

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, 1999

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, Suite 311, 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 No

As of October 31, 1999 there were 7,098,911 shares of the Registrant's Common Stock, no par value per share, outstanding.

C3, Inc.
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

C3, Inc.
Condensed Statements of Operations
(Unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	1999	1998	1999	1998
Net sales	\$ 2,169,539	\$ 1,326,373	\$ 8,932,615	\$ 1,778,938
Cost of goods	949,535	1,089,648	4,676,790	1,380,200
Gross profit	1,220,004	236,725	4,255,825	398,738
Operating expenses:				
Marketing and sales	1,461,286	928,598	3,236,924	2,202,597
General and administrative	815,843	543,018	2,256,653	1,885,224
Research and development	682,237	785,869	2,274,987	3,196,711
Total operating expenses	2,959,366	2,257,485	7,768,564	7,284,532
Operating loss	(1,739,362)	(2,020,760)	(3,512,739)	(6,885,794)
Interest income, net	291,949	467,532	978,290	1,461,718
Net loss	<u>\$ (1,447,413)</u>	<u>\$ (1,553,228)</u>	<u>\$ (2,534,449)</u>	<u>\$ (5,424,076)</u>
Basic and diluted net loss per share	<u>\$ (0.21)</u>	<u>\$ (0.22)</u>	<u>\$ (0.36)</u>	<u>\$ (0.78)</u>
Weighted-average common shares, basic and diluted	<u>7,054,383</u>	<u>6,956,071</u>	<u>7,021,339</u>	<u>6,945,356</u>

See Notes to Condensed Financial Statements.

C3, Inc.
Condensed Balance Sheets

	September 30, 1999	December 31, 1998
	(Unaudited)	
ASSETS		
Current Assets:		
Cash and equivalents	\$ 21,973,656	\$ 32,004,045
Accounts receivable, net	881,031	546,921
Interest receivable	123,024	121,276
Inventories	10,312,033	3,092,448
Prepaid expenses and other assets	596,585	294,797
Total current assets	33,886,329	36,059,487
Equipment, net	6,418,795	3,832,019
Patent and license rights, net	536,021	276,817
Total assets	\$ 40,841,145	\$ 40,168,323
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable:		
Cree Research, Inc.	\$ 3,532,119	\$ 1,679,600
Other	970,234	250,157
Accrued expenses	267,119	223,248
Deferred revenue	32,372	18,986
Total current liabilities	4,801,844	2,171,991
Commitments		
Shareholders' Equity:		
Common stock	48,757,702	48,149,406
Additional paid-in capital - stock options	1,879,490	1,910,368
Accumulated deficit	(14,597,891)	(12,063,442)
Total shareholders' equity	36,039,301	37,996,332
Total liabilities and shareholders' equity	\$ 40,841,145	\$ 40,168,323

See Notes to Condensed Financial Statements

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

	Nine Months Ended September 30,	
	1999	1998
OPERATING ACTIVITIES:		
Net loss	\$(2,534,449)	\$(5,424,076)
Adjustments:		
Depreciation and amortization	474,811	106,345
Compensation expense related to stock options	210,496	276,648
Change in operating assets and liabilities:		
Net change in assets	(7,857,231)	(2,263,796)
Net change in liabilities	2,629,853	754,901
Net cash used in operating activities	(7,076,520)	(6,549,978)
INVESTING ACTIVITIES:		
Purchase of equipment	(3,010,790)	(2,980,066)
Patent costs	(310,001)	(72,534)
Net cash used in investing activities	(3,320,791)	(3,052,600)
FINANCING ACTIVITIES:		
Stock options exercised	366,922	23,694
Net cash provided by financing activities	366,922	23,694
Net change in cash and equivalents	(10,030,389)	(9,578,884)
Cash and equivalents, beginning of period	32,004,045	43,980,385
Cash and equivalents, end of period	\$21,973,656	\$34,401,501

See Notes to Condensed Financial Statements.

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 year. Certain reclassifications have been made to prior year's financial statements to conform to the classifications used in fiscal 1999. These financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 1998, as set forth in the Company's Form 10-K, filed with the Securities and Exchange Commission on March 18, 1999.

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. As part of the Company's transition from a technology-focused manufacturing company to a consumer-focused marketing company, C3 began doing business as Charles & Colvard in October 1999. The name reflects the heritage of the Company as well as the long-term branding and marketing strategy.

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 determined on a first in, first out basis. Test instruments are shown net of a reserve for excess inventory of \$356,000 at September 30, 1999 and \$132,000 at December 31, 1998.

