

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 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)

(I.R.S. Employer Identification No.)

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

27560

(Address of principal executive offices)

(Zip Code)

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

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

None

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

Common Stock, no par value per share

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K .

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of January 31, 1999 was \$111,892,944. On January 31, 1999 there were 6,993,309 outstanding shares of the Registrant's Common Stock.

DOCUMENT INCORPORATED BY REFERENCE

Certain portions of the Proxy Statement of the Registrant for the Annual Meeting of Shareholders to be held on May 17, 1999 have been incorporated by reference into Part III of this Annual Report on Form 10-K.

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FORWARD LOOKING STATEMENTS

This Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements represent the Company's judgment on future events. Because the Company is in the early stages of its key supplier's establishment of manufacturing processes and capacity and of building the Company's own distribution channels and has not yet engaged in significant revenue-producing activities, the Company is subject to risks and uncertainties that could cause the Company's actual performance and results to differ materially from those projected or discussed herein. These risks and uncertainties are discussed in "Business Risks" in Item 1 below and in "Risk Factors" in the Company's Prospectus dated November 14, 1997.

PART I

ITEM 1. BUSINESS

INTRODUCTION

The Company manufactures, markets and distributes lab-created moissanite gemstones (hereinafter referred to as moissanite or moissanite gemstones) for sale in the jewelry market. Moissanite, also known by its chemical name, silicon carbide (SiC), is a rare, naturally occurring mineral found primarily in meteorites. See "--Moissanite." Moissanite is being marketed as an exclusive new gemstone with properties, including brilliance, fire, luster and hardness that rival other fine gemstones like diamonds, rubies and emeralds. See "--Distribution, Marketing and Sales".

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 moissanite gemstones, market research, developing initial consumer marketing themes and assembling a management team. The Company began shipping moissanite to jewelry 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 second half of 1998 the Company expanded the number of authorized retail jewelers in the southeastern states of North Carolina, South Carolina, Georgia and Florida. In addition, the Company continued limited distribution and promotional activities in domestic locations outside this region. The Company also entered into exclusive distribution agreements with a number of international distributors. See "--Distribution, Marketing and Sales".

The Company's moissanite gemstones are currently made from SiC crystals grown by Cree Research, Inc. ("Cree"). Cree has an exclusive license to a patent related to a process for growing large single crystals of SiC. To the Company's knowledge, there are currently no producers of SiC other than Cree that could readily supply lab-grown SiC crystals in qualities, sizes or volumes suitable for use as gemstones. The Company has certain exclusive licenses and supply rights with Cree for SiC materials to be used for gemstone applications. See "--Products and Product Development" and "Business Risks." The Chief Executive Officer of the Company and one of the founders of the Company are the brothers of the Chief Executive Officer of Cree. As of August 7, 1998, based on the shareholdings reported in Cree's Proxy statement dated October 1, 1998, Cree and certain of its officers and directors own approximately five percent (5%) of the Company's outstanding Common Stock.

The Company believes that its sales volumes will increase as the yield of salable gemstones from each crystal provided by Cree increases, larger diameter crystals are produced, additional crystal growth capacity is added, and as the market introduction of moissanite gemstones 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 and yields, 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 at least part 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. See "Business Risks."

THE JEWELRY MARKET

In 1997, worldwide retail jewelry sales were estimated to be in excess of \$90 billion and jewelry sales in the United States were estimated to be approximately \$35 billion. The volume of natural diamond, ruby, emerald and sapphire imported into the U.S. for jewelry consumption exceeds 30 million carats annually. In comparison, slightly more than 18,000 carats of moissanite were shipped worldwide in 1998 demonstrating the exclusive nature of this product.

DIAMOND JEWELRY. In 1997, worldwide retail diamond jewelry sales were estimated to be in excess of \$52 billion and diamond jewelry sales in the United States were estimated to be \$ 20.4 billion. In 1997, approximately 70 million pieces of diamond jewelry were sold worldwide of which over 32 million were sold in the United States. Over 80% of the diamond jewelry pieces sold domestically used settings other than engagement rings (i.e., pendants, bracelets, etc.).

