shall be taken into account.

8. Covenant Not to Compete. Employee agrees that during his employment with the Company and for a period of one (1) year following the termination of his employment with the Company, for whatever reason:

(a) Employee shall not, directly or indirectly, own any interest in, manage, operate, control, be employed by, render advisory services to, or participate in the management or control of any business that operates in the same business as the Company, which Employee and the Company specifically agree as the business of fabricating (wafering, preforming and faceting), marketing and

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distributing moissanite gemstones or other diamond simulants to the gem and jewelry industry (the "Business"), unless Employee's duties, responsibilities and activities for and on behalf of such other business are not related in any way to such other business's products which are in competition with the Company's products. For purposes of this section, "competition with the Company" shall mean competition for customers in the United States and in any country in which the Company is selling the Company's products at the time of termination. Employee's ownership of less than one percent of the issued and outstanding stock of a corporation engaged in the Business shall not by itself be deemed to be a violation of this Agreement. Employee recognizes that the possible restriction on his activities which may occur as a result of his performance of his obligations under Paragraph 8(a) are substantial, but that such restriction is require for the reasonable protection of the Company.

(b) Employee shall not, directly or indirectly, influence or attempt to influence any customer of the Company to discontinue its purchase of any product of the Company which is manufactured or sold by the Company at the time of termination of Employee's employment or to divert such purchases to any other person, firm or employer.

(c) Employee shall not, directly or indirectly, interfere with, disrupt or attempt to disrupt the relationship, contractual or otherwise, between the Company and any of its suppliers.

(d) Employee shall not, directly or indirectly, solicit any employee of the Company to work for any other person, firm or employer.

9. Confidentiality. In the course of his employment with the Company, Employee will have access to confidential information, records, data, customer lists, lists of product sources, specifications, trade secrets and other information which is not generally available to the public and which the Company and Employee hereby agree is proprietary information of the Company ("Confidential Information"). During and after his employment by the Company, Employee shall not, directly or indirectly, disclose the Confidential Information to any person or use any Confidential Information, except as is required in the course of his employment under this Agreement. All Confidential

Information as well as records, files, memoranda, reports, plans, drawings, documents, models, equipment and the like, including copies thereof, relating to the Company's business, which Employee shall prepare or use or come into contact with during the course of his employment, shall be and remain the Company's sole property, and upon termination of Employee's employment with the Company, Employee shall return all such materials to the Company.

10. Proprietary Information. Employee shall assign to the Company, its successors or assigns, all of Employee's rights to copyrightable works and inventions which, during the period of Employee's employment by the Company or its successors in business, Employee makes or conceives, either solely or jointly with others, relating to any subject matter with which Employee's work for the Company is or may be concerned ("Proprietary Information"). Employee shall promptly disclose in writing to the Company such copyrightable works and inventions and, without charge to the Company, to execute, acknowledge and deliver all such further papers, including applications for copyrights and patents for such copyrightable works and inventions, if any, in all countries and to vest title thereto in the Company, its successors, assigns or nominees. Upon termination of Employee's employment hereunder, Employee shall return to the Company or its successors or assigns, as the case may be, any Proprietary Information. The obligation of Employee to assign the rights to such copyrightable works and inventions shall survive the discontinuance or termination of this Agreement for any reason.

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11. Entire Agreement. This Agreement contains the entire agreement of the parties with respect to Employee's employment by the Company and supersedes any prior agreements between them, whether written or oral.

12. Waiver. The failure of either party to insist in any one or more instance, upon performance of the terms and conditions of this Agreement, shall not be construed as a waiver or a relinquishment of any right granted hereunder or of the future performance of any such term or condition.

13. Notices. Any notice to be given under this Agreement shall be deemed sufficient if addressed in writing and delivered personally, by telefax with receipt acknowledged, or by registered or certified U.S. mail to the address first above appearing, or to such other address as a party may designate by notice from time to time.