	September 30, 1999	December 31, 1998
	-----	-----
Moissanite		
Raw materials	\$ 397,516	\$ 140,411
Work-in-process	3,937,308	819,953
Finished goods	5,435,612	1,113,619
	-----	-----
	9,770,436	2,073,983
Test Instruments	541,597	1,018,465
	-----	-----
Total Inventory	\$10,312,033	\$ 3,092,448
	=====	=====

3. STOCK BASED COMPENSATION

During the quarter and nine months ended September 30, 1999, in accordance with Accounting Principles Board Opinion No. 25, the Company recorded compensation expense of \$58,665 and \$210,496, respectively, relating to stock options. Compensation expense related to stock options for the quarter and nine months ended September 30, 1998 was \$129,870 and \$276,648, respectively. This compensation expense is recorded in general and administrative expense in the statements of operations.

4. NEWLY ISSUED ACCOUNTING PRONOUNCEMENTS

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, as amended by FAS 137, is effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. The Company has not evaluated the impact of the adoption of this Statement on the financial statements.

5. ADVERTISING COSTS

Advertising production costs are expensed as incurred. Media placement costs are expensed over the period the advertising appears. Advertising expenses for the quarter and nine months ended September 30, 1999 amounted to approximately \$383,000 and \$905,000 respectively. Advertising expenses for the quarter and nine months ended September 30, 1998 amounted to approximately \$319,000 and \$440,000 respectively.

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 SiC 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, 1998, which was filed with the Securities and Exchange Commission on March 18, 1999. 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

The Company's principal business is to manufacture moissanite jewels and market them on a worldwide basis. As the sole manufacturer of scientifically-made moissanite jewels, the Company plans to create a unique brand image which positions moissanite as a jewel in its own right, distinct from all other jewels based on its fire, brilliance, luster and durability.

From its inception in June 1995 through June 30, 1998, the Company was a development stage enterprise that devoted its resources to fund research and development of colorless, scientifically-made moissanite jewels. At the same time, the Company assembled a management team, conducted market research and developed its strategic business plans.

The Company began shipping moissanite to authorized retail jewelers in Atlanta and Miami/Ft. Lauderdale during the second quarter of 1998. Through the first half of 1999, the Company's distribution of moissanite was inhibited by limited product availability.

During the second quarter of 1999, Cree showed marked improvement in silicon carbide crystal quality resulting in increased yield of salable jewels from 2-inch diameter crystals. The improvements in SiC crystal yield continued through the third quarter of 1999. All of the new 3-inch diameter crystal growth systems came on-line during the third quarter. Although the yields of the 3-inch diameter crystals are much lower than the yields on the 2-inch diameter crystals, the yield of the initial deliveries of 3-inch diameter crystals exceeded the Company's expectations. The Company expects the yields of the 3-inch diameter crystals to vary over the next several quarters as a manufacturing process evolves. Any significant increases or decreases in yields would have a corresponding material impact on gross margins.

As the Company continues to expand its distribution channels, it is developing a deeper understanding of the dynamics of the market, especially the impact of seasonality on quarterly sales. The Company identified several issues in the third quarter, including a slower than expected rate of adding retailers in the U.S., lack of targeted retailer-driven marketing programs abroad, and third quarter seasonality, particularly in international markets. The Company has developed a global, strategic marketing program which it believes will address these issues as well as increase consumer awareness of moissanite jewels.

This program is focused on creating consumer demand for the moissanite brand and is based on new insight into the Company's target consumer. Its aim is to inspire the target group to seek out moissanite. The Company believes that seasonality will continue to have a meaningful impact on its results of operations.

The global strategic marketing campaign opened November 1999. The first 100 days is a consumer communications blitz greater than any in the Company's history. It targets the Company's consumers on national cable television, in Harper's Bazaar, local market special events and promotions. And, in a non-traditional media purchase, advertising will appear in movie theaters in 10 of the leading media markets. An estimated advertising and promotional budget of \$6 million is projected for 2000, with an additional expenditure of \$2 million in the fourth quarter of 1999. Furthermore, the Company's integrated marketing program, which includes point-of-purchase materials, became available to the Company's exclusive retailers in the second half of October. This global campaign will target early adapter working women ages 25-54 with an annual household income in excess of \$50,000, will feature a new corporate logo, and will expand into international markets next year. Additionally, as part of the Company's transition from a technology-focused manufacturing company to a consumer-focused marketing company, C3 has begun doing business as Charles & Colvard. This name reflects the heritage of the Company as well as the long-term branding and marketing strategy to be executed in the fourth quarter and beyond.

In concert with the advertising program, the Company's sales efforts are focused on ten of the leading media markets in the U.S. to capitalize upon placement of the product in influential, trend-setting cities. The Company will continue to add qualified retailers domestically and expects carat shipments to increase in the fourth quarter. However, the Company will not meet previously announced estimates for the second half of the year. As the Company is expanding its marketing and promotion activities, it expects to continue operating at a loss through at least the end of 1999. Moreover, there can be no assurance that the Company will ever achieve sales increases or profitability, or that if profitability is achieved, that such profitability can be sustained.