DISTRIBUTION CHANNELS. Traditionally, jewelry has been sold to consumers through independent and chain jewelry stores and department stores. However, in the past two decades, non-traditional distribution channels have emerged including catalog showrooms, mass-market discounters, price clubs, mail order, TV shopping channels and the internet. Moissanite currently is sold through single and multiple location independent jewelry stores. Independent jewelry stores comprise approximately 50% of the estimated 40,000 retail jewelry outlets in the United States.

MOISSANITE

Moissanite is a rare, naturally occurring mineral which is found primarily in meteorites. The naturally occurring moissanite that has been found has generally been very small in size and dark green or black in color and is not a commercially viable gemstone material. Therefore, only lab-grown SiC crystals are expected to provide a meaningful source of moissanite for gemstones.

The Company believes that moissanite gemstones have unique features that compare favorably to diamond and other fine gemstones and that make it attractive for use as a gemstone which will result in market demand for the Company's products. Because of its unique atomic structure, moissanite can be grown in a variety of colors including blue, green or yellow. Additionally, although none have been produced to date, the color red is theoretically possible to grow. To date, the Company has focused its development, manufacturing and distribution efforts on the colorless form of moissanite.

It is generally accepted that, in addition to carat size, the most important characteristics of a gemstone are its beauty, durability and rarity. The beauty of gemstones is determined by the stone's color, brilliance,

"fire" and luster. The brilliance of a gemstone is measured by its refractive index or the extent to which it reflects light. The "fire" of a gemstone, or the breaking of light rays into the spectrum of colors, is measured by its dispersion. Luster is the amount of light that is reflected back to the observer from the surface of the gemstone. The durability of a gemstone is determined by the gem's hardness, or resistance to scratching, and its toughness, or resistance to chipping or cleaving. The gemstone's hardness also determines the extent to which brilliance and "fire" can be highlighted by cutting with sharp, highly polished facets. Rarity is the availability or perceived availability of a gemstone.

Based on their physical properties, the Company believes that moissanite gemstones compare favorably to diamond, ruby, emerald and other fine gemstones for beauty and durability. The refractive index and dispersion of moissanite gemstones are higher than other fine gemstones. The Company believes that the hardness of moissanite gemstones is greater than all known gemstone materials except diamond. As a result, the Company believes that moissanite gemstones, like diamond, can be cut with sharp, highly polished facets that accentuate their brilliance and "fire." The cutting specifications for moissanite gemstones are designed to maximize the brilliance and fire inherent in the material. Additionally, the Company evaluates the finished stones to exacting standards with automated video-imaging equipment and specially trained quality control personnel. In light of the very rare natural occurrence of moissanite and the proprietary and technical limitations in producing gem quality moissanite, the Company believes that moissanite is among the rarer gemstones.

The Company believes that other physical properties of moissanite gemstones compare favorably to diamond and other fine gemstones and will aid in jewelers' acceptance of its products. Moissanite gemstones, like diamond, can withstand high temperatures which allows jewelers to make extensive repairs to the jewelry setting without removing the stone and to use the same basic methods that are used to repair diamond jewelry.

The following table compares the physical properties of moissanite gemstones with other fine gemstone materials:

Gemstone Material Comparison (1)

Gemstone Material -----	Hardness (Mohs Scale) (2) -----	Toughness -----	Refractive Index -----	Dispersion -----	Specific Gravity -----
Diamond	10	Good*	2.42	.044	3.52
Lab Created Moissanite (3)	9.25-9.50	Excellent	2.65-2.69	.090-.104	3.14-3.22
Sapphire & Ruby	9	Excellent	1.76-1.78	.018	3.90-4.00
Emerald	7.5	Poor to Good	1.56-1.60	.014	2.69-2.75

* In cleavage directions, otherwise excellent.