14. Severability. In the event that any provision of any paragraph of this Agreement shall be deemed to be invalid or unenforceable for any reason whatsoever, it is agreed such invalidity or unenforceability shall not affect any other provision of such paragraph or of this Agreement, and the remaining terms, covenants, restrictions or provisions in such paragraph and in this Agreement shall remain in full force and effect and any court of competent jurisdiction may so modify the objectionable provision as to make it valid, reasonable and enforceable.

15. Amendment. This Agreement may be amended only by an agreement in writing signed by each of the parties hereto.

16. Arbitration. Any controversy or claim arising out of or relating to this Agreement, or breach thereof, shall be settled by arbitration in Raleigh, North Carolina in accordance with the expedited procedures of the Rules of the American Arbitration Association, and judgment upon the award may be rendered by the arbitrator and may be entered in any court having jurisdiction thereof.

17. Governing Law. This Agreement shall be governed and construed in accordance with the laws of the State of North Carolina. Each of the parties hereto irrevocably submits to the exclusive jurisdiction of the courts located in North Carolina for the purposes of any suit, action or other proceeding contemplated hereby or any transaction contemplated hereby.

18. Benefit. This Agreement shall be binding upon and inure to the benefit of and shall be enforceable by and against the Company, its successors and assigns, and Employee, his heirs, beneficiaries and legal representatives. It is agreed that the rights and obligations of Employee may not be delegated or assigned except as may be specifically agreed to by the parties hereto.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

C3, Inc.

By: /s/ Jeff N. Hunter

Jeff N. Hunter, President

/s/ Mark Kellam

Mark Kellam

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Position Description

Mark Kellam - Director of Technology

Exhibit A

Purpose:

The Director of Technology is responsible for all research and product development activities at the Company including, but not limited to, interfacing with Cree Research on moissanite development programs, developing methods to maximize gemstone yields and identifying effective test instrument technologies. This position reports to the President.

Responsibilities:

1. Lead the research and product development activities for the Company, including planning, budgeting and policy setting.
2. Interface with Cree Research on silicon carbide development programs working closely with the Director of Manufacturing at the Company.
3. Identify and implement solutions, working closely with the Director of Manufacturing, to maximize gemstone yields and improve the efficiency and effectiveness of manufacturing processes.
4. Develop effective test instrument technologies for distinguishing gemstones from diamond and similar gemstones.
5. Serve on company-wide project teams and perform such other responsibilities as may be assigned by the President or Board of Directors from time to time.

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Incentive Compensation Plans

Mark Kellam

Exhibit B

Background

Each member of the management team can have a significant impact on the Company's ability to meet and exceed its goals. The Company has established an Annual Incentive Compensation Plan and a Long-term Incentive Compensation Plan to provide management and key employees with incentives to not only achieve the performance goals outlined in the business plan, but to exceed those goals.

New goals and targets will be established each year for the Annual Incentive Compensation Plan and goals and targets for the Long-term Incentive Plan will be established from time-to-time.

1998 Annual Incentive Compensation Plan

The 1998 Annual Incentive Compensation Plan (Annual Plan) provides for a "target bonus" which is based on a percentage of base compensation. Your specific "target bonus" is outlined below. Each person that participates in the Annual Plan has the ability to earn far in excess of their "target bonus" if the Company exceeds its performance goals.

I. Your "Target Bonus". Your 1998 "target bonus" is 35% of your base compensation, or \$36,400.

2. Performance Goals. The Annual Plan performance goals for 1998 have been separated into several categories based on the Company's performance relative to net revenue and pre-tax income. Based upon the Company achieving different performance levels, as outlined in the chart below, the participating employee can earn different percentages of their "target bonus".