The Company is in the process of refining its international distribution methods, beginning with Western Europe. The Company is in discussions with certain of its exclusive international distributors to expand their distribution territories and provide the Company with more control over the positioning and advertising of moissanite in their respective territories. The Company anticipates that the distribution of moissanite in Western Europe will be performed by two independent distributors.

RESULTS OF OPERATIONS

QUARTER ENDED SEPTEMBER 30, 1999 COMPARED WITH QUARTER ENDED SEPTEMBER 30, 1998.

Net sales were \$2,169,539 for the quarter ended September 30, 1999 compared to \$1,326,373 for the quarter ended September 30, 1998, an increase of 843,166 or 63.6%. The increase resulted primarily from expanded distribution of moissanite jewels. The Company will continue to add qualified retailers domestically and expects carat shipments to increase in the fourth quarter. However, the Company will not meet previously announced estimates for the second half of the year.

The Company's gross profit margin was 56.2% for the quarter ended September 30, 1999 compared to 17.8% for the quarter ended September 30, 1998. The increase resulted from higher yields of moissanite jewels from SiC crystals purchased from Cree, thereby lowering the cost per carat. Throughout the remainder of 1999, particularly as the Company works with Cree to develop a manufacturing process for the new 3-inch diameter crystal growth systems, yields may vary. Any significant yield changes would have a material impact on gross profit.

Marketing and sales expenses were \$1,461,286 for the quarter ended September 30, 1999 compared to \$928,598 for the quarter ended September 30, 1998, an increase of \$532,688 or 57.4%. The increase was due primarily to the development of the strategic global marketing program, including the creative and production efforts supporting the specific advertising messages and materials to be launched in the fourth quarter of 1999, as well as compensation and other expenses related to additional staff.

General and administrative expenses were \$815,843 for the quarter ended September 30, 1999 compared to \$543,018 for the quarter ended September 30, 1998, an increase of \$272,825 or 50.2%. The increase resulted primarily from compensation and other expenses related to additional staff and increased insurance and taxes on the Company's increasing fixed assets.

Research and development expenses were \$682,237 for the quarter ended September 30, 1999 compared to \$785,869 for the quarter ended September 30, 1998, a decrease of \$103,632 or 13.2%. The decrease resulted primarily from the reduction of development efforts effective September 1, 1999, as provided in the May 1999 letter agreement between the Company and Cree.

Net interest income was \$291,949 for the quarter ended September 30, 1999 compared to \$467,532 for the quarter ended September 30, 1998, a decrease of \$175,583 or 37.6%. This decrease resulted from lower interest income earned on lower cash balances due primarily to the use of the invested proceeds from the Company's initial public offering in November 1997. See Part II, Item 2.

NINE MONTHS ENDED SEPTEMBER 30, 1999 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 1998.

Net sales were \$8,932,615 for the nine months ended September 30, 1999 compared to \$1,778,938 for the nine months ended September 30, 1998, an increase of \$7,153,677 or 402%. The increase resulted primarily from expanded distribution of moissanite jewels. During the first six months of 1998, prior to emerging from the development stage, the Company generated net sales of approximately \$324,000 from moissanite jewels, which have been netted against research and development expenses on the operating statement because many of the jewels sold were associated with the Company's research and development program. Net sales from the Company's proprietary test instrument decreased from approximately \$560,075 for the nine months ended September 30, 1998 to \$436,472 for the nine months ended September 30, 1999, primarily as a result of a market driven decrease in the selling price. The Company will continue to add qualified retailers domestically and expects carat shipments to increase in the fourth quarter. However, the Company will not meet previously announced estimates for the second half of the year.

Gross margin was 47.6% for the nine months ended September 30, 1999 compared to 22.4% for the nine months ended September 30, 1998. The increase resulted from higher yields of moissanite jewels from SiC crystals purchased from Cree, thereby lowering the cost per carat. Throughout the remainder of 1999, particularly as the Company works with Cree to develop a manufacturing process for the new 3-inch diameter crystal growth systems, yields may vary. Any significant yield changes would have a material impact on gross profit.

Marketing and sales expenses were \$3,236,924 for the nine months ended September 30, 1999 compared to \$2,202,597 for the nine months ended September 30, 1998, an increase of \$1,034,327 or 47.0%. The increase was due primarily to the development of the strategic global marketing program, including the creative and production efforts supporting the specific advertising messages and materials to be launched in the fourth quarter of 1999, as well as advertising expenses in selected markets and compensation and other expenses related to additional staff.

General and administrative expenses were \$2,256,653 for the nine months ended September 30, 1999 compared to \$1,885,224 for the nine months ended September 30, 1998, an increase of \$371,429 or 19.7%. The increase resulted primarily from compensation and other expenses related to additional staff and increased insurance and taxes on the Company's increasing fixed assets.