1. Sources: Gemological Institute Of America, Gem Reference Guide For The GIA Colored Stones, Gem Identification And Colored Stone Grading Courses 32-35, 65-82, 87-90 (1995); Cornelius S. Hurlburt, Jr. & Robert C. Kammerling, Gemology 320-324 (2d Ed. 1991); Kirk-Othmer Encyclopedia Of Chemical Technology 891-906 (4th Ed. 1994); Institution Of Electrical Engineers, Properties Of Silicon Carbide (Gary L. Harris, Ed., 1995); Robert Webster, Gems: Their Sources, Descriptions and Identification 889-940 (5th Ed. 1994); W. Von Muench, "Silicon Carbide" in Landolt-Boemstein Numerical Data and Functional Relationships in Science and Technology, New Series, Group III, Vol. 17C, pp. 403-416 and 585-592 (M. Schultz And H. Weiss, Eds., 1984); Kurt Nassau, Shane F. McClure, Shane Elen & James E. Shigley, "Synthetic Moissanite: A New Diamond Substitute" in Gems & Gemology, Winter 1997, 260-275.

2. The Mohs Scale is approximately logarithmic and quantitative comparisons of different gemstone materials cannot be made directly using the Mohs Scale. Moissanite gemstones are approximately 1/2 to 1/3rd as hard as diamond.
3. With the exception of the "Synthetic Moissanite: A New Diamond Substitute" article, the physical properties of moissanite gemstones set forth in the preceding table utilized materials from SiC crystals produced by parties other than the Company or Cree. These crystals had various sizes, colors and atomic structures that the Company believes made them unsuitable for use as a gemstone. The Company has conducted tests on the hardness, toughness and refractive index of samples of its gemstones, and the results of these tests are consistent with the results reported in this table. Because the Company, through development programs with Cree, continues to work toward improved quality of SiC crystals, the specific properties of the moissanite gemstones that will eventually be commercialized are not now known. However, the Company believes that the physical properties of its moissanite gemstones will fall within the ranges of the moissanite shown in this table.

PRODUCTS AND PRODUCT DEVELOPMENT

MOISSANITE GEMSTONES. The Company currently sells primarily colorless moissanite gemstones cut in the round brilliant shape in sizes ranging from 3 to 9mm (approximately .09 to 2.3 carats) to authorized domestic retail jewelers and exclusive international distributors. The Company also has available for sale to its authorized retail customers a limited number of pieces of custom designed jewelry featuring moissanite gemstones. The Company offers this jewelry as a result of customer demand and to explore other means of distributing moissanite gemstones. For the foreseeable future, the Company plans to continue to sell loose round brilliant cut moissanite gemstones primarily in sizes of two carats or less. Demand for larger size stones in the one to two carat range currently exceeds supply. Over time, the Company intends to market a greater percentage of larger carat gemstones depending on progress made by Cree in improving yields. In 1999, the Company began distribution of a limited quantity of green moissanite gemstones to evaluate the market potential of colored moissanite. In addition, the Company may elect to offer, from time to time, additional cuts or colors of moissanite gemstones.

AMENDED AND RESTATED EXCLUSIVE SUPPLY AGREEMENT WITH CREE. On June 6, 1997, the Company and Cree entered into the Amended and Restated Exclusive Supply Agreement (Exclusive Supply Agreement) whereby the Company has agreed to purchase from Cree at least fifty percent (50%), by dollar volume, of the Company's requirements for SiC crystals for the production of gemstones in each calendar quarter during the term of the Agreement, and Cree is obligated to supply this amount of crystals to the Company. Although the Company is obligated to purchase only fifty percent (50%) of its requirements from Cree, the Company does not believe there are currently any other alternative sources of supply for SiC crystals suitable for gemstones. Therefore, at the present time, the Company is dependent on Cree as its sole source of supply of lab-grown SiC crystals. The price for SiC crystals is set at Cree's loaded manufacturing cost plus a margin, which margin may increase if the price of crystals declines below a specified amount. Through June 30, 1999 the Company has agreed to purchase all crystals produced by existing crystal growers and the Company and Cree have agreed that the price paid to Cree for SiC crystals will be based upon a sliding scale depending on the quality of each crystal received. Under the Exclusive Supply Agreement, Cree has agreed not to sell SiC crystals for gemstone applications to anyone other than the Company.