Pre-tax Income	Net Revenue			
	Target > \$31.7 M	Target + >\$35.6 M	Optimum >\$42.2 M	Outstanding >\$48.5 M
Target > \$12.4 M	100%	110%	120%	130%
Target + > \$16.3 M	150%	165%	180%	195%
Optimum > \$22.9 M	225%	245%	270%	290%
Outstanding > \$29.2 M	325%	360%	390%	425%

The actual net revenue and pre-tax income from the Company's 1998 audited financial statements will be used to determine the appropriate percentage in the table above. For example, net revenue of \$34 million with pre-tax income of \$14 million would lead to a bonus equal to 100% of the participant's "target bonus"; net revenue of \$35.6 million with pre-tax income of \$16.3 million would lead to a bonus equal to 165% of the participants "target bonus", etc.

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If the performance of the Company exceeds the criteria above, the percentages will increase on a similar basis to those used above. If however, the Company does not meet the criteria above, the bonus structure will be modified as follows:

- (a) As long as the \$12.4 million pre-tax income target is met the bonuses will be awarded at the 100% level.
- (b) If pre-tax income is below \$12.4 million, so long as the Company achieves a positive pre-tax income, the percentage of the "target bonus" bonus would be reduced on a linear basis. Therefore, the percentage will be calculated by dividing the actual pre-tax net income by the \$12.4 million target. No bonuses will be earned or paid if the Company does not achieve positive pre-tax net income.

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THE REGISTRANT HAS REQUESTED THAT CERTAIN PORTIONS OF THIS EXHIBIT BE GIVEN CONFIDENTIAL TREATMENT. AN UNREDACTED VERSION OF THIS EXHIBIT HAS BEEN FILED WITH THE COMMISSION.

FIRST AMENDMENT TO AGREEMENT
DATED MARCH 23, 1998
BETWEEN C3, INC. AND JOHN M. BACHMAN, INC.

REDACTED - - OMITTED MATERIAL HAS BEEN FILED SEPARATELY WITH THE COMMISSION AND IS DENOTED HEREIN BY *****

FIRST AMENDMENT TO AGREEMENT

THIS FIRST AMENDMENT TO AGREEMENT (this "Amendment") is entered into as of March 23, 1998 by and among C3, INC., a North Carolina corporation ("C3"), JOHN M. BACHMAN, INC. ("JMB").

Statement of Purpose

C3 and JMB entered into an Agreement dated September 24, 1997 (the "Agreement") to formalize the terms upon which JMB will cut moissanite gemstones for C3. C3 and JMB now desire to amend the Agreement to provide additional expansion funds to JMB, to extend the term of the Agreement, and to provide C3 certain rights as to additional capacity and equity investments as set forth below.

Therefore, in consideration of the foregoing, the mutual covenants and agreements contained herein, and other good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. Additional Expansion Funds. Within 3 business days after the date of this Amendment, C3 will advance to JMB by certified check delivered to the address set forth in Section 7 of the Agreement, additional expansion funds in the amount of *****, which will make the total expansion funds advances by C3 equal ***** (the "Expansion Funds"), which funds will be utilized by JMB solely to expand its affiliate's production facility and procure additional equipment and labor as needed to enable JMB and its affiliate to satisfy the production volumes contemplated by the Agreement. The entire amount of the Expansion Funds will be an advance against production charges payable by C3 pursuant to Section 2, below, and C3 will be credited against production charges for the entire amount of the Expansion Funds pursuant to Section 2, below.

2. Cutting Charges. C3 will pay JMB for Moissanite Gemstone cutting services the prices set out in the Agreement. Beginning with the invoice reflecting cutting services provided by JMB from and after May 1, 1998, the amount payable to JMB by C3 reflected on each invoice will be reduced by 25% until the aggregate amount of such reductions equals ***** and C3 has received full credit against production charges for the amount of the Expansion Funds.

3. Extension of Term. The initial term of the Agreement will be extended from the date first set forth in the Agreement through December 31, 1999. In all other aspects the term and termination provisions in the Agreement are hereby confirmed.