Research and development expenses were \$2,274,987 for the nine months ended September 30, 1999 compared to \$3,196,711 for the nine months ended September 30, 1998, a decrease of \$921,724 or 28.8%. The decrease resulted primarily from the more focused development effort under the Company's July 1998 Amended and Restated Development Agreement with Cree. The July 1998 agreement replaced the June 1997 Development Agreement and the January 1998 Supplemental Development Agreement 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.

Net interest income was \$978,290 for the nine months ended September 30, 1999 compared to \$1,461,718 for the nine months ended September 30, 1998, a decrease of \$483,428 or 33.1%. This decrease resulted from lower interest income earned on lower cash balances due primarily to the use of the invested proceeds from the Company's initial public offering in November 1997. See Part II, Item 2.

LIQUIDITY AND CAPITAL RESOURCES

The Company has financed its operations since inception primarily through the net proceeds of its initial public offering of Common Stock in November 1997 and, prior to such offering, through private equity sales. Net proceeds from the Company's initial public offering were \$41,072,982. During the third quarter of 1999, the Company used \$3,019,313 to fund operations and \$3,154,434 to fund capital expenditures and patent expenses. At September 30, 1999, the Company had \$21,973,656 of cash and equivalents and \$29,084,485 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.

The Company has 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 substantial inventory levels and intends to significantly increase its advertising and marketing expenditures as it implements the domestic launch of its global strategic marketing program during the fourth quarter 1999. The Company expects its advertising and promotional expenditures to exceed \$2 million in the fourth quarter of 1999 and \$6 million in the year 2000. If the Company is unable to significantly increase sales of moissanite jewels, inventories will increase substantially. The Company intends to fund these increased inventories and advertising and marketing expenditures from its existing cash and equivalents.

In May 1999, the Company entered into a letter agreement ("Letter Agreement") with its exclusive supplier, Cree. Under the Letter Agreement the Company agreed to purchase \$2.8 million of crystal growth equipment from Cree and to purchase all crystals produced by existing crystal growers and the new crystal growers through June 30, 2000 at a price based upon a sliding scale depending on the quality of each crystal received. Additionally, the two companies agreed to reduce the Company's monthly funding commitment under the Amended and Restated Development Agreement from \$240,000 to \$120,000. All of the crystal growers were built to grow 3-inch diameter crystals and came on-line during the third quarter. Through September 30, 1999 the Company paid approximately one-half of the cost of these growers. The balance will be paid during the fourth quarter from the Company's 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 selected and implemented an enterprise-wide information technology system to support the 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 has substantially completed the implementation of this system and the testing of the Year 2000 compliance of the system and does not expect the Year 2000 issue to pose significant operational problems for its computer systems. The Company has also substantially completed reviewing its non-information technology systems for Year 2000 compliance and believes the Year 2000 exposure with respect to those systems is not material.

The Company believes that its greatest risk with respect to the Year 2000 issue stems from the potential non-compliance of our suppliers. The Company depends on one supplier of SiC crystals, Cree, and on a limited number of suppliers of other component services necessary for the manufacture of moissanite jewels. Accordingly, if those suppliers are unable to process or fill the Company's orders or otherwise interact with the Company because of Year 2000 problems, the Company could experience material adverse effects to its business. Although the Company cannot control whether and how third parties will address the Year 2000 issue, the Company has contacted critical vendors, including Cree, and have been informed that they have the ability to ensure smooth delivery of products without disruptions caused by Year 2000 problems. Based on the responses of these vendors, the Company believes that all vendors are either substantially Year 2000 compliant or that any noncompliance will not have a material effect on the Company's operations.

The crystal growth systems, which Cree uses to produce SiC crystals for the Company, are dependent upon microprocessors. The Company has received written confirmation from Cree that it has evaluated the crystal growth systems and determined that they are fully Year 2000 compliant. Cree has also evaluated and remediated its other business systems that rely on microprocessors. According to Cree's Form 10-Q for the quarter ended September 26, 1999, Cree has completed all Year 2000 compliance efforts with respect to its business systems. Any unexpected Year 2000 issues at Cree could cause delays in the receipt of SiC crystals which could, in turn, delay deliveries of moissanite jewels to the Company's customers. The Company has developed a significant inventory of finished moissanite jewels and work-in-process that the Company believes could fulfill its needs if there is a short-term delay in receipt of SiC crystals from Cree. However, any significant delay in the Company's receipt of SiC crystals or resulting delay in delivery of moissanite jewels to the Company's retailers would have a material adverse effect on the Company's business, operating results and financial condition.