Under the terms of the Exclusive Supply Agreement, when C3's orders for SiC crystals exceeds the capacity of the existing crystal growth systems, Cree may, at its sole discretion, elect to have the Company purchase the additional growth systems that will be needed or to fund the cost of the systems on its own and recoup its costs by incorporating the costs of the additional systems into the cost of the SiC crystals purchased by the Company. If the Company funds the costs of the crystal growth systems, Cree must supply the Company with one hundred percent (100%) of the output from these systems,

unless Cree gives notice of certain production time available in excess of the Company's then-current demand and C3 does not demonstrate a need for the excess production capacity, in which case Cree may sell SiC crystals produced by these systems to any of its other customers for any use other than gemstone applications. The title to these crystal growth systems passes to Cree once they are fully depreciated by C3. If Cree elects to fund the cost of additional growth systems on its own, there can be no assurance that Cree will supply the Company with all of the output from these crystal growth systems or fill all of the Company's orders, however it will be obligated to use the capacity to supply the quantities that the Company is required to purchase from Cree. Additionally, when new crystal growth systems are added, the Company must commit to purchase all of the output of the new systems for at least six months. Any delay or reduction in the availability of SiC crystals could delay or limit the Company's ability to deliver and sell its gemstones, which would have a material adverse effect on the Company. See "Business Risks - Reliance on Cree Research, Inc."

In May 1998 the Company ordered quantities of SiC crystals exceeding the capacity of the existing crystal growth systems. Cree elected to have the Company purchase \$3.4 million of additional crystal growers. The first of these crystal growers became operational in August 1998 with all the ordered growers on-line by December 1998. The Company funded this purchase on a monthly basis as the systems were manufactured.

The Exclusive Supply Agreement also restricts the Company from entering into numerous types of arrangements with identified parties. See "--Distribution, Marketing and Sales" and "Business Risks--Anti-Takeover and Certain Other Provisions." The Exclusive Supply Agreement has an initial term through June 2005, which may be extended for an additional ten years by either party if the Company orders in any 36-month period SiC crystals with an aggregate purchase price in excess of \$1.0 million. The Company has met this order threshold and expects to extend the term of the Agreement.

AMENDED AND RESTATED DEVELOPMENT AGREEMENT WITH CREE. On July 1, 1998, the Company entered into an Amended and Restated Development Agreement (Development Agreement) with Cree, which is focused on increasing the yield of usable material in each SiC crystal manufactured by Cree for use by C3 in the production of moissanite gemstones. In June 1998 Cree demonstrated its ability to meet the definition of a "repeatable process" for 2-inch diameter crystals and began to produce 2-inch crystals using that process. The Development Agreement establishes performance milestones, primarily focused on yield improvement, 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. The 4-year Development Agreement replaces the June 1997 Development Agreement and the 1998 Supplemental Development Agreement between the parties and requires the Company to fund the program at \$2.88 million annually. Either party may terminate the Agreement if Cree does not meet the annual performance milestones or if the Company and Cree do not mutually agree on the performance milestones for the ensuing year. The Company expensed \$3.1 million, \$1.7 million and \$0.2 million under development arrangements with Cree in 1998, 1997 and 1996 respectively.

In addition, on October 20, 1998, Cree achieved the first milestone for 3-inch diameter crystals under the Development Agreement 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 yield of useable material. Future activities under the development program will be focused on moving this initial achievement to a repeatable process with continued efforts to maximize the crystal quality.

MOISSANITE/DIAMOND TEST INSTRUMENT. Gemstone test instruments most commonly used by jewelry industry employees rely on thermal properties to distinguish diamond from other gemstones or diamond simulants such as synthetic cubic zirconia. Because the thermal properties of moissanite gemstones are relatively close to those of diamond, such instruments have not, to date, been able to reliably differentiate between diamond and moissanite gemstones. Although gemologists trained in the physical properties of moissanite gemstones may find a number of ways to distinguish moissanite from diamond, the Company believes that a moissanite/diamond test instrument must be available to jewelers and pawnbrokers to help prevent fraud.

The Company began shipping its moissanite/diamond test instrument, the Tester Model 590, during the first quarter of 1998. This instrument, which distinguishes moissanite gemstones from diamonds in the colors and clarities most commonly sold by retail jewelers, is used in conjunction with existing thermal test instruments. A number of other companies have introduced devices that claim to distinguish moissanite gemstones from diamonds at retail prices substantially lower than the Tester Model 590. There can be no assurance that a significant market will develop for the Company's test instrument, that other competing devices will not be introduced or that other readily available means will not be developed which can effectively distinguish moissanite gemstones from diamond.