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REDACTED - - OMITTED MATERIAL HAS BEEN FILED SEPARATELY WITH THE COMMISSION AND IS DENOTED HEREIN BY *****

4. Production Procedures: Standards The volume of Moissanite Gemstones to be cut by JMB from January 1999 to December 1999 will be ***** pieces per month. JMB agrees to return to C3 any residual pieces of material from the cutting process. In all other respects the production procedures and standards

in the Agreement are hereby confirmed.

5. Rights of First Refusal

a. Additional Capacity at the Affiliate. In the event JMB's affiliate has additional capacity to cut gemstones, whether moissanite or otherwise, C3 shall be offered in writing a right of first refusal to utilize such capacity, on the same terms as otherwise provided in the Agreement, as amended by this Amendment, prior to any gemstone cutting services being offered to any third party.

b. Additional Equity. In the event JMB or its affiliate enter into negotiations for equity investments by any third party, JMB and its affiliate agree to provide a copy of any bona fide offer for such equity investment to C3. From the date of receipt of such bona fide offer, C3 shall have 30 days to exercise its right of first refusal to make such equity investment in JMB or its affiliate on the same terms as provided in such bona fide offer.

6. Confirmation of Agreement. In all other respects the parties hereto confirm the terms of the Agreement. JMB will obtain in writing, and provide to C3, the consent of its affiliate to be bound by the terms of this Amendment.

IN WITNESS WHEREOF, each of the parties has executed and delivered this Amendment by its duly authorized officer, as of the date first above written.

C3, INC.

By: /s/ Mark W. Hahn

Name: Mark W. Hahn

Title: CFO

JOHN M. BACHMAN, INC.

By: /s/ John M. Bachman

Name: John M. Bachman

Title: President

THE REGISTRANT HAS REQUESTED THAT CERTAIN PORTIONS OF THIS EXHIBIT BE GIVEN CONFIDENTIAL TREATMENT. AN UNREDACTED VERSION OF THIS EXHIBIT HAS BEEN FILED WITH THE COMMISSION

SECOND AMENDMENT TO AGREEMENT
DATED SEPTEMBER 24, 1998
BETWEEN C3, INC. AND JOHN M. BACHMAN, INC.

REDACTED - - OMITTED MATERIAL HAS BEEN FILED SEPARATELY WITH THE COMMISSION AND IS DENOTED HEREIN BY *****

SECOND AMENDMENT TO AGREEMENT

THIS SECOND AMENDMENT TO AGREEMENT (this "Amendment") is entered into as of September 28, 1998 by and among C3, INC., a North Carolina corporation ("C3"), JOHN M. BACHMAN, INC. ("JMB").

Statement of Purpose

C3 and JMB entered into an Agreement dated September 24, 1997 (the "Agreement") to formalize the terms upon which JMB will cut moissanite gemstones for C3 and a First Amendment to the Agreement dated March 23, 1998 (the "First Amendment"). C3 and JMB now desire to amend the Agreement to provide additional expansion funds to JMB, to provide for JMB to perform certain preform identification and finished gemstone grading services, to extend the term of the Agreement and to adjust the per piece cutting charges as set forth below.

Therefore, in consideration of the foregoing, the mutual covenants and agreements contained herein, and other good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. Additional Expansion Funds. Within 3 business days after the date of this Amendment, C3 will advance to JMB by certified check delivered to the address set forth in Section 7 of the Agreement, additional expansion funds in the amount of *****, which will make the total expansion funds advances by C3 equal ***** (the "Expansion Funds"), which funds will be utilized by JMB solely to expand its affiliate's production facility and procure additional equipment and labor as needed to enable JMB and its affiliate to satisfy the production volumes contemplated by the Agreement. The entire amount of the Expansion Funds will be an advance against production charges payable by C3 pursuant to Section 2, below, and C3 will be credited against production charges for the entire amount of the Expansion Funds pursuant to Section 2, below.