There can be no assurance that the systems of third parties on which the Company's business relies will be modified on a timely basis. Additionally, to the extent that the general economy slows down as a result of Year 2000 compliance issues, the Company's operations could be affected. The Company's business, financial condition and 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.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company believes that its exposure to market risk for changes in interest rates is not significant because the Company's investments are limited to highly liquid instruments with maturities of three months or less. At September 30, 1999 the Company has approximately \$21.3 million of short-term investments classified as cash and equivalents. All of the Company's transactions with international customers and suppliers are denominated in US dollars.

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, 1999, the Company had approximately \$10,500,000 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 \$6,850,000 of the proceeds has been used in research and development, of which \$250,000 was paid to officers, directors or shareholders owning more than 10 percent (10%) of the Common Stock outstanding. The Company has also used approximately \$9,375,000 to fund sales, marketing and administrative expenses, of which \$640,000 was paid to officers, directors or shareholders owning more than ten percent (10%) of the Common Stock outstanding. The Company also expended approximately \$8,500,000 to fund working capital. In addition, the Company acquired \$5,525,000 of production equipment, including \$4,625,000 of crystal growth systems from Cree; certain computerized wafering and preform development equipment, and other equipment. Other expenditures include \$325,000 for intangible assets.

ITEM 5: OTHER INFORMATION

The Company has entered into a number of agreements with specialty retail jewelers with an aggregate of over 221 locations in 35 states. Additionally, the Company has entered into 28 international agreements for distribution of moissanite jewels in 46 countries and various areas in the Caribbean.

In October 1999, the Company entered into a fourth amendment to its agreement with John M. Bachman, Inc. ("JMB"). The amendment provides for the Company to advance JMB additional funds to expand the production facilities of its affiliate which facets the Company's moissanite jewel preforms. These funds will be repaid through reductions to future cutting charges. The amendment extends the term of the Company's agreement with JMB to December 31, 2002. The Company has the right to terminate the agreement at any time after January 1, 2002 upon 90 days written notice.

In October 1999, the Company entered into an employment agreement with David Fudge, who will be employed in the capacity of Vice President of Sales effective as of November 1, 1999. Mr. Fudge has 14 years experience in business, sales management and sales training.

On November 4, 1999, the Company's board of directors elected Cecil D. Raynor as a director. Mr. Raynor has more than 26 years of manufacturing and engineering management experience primarily in the telecommunications industry, both domestically and internationally. Mr. Raynor is currently Vice President of Manufacturing at Nortel Networks, a telecommunications equipment manufacturer.

ITEM 6: EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit No.	Description
10.37	Fourth Amendment to Agreement, dated October 5, 1999, between John M. Bachman, Inc. and C3, Inc.*
10.38	Employment Agreement, dated November 1, 1999 between David Fudge and C3, Inc.+*
27.1	Financial Data Schedule

+ Denotes a management contract or compensatory plan or arrangement.

* The Company has requested that certain portions of this exhibit be given confidential treatment.

(b) Report on Form 8-K

The Company did not file any reports on Form 8-K during the quarter ended September 30, 1999.

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.

Date: November 15, 1999

/s/ Jeff N. Hunter

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

Date: November 15, 1999

/s/ Mark W. Hahn

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

FOURTH AMENDMENT TO AGREEMENT

THIS FOURTH AMENDMENT TO AGREEMENT (this "Amendment") is entered into as of October 5, 1999 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, a First Amendment to the Agreement dated March 23, 1998 (the "First Amendment"), a Second Amendment to the Agreement dated September 28, 1998 (the "Second Amendment") and a Third Amendment to the Agreement dated June 16, 1999 (the "Third 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 as 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 at rates as set forth on Exhibit A to the Second Amendment. For cutting services provided by JMB through January 31, 2000, the amount payable to JMB by C3 reflected on each invoice will be reduced by **% and from and after February 1, 2000 by **% 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, the First Amendment and the Second Amendment are hereby confirmed.

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, 2002, however, C3 may terminate the Agreement at any time after January 1, 2002 with 90 days prior written notice.

4. Production Procedures: Standards

a. The monthly production volumes (in finished pieces) will be as follows:

Sep 1999	*****
Oct 1999	*****
Nov 1999	*****
Dec 1999	*****
Jan 2000	*****
Feb 2000	*****
March 2000	*****
April 2000	*****
May 2000	*****
Jun 2000	*****
July 2000	*****
Aug 2000	*****
Sep 2000	*****
Oct 2000	*****
Nov 2000	*****
Dec 2000-Dec 2002	*****

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

5. Confirmation of Agreement. In all other respects the parties hereto confirm the terms of the Agreement, the First Amendment, the Second Amendment

and the Third Amendment. 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: Chief Financial Officer

JOHN M. BACHMAN, INC.