MOISSANITE/DIAMOND TEST INSTRUMENT COMPONENT. Under a letter agreement (Instrument Agreement) dated February 12, 1996, Cree is the sole supplier of a component proprietary to Cree used in the Company's Tester Model 590. The Instrument Agreement, which expires in 2016, obligates the Company to purchase all of its requirements for that component from Cree and gives the Company the exclusive right to purchase those components from Cree. The Company is also obligated to pay Cree a royalty of two and one-half percent (2 1/2%) of net sales of all test instruments incorporating the Cree component. Although to date Cree has supplied a sufficient quantity of this component, if Cree were to fail to deliver this component, as required, the Company would not be able to manufacture additional test instruments.

INTELLECTUAL PROPERTY

INTELLECTUAL PROPERTY OF THE COMPANY. The Company has been issued U.S. product and method patents for moissanite gemstones, which expire in 2015, under which the Company has broad, exclusive rights to manufacture, use and sell moissanite gemstones in the United States. The Company has applications pending in a number of foreign jurisdictions for these same patents. In addition, the Company has been issued a U.S. apparatus and method patent for the Tester Model 590, which expires in 2016, that covers the physical structure and the testing techniques so employed in the Tester Model 590. This patent gives the Company exclusive rights to manufacture and sell the Tester Model 590 in the United States. The Company also has patent applications pending related to certain methods of producing moissanite gemstones and related technologies. Although the Company intends to enforce its patent rights and vigorously prosecute all its patent applications, there can be no assurance that such actions will be successful, that any additional patents will be issued, that any issued patent will not be challenged, invalidated or circumvented or that any issued patent will have any competitive or commercial value.

The Company's success and ability to compete successfully is heavily dependent upon its proprietary technology. In addition to its patents and pending patents, the Company relies on trade secret laws and employee, consultant and customer confidentiality agreements to protect certain aspects of its technology. There can be no assurance that the Company will be able to protect its proprietary technology from disclosure or that others will not develop technologies that are similar or superior to its technology. See "Business Risks -- Dependence on Intellectual Property."

While the Company has not received any claims that its products or processes infringe on the proprietary rights of third parties, there can be no assurance that third parties will not assert such claims against the Company with respect to its existing and future products. In the event of litigation to determine the validity of any third party's claims, such litigation could result in significant expense to the Company and divert the efforts of the Company's technical and management personnel, whether or not such litigation is determined in favor of the Company. In the event of an adverse result of any such litigation, the Company could be required to expend significant resources to develop non-infringing technology or to obtain licenses to, and pay royalties on the use of, the technology which is the subject of the litigation. There can be no assurance that the Company would be successful in such development or that any such license would be available on commercially reasonable terms.

PROPRIETARY TECHNOLOGY OF CREE. Cree, the Company's current source for development and supply of lab-grown SiC crystals, has developed or licensed numerous proprietary processes for the growth of SiC crystals that it uses in semiconductor, laser and other applications. The founders of the Company recognized the potential use of SiC as a gemstone, and the Company has obtained the exclusive right to purchase SiC crystals from Cree for gemstones and gemological instrumentation. The Company believes that Cree is currently the only producer of SiC crystals in sizes and qualities suitable for commercial production of gemstones. In addition, Cree is the only producer of SiC known by the Company to be developing colorless SiC crystals suitable for gemstone use at the present time. Cree has significant proprietary rights related to its processes for growing SiC crystals. Cree has an exclusive license on a patent for a process of growing large single crystals of SiC. This patent expires in years ranging from 2006 to 2011, depending on the country in which issued. In addition, Cree has a patent for a process for growing colorless SiC and other patents relating to certain aspects of its SiC crystal growth process. To further protect its proprietary SiC crystal growth process, Cree internally produces the crystal growth systems used to produce its SiC crystals. The Company has a royalty-free, perpetual license for the use in gemstone applications of the technology covered by Cree's patent for growing colorless SiC.