2. Cutting Charges. Beginning with the invoice reflecting cutting services provided by JMB from and after C3 PO # 10730, C3 will pay JMB for Moissanite Gemstone cutting services at rates as set forth on Exhibit A hereto and the amount payable to JMB by C3 reflected on each invoice will be reduced by 25% until the aggregate amount of such reductions prior to and after this Amendment equals ***** and C3 has received full credit against production charges for the amount of the Expansion Funds. In all other respects the cutting charges and payment procedures in the Agreement and the First Amendment are hereby confirmed.

REDACTED - - OMITTED MATERIAL HAS BEEN FILED SEPARATELY WITH THE COMMISSION AND

IS DENOTED HEREIN BY *****

3. Extension of Term. The initial term of the Agreement will be extended from the date first set forth in the Agreement through December 31, 2000, however, C3 may terminate the Agreement at any time after January 1, 2000 with 90 days prior written notice.

4. Production Procedures: Standards

a. JMB or its affiliate will determine the proper table orientation for each gemstone based on the shape of the gemstone preform provided by C3. C3 will have the right to deduct from the payment of each invoice the cutting charges related to any gemstones that are not cut with the appropriate table orientation.

b. Based on the current and anticipated requirement for the production of a higher percentage of gemstones larger than *** mm in size than contemplated in the Agreement, the monthly production volumes (in finished pieces) will be as follows:

Sep 1998	*****
Oct 1998	*****
Nov 1998	*****
Dec 1998	*****
Jan 1999	*****
Feb 1999	*****
Mar-Dec 2000	*****

c. JMB or its affiliate will separate the finished gemstones by millimeter size of the girdle of the gemstone and will further separate the gemstones by the clarity grade using the master stone set and written instructions previously provided.

d. In all other respects the production procedures and standards in the Agreement and the First Amendment are hereby confirmed.

5. Confirmation of Agreement. In all other respects the parties hereto confirm the terms of the Agreement and the First Amendment. JMB will obtain in writing, and provide to C3, the consent of its affiliate to be bound by the terms of this Amendment.

REDACTED - - OMITTED MATERIAL HAS BEEN FILED SEPARATELY WITH THE COMMISSION AND IS DENOTED HEREIN BY *****

IN WITNESS WHEREOF, each of the parties has executed and delivered this Amendment by its duly authorized officer, as of the date first above written.

C3, INC.

By: /s/ Robert S. Thomas

Name: Robert S. Thomas

Title: President

JOHN M. BACHMAN, INC.

By: /s/ John M. Bachman

Name: John M. Bachman

Title: President

REDACTED - - OMITTED MATERIAL HAS BEEN FILED SEPARATELY WITH THE COMMISSION AND IS DENOTED HEREIN BY *****

September 23, 1998

Attention: Earl Hines c/o C3, Inc.
Fax 919-468-0486

Dear Earl,

I communicated with Robits and Chris, and we have agreed to revise the rates. Please call when you have looked over them so I can finalize the proposal.

Best regards,

For Rounds and Squares:

Size in mm	Per Price
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****
*****	*****

REDACTED - - OMITTED MATERIAL HAS BEEN FILED SEPARATELY WITH THE COMMISSION AND IS DENOTED HEREIN BY *****

For average dimensions of ***** mm and under.

Shape	Add to Above Rates:
Oval and Baguette	*****
Marquise, Pear and Princess	*****
Trillion	*****
Heart and Tapered Baguette	*****

For average dimensions over ***** mm:

Shape	Total Charge
Round and Square	*****

Oval, Baguette, Marquise, Pear, Princess and
Trillion

Heart and Tapered Baguette

<ARTICLE>

5

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This Schedule Contains Summary Financial Information Extracted From The Condensed Balance Sheet As Of September 30, 1998 And The Condensed Statement Of Operations For The Nine Months Ended September 30, 1998 And Is Qualified In Its Entirety By Reference To Such Financial Statements.

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