By: /s/ John M. Bachman

Name: John M. Bachman

Title: Managing Director

CONSENT

Beehive Industries PVT, Ltd. has reviewed the Fourth Amendment dated October 5, 1999 to the Agreement dated September 24, 1997 by and between C3, Inc and John M. Bachman, Inc. and agrees to be bound by the terms as set out therein.

This the 5 day of October, 1999.

Beehive Industries PVT, Ltd.

By: _____
Its: Managing Director

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (the "Agreement") is made and entered into effective as of November 1, 1999 by and between C3, Inc., a North Carolina company, DBA Charles & Colvard, with its principal office at 3800 Gateway Boulevard, Suite 310, Morrisville, North Carolina, 27560 (the "Company"), and David Fudge, an individual currently residing at 107 Planter Place, Oxford, North Carolina, 27565 ("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 October 31, 2002. This Agreement shall automatically, at the expiration of the then current term, renew for successive one year terms, unless terminated by either party upon no less than 30 days prior written notice to the other, or is otherwise terminated pursuant to Paragraph 7.

3. Position and Duties. The Employee shall serve as Vice President of Sales of the Company. As such, it is understood and agreed that Employee lives in Oxford, North Carolina and shall not be required to change his place of residence to fulfill the duties of his employment. 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 in his job description 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 \$125,000, payable in regular and equal monthly installments ("Base Salary"); provided, however, that the Base Salary shall be adjusted as per the description and example shown on Exhibit B hereto. The

adjustment shall occur after the annual audit of the companies books is concluded by the company's outside auditors, with the first adjustment occurring in 2001.

(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 for the officers of the Company. Additionally, the Employee shall receive a "commission" of \$0.30 per carat of moissanite sold by the Company in the twenty four target US Media markets, as defined by the Neilson Rating Service, identified on Exhibit C, list "B", to this agreement and \$0.10 per carat of moissanite sold by the Company in any other markets. Exhibit C is incorporated herein by reference as if it were a part hereof. Such commissions shall be paid quarterly, after the review of the Company's books by the outside auditors for the quarter then ending. This provision shall be in effect until the company achieves it's sales objective for the year 2000 or 2001, or 2002, as approved by the Company's Board of Directors. Upon that event, the commissions shall become \$0.20 per carat on all sales irrespective of the market where sold.

(d) Employee Stock Option Participation. Employee shall be granted, as additional consideration for entering into this Agreement,

an option to purchase 60,000 shares of the Company's common stock in accordance with the terms and conditions of the Employee Stock Option Agreement annexed hereto as Exhibit D and incorporated herein by reference as if it were a part hereof. Employee shall receive options to purchase an additional 40,000 shares of the shares of the common stock of the Company if increased distribution goals are met. Those options can be earned and granted according to the following schedule.

(i) If within six (6) months of the date of this agreement, 8,000 options will be earned and granted if the number of retailers in the targeted markets identified on Exhibit C, list "A" domestic markets doubles from the current ** to ***. An additional 2,000 options will be earned and granted if at least 25% of the retailers added are "AGS" or "AGTA" or similar retailers; (ii) if within 12 months, 8,000 options will be earned and granted if the total number of retail outlets in the targeted markets (Exhibit C, List B) reaches ***. An additional 2,000 options will be earned and granted if at least 25% of the retailers added are "AGS" or "AGTA" or similar retailers; (iii) if within 18 months, 8,000 options will be earned and granted if the Company has *** retail stores in the 24 targeted markets, (Exhibit C, List B). An additional 2,000 options will be earned and granted 25% of those added are "AGS" or "AGTA" or similar retailers; (iv) if within 30 months 10000 options will be earned and granted if the total number of retailers in the targeted markets (Exhibit C, List B) becomes ***; or in the event the options set out above are not earned. (v) Employee shall receive options to purchase an additional 20,000 shares of the shares of the common stock

of the Company if within twelve (12) months from the effective date of this Agreement the number of retail outlets in the United States increase by one hundred percent, or to ***, from the current level of *** such retail outlets. Further, Employee shall receive options to purchase 20,000 shares of the common stock of the Company within thirty (30) months from the effective date of this Agreement if the number of retail outlets in the United States increase by three hundred percent, or to ***, from the current level of *** such retail outlets. The granting of the second 20,000 options described herein shall not be conditional upon the grant of the initial 20,000 options. In no event may the number of options earned pursuant to this paragraph exceed 40,000. All references to "retailers" in this paragraph shall mean retail distribution outlets actively selling Charles & Colvard created moissanite. All references to "AGS" retailers in this document, shall mean retailers which are members of the industry trade group, the American Gem Society, and all references to "AGTA" in this document, shall mean retailers which are members of the industry trade group, the American Gem Trade Association. Similar retailers shall mean retailers that conduct their business to the ethical standards of either AGS or AGTA member retailers, but are not members of either association.

All options which may be earned under the incentive to open additional retail outlets for the Company's products shall be granted when the targeted levels of retail outlets is achieved, as the case may be, and shall be vested when granted. The price of all such options shall be the publicly traded stock price at closing on the day proceeding the date the options are granted.

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 for Just Cause. The Company shall have the right to terminate the Employee's employment under this Agreement for "Just Cause". Termination for "Just Cause" shall mean termination for Employee's gross incompetence, failure, after written notice, to perform stated duties covered by the Employee's written job description (as in effect as the effective date of this Agreement), material breach of a fiduciary duty related to the Employee's job description and involving personal gain, willful violation of a material written company policy of general applicability, unethical business practices in connection with the Company's business, conviction of a felony or misdemeanor involving moral turpitude, theft of Company assets or 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 highest amount of the annual cash compensation (including cash bonuses and other cash-based benefits, including for these purposes amounts earned or payable whether or not deferred) received from the Company during any of the five calendar years immediately preceding such termination ("Termination Compensation") in each year until the end of the Term, 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. 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 2.99, 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, not withstanding 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.

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 Payments. 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 Payments. 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 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 required 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.

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: _____
Robert S. Thomas, President

David Fudge

Exhibit A
JOB DESCRIPTION

Vice President of Sales
SUMMARY

Develops the policies, procedures and objectives for sales of the Company's products. Leads and directs the activities of the sales personnel. Continually evaluates the Company's sales efforts and develops and implements programs to strengthen the Company's sales efforts. Provides sales expertise to other members of the Company's management team, and coordinates the Company's sales efforts with other Company activities including but not limited to marketing and manufacturing.

PRIMARY RESPONSIBILITIES

1. Directs activities of the sales function of the Company to achieve Company objectives for sales volume and market penetration. Responsible for advancing the Company's performance management system, especially in sales.
2. Directs activities of the sales function. This includes competitive analysis, product and consumer research, establishing sales budgets and quotas, product pricing and distribution.
3. Leads and directs activities of the Company's sales force and any representatives and/or distributors of the Company's products. Provides leadership, training (including coaching), management and sales support. Coordinates field sales efforts to enhance ability of sales personnel to work effectively and achieve goals.
4. Directs product and customer service activities. Responsible for maintaining satisfactory customer perception of Company services and products by working with the marketing staff to insure that the Company's branding and positioning strategy is consistent with the Company's sales activities.
5. Works closely with members of the management team, especially manufacturing, to ensure that the product mix and availability is in synch with customer demand.
6. Analyzes actual sales and marketing performance against budgeted sales volume and market penetration levels.
7. Manages all sales promotion activities, including planning and executing the Company's participation in industry trade shows. Responsible for the coordination of all sales efforts with the marketing department and public relations and advertising agencies of record.
8. Establishes and maintains contact with potential customers and actively participates in the selling effort to support key accounts and with a high level of sales.
9. Responsible for submitting annual projected sales forecast, including the necessary product mix, and budget for inclusion in the Company's annual business plan for approval by the Company's Board of Directors. Is accountable for the execution of the sales plan as presented in the annual business plan, which includes the management of the sales budgets for both planned sales income and planned sales expenses.
10. Presents updates to the Board of Directors during quarterly meetings and management briefings.

11. Performs such activities consistent with the position of Vice President of Sales as may be reasonably delegated by the CEO, COO, President or the Board of Directors of the Company.

Exhibit B

Base Salary Adjustment

Base Salary to increase at twenty five percent (25%) of the rate of growth of the company's top line net sales growth. The calculation will be done on the calendar and fiscal year ending December 31 of each year, beginning with the comparison between 1999 and 2000. The salary adjustment will be effective on January 1 of each year of the contract period, with the first adjustment occurring effective January 1, 2001.

Example:

1. 1999/2000 Base Salary equals \$125,000.00
2. Adjustment percentage equals 25%
3. 1999 Net Sales equals \$12,500,000.00
4. 2000 Net Sales equals \$30,000,000.00
5. Company Sales growth equals 140% (#4 minus #3, divided by #3)
6. The salary adjustment becomes 35%. (#5 (140%) times #2 (25%))
7. 2001 Base salary becomes \$168,750.00. (#1 times #6, plus #1)

EXHIBIT C

Targeted United States Media Markets*

List A

New York
Washington DC
Atlanta
Charlotte
Miami
Dallas
Houston
Raleigh/Durham
Los Angeles
San Diego
San Francisco
Greensboro/Winston Salem

List B

New York
Washington DC
Atlanta
Charlotte
Miami
Dallas
Houston
Baltimore
Los Angeles
San Diego
San Francisco
Boston
Philadelphia
Cincinnati
Cleveland
Detroit
Chicago
Denver
Phoenix
New Orleans
Las Vegas
Minneapolis
Orlando
Seattle

* Media markets as defined by the Neilson Rating Service

EXHIBIT D

1997 OMNIBUS STOCK PLAN
OF C3, INC.
(EMPLOYEE OPTION AGREEMENT)

THIS AGREEMENT (the "Agreement"), made the 1st day of November 1999, between C3, INC., a North Carolina corporation doing business as Charles & Colvard (the "Corporation"), and David Fudge an employee of the Corporation or a related corporation (the "Optionee");

R E C I T A L S :

In furtherance of the purposes of the 1997 Omnibus Stock Plan of C3, Inc., as it may be hereafter amended (the "Plan"), the Corporation and the Optionee hereby agree as follows:

1. The rights and duties of the Corporation and the Optionee under this Agreement shall in all respects be subject to and governed by the provisions of the Plan, a copy of which is delivered herewith or has been previously provided to the Optionee and the terms of which are incorporated herein by reference.

2. The Corporation hereby grants to the Optionee pursuant to the Plan, as a matter of separate inducement and agreement in connection with his employment or service to the Corporation, and not in lieu of any salary or other compensation for his services, the right and Option (the "Option") to purchase all or any part of an aggregate of Sixty Thousand (60,000) shares (the "shares") of the Common Stock of the Corporation, at the purchase price of Nine and 75/100 Dollars (\$9.75) per share. The option to purchase the shares shall be designated as an Incentive Option. To the extent that any Option is designated as an Incentive Option and such Option does not qualify as an Incentive Option, it shall be treated as a Nonqualified Option. Except as otherwise provided in the Plan, the Option will expire if not exercised in full before October 31, 2009.

3. The Option shall become exercisable on the date or dates set forth on Schedule A attached hereto. To the extent that an Option which is exercisable is not exercised, such Option shall accumulate and be exercisable by the Optionee in whole or in part at any time prior to expiration of the Option. The minimum number of shares that may be purchased under the Option at one time shall be ten (10). Upon the exercise of an Option in whole or in part, the Optionee shall pay the Option price to the Corporation in accordance with the provisions of Section 6 of the Plan, and the Corporation shall as soon thereafter as practicable deliver to the Optionee a certificate or certificates for the shares purchased.

4. Nothing contained in this Agreement or the Plan shall require the Corporation or a related corporation to continue to employ the Optionee for any particular period of time, nor shall it require the Optionee to remain in the employ of the Corporation or such related corporation for any particular period of time. Except as otherwise expressly provided in the Plan, all rights of the Optionee under the Plan with respect to the unexercised portion of his Option shall terminate upon termination of the employment of the Optionee with the Corporation or a related corporation.

5. This Option shall not be transferable other than by will or the laws of intestate succession or pursuant to a qualified domestic relations order. This Option shall be exercisable during the Optionee's lifetime only by the Optionee.

6. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective executors, administrators, next-of-kin, successors and assigns.

7. Except as otherwise provided in the Plan or herein, this Agreement shall be construed and enforced according to the laws of the State of North Carolina.

IN WITNESS WHEREOF, this Agreement has been executed in behalf of the Corporation and by the Optionee on the day and year first above written.

C3, INC.

By: _____
Robert S. Thomas
President

Attest:

Mark W. Hahn
Secretary

[Corporate Seal]

OPTIONEE

_____(SEAL)
David Fudge

1997 OMNIBUS STOCK PLAN
OF C3, INC.
(EMPLOYEE OPTION AGREEMENT)

SCHEDULE A

Date Option granted: November 1, 1999
Date Option expires: October 31, 2009
Number of shares subject to Option: 60,000
Option price (per share): \$9.75

Date Installment First Exercisable -----	Percentage of Shares In Installment -----	Incentive or Nonqualified Stock Option -----
October 28, 2000	20,000 shares or 33 1/3%	Incentive Option
October 28, 2001	20,000 shares or 33 1/3%	Incentive Option
October 28, 2002	20,000 shares or 33 1/3%	Incentive Option

This Schedule Contains Summary Financial Information Extracted From The Condensed Balance Sheet As Of September 30, 1999 And The Condensed Statement Of Operations For The Nine Months Ended September 30, 1999 And Is Qualified In Its Entirety By Reference To Such Financial Statements.

9-MOS	DEC-31-1999	
	JAN-01-1999	
	SEP-30-1999	
		21,973,656
		0
		1,004,055
		104,000
		10,312,033
		33,886,329
		7,074,822
		656,027
		40,841,145
		4,801,844
		0
		0
		0
		48,757,702
		(12,718,401)
40,841,145		
		8,932,615
		8,932,615
		4,676,790
		4,676,790
		0
		0
		0
		(2,534,449)
		0
(2,534,449)		
		0
		0
		0
		(2,534,449)
		(.36)
		(.36)