At the present time, the Company's success and ability to compete is heavily dependent upon Cree's ability to successfully complete the objectives of the Development Agreement and on Cree's proprietary technology. See "Business Risks--Dependence on Intellectual Property."

MANUFACTURING

The production of moissanite gemstones includes (i) growing SiC crystals, (ii) cutting crystals into preforms that will yield gemstones of an approximate carat weight and millimeter size, (iii) faceting preforms into gemstones, and (iv) inspecting, sorting and grading faceted gemstones.

GROWTH OF SiC CRYSTALS. SiC crystals are grown for the Company by Cree in accordance with the terms of the Exclusive Supply Agreement. Under the Exclusive Supply Agreement, Cree is required to sell to the Company all of the crystals grown in a specified number of crystal growth systems without charging the Company for such crystal growth systems and all the crystals grown in the new crystal growth systems acquired by the Company from Cree during 1998, unless Cree gives notice of certain production time available in excess of the Company's then-current demand and the Company does not demonstrate a need for the excess production capacity, in which case Cree may sell SiC crystals produced by these systems to any of its other customers for any use other than gemstone applications. Upon its receipt of an order from the Company for a quantity of crystals that will require the acquisition of additional crystal growth systems, Cree may elect, in its sole discretion, to have the Company purchase the additional growth systems that will be needed or to fund the costs on its own and recoup its costs by incorporating the costs of the systems into the cost of the SiC crystals purchased by the Company. See "--Products and Product Development - Amended and Restated Exclusive Supply Agreement with Cree."

The Company routinely evaluates Cree's progress under the Development Agreement and the yield of salable gemstones from SiC crystals being produced by Cree to determine when to place additional orders with Cree that will require the acquisition of crystal growth systems. The yield of salable gemstones from each crystal is the most significant factor affecting the volume and cost of gemstones available for sale and, therefore, is a key driver in the Company's consideration of placing orders for additional crystals. Yield of salable gemstones is dependent on the quality of the crystals. Improvements in crystal quality increase the volume, or yield, of gemstones from a crystal and decrease the cost of each gemstone produced. The yields of salable gemstones increased during the first half of 1998 as Cree announced the repeatable process for two-inch diameter crystals, and the Company expected yields to continue to improve throughout the year. Yields from the highest quality crystals did improve in the fourth quarter of 1998, however, on average, net yields remained constant during the second half of the year. This effect resulted largely from the Company cutting the highly demanded larger stones that require higher quality crystals. Continued significant improvements in the quality of SiC crystals and the resulting higher yield of salable gemstones of all sizes are required for the Company to achieve its profitability goal. The Company intends to order quantities of SiC crystals in amounts that would require the purchase of additional growth systems as, on average, net yields of salable gemstones improve. There can be no assurance that Cree will achieve the required yield improvements or that, if achieved, the yield improvements will occur as rapidly as demand increases. Additionally, once appropriate improvements in crystal yield are achieved, the Company may be unable to rapidly increase its production of moissanite gemstones to satisfy the demand as a result of the several months that may elapse between the Company placing an order for crystals and the time that additional growth systems needed could begin producing crystals. See "Business Risks--Reliance on Cree Research, Inc."

PREFORMS. The Company divides all SiC crystals through slicing and dicing processes into preforms in sizes suitable for faceting into predetermined calibrated-size gemstones. The Company uses readily available automated and computerized equipment utilized in the semiconductor industry along with proprietary technology developed in-house to slice and dice crystals into preforms. The Company believes that this equipment will enable it to maximize the number of preforms obtained from each SiC crystal.

FACETING GEMSTONES. The faceting of preforms is a critical stage in obtaining quality gemstones. The techniques and skills used in faceting moissanite gemstones differ somewhat from those used in faceting diamonds and other gemstones. The Company is, and expects to continue, outsourcing the faceting of its moissanite gemstones, other than faceting for research and product development purposes which it conducts internally. The Company currently has two suppliers of volume faceting services which are located in Asia. To date the Company has been satisfied with the capabilities and performance of these two suppliers. The Company has identified three additional suppliers of faceting services in Asia, has qualified their faceting skills on a sample basis and is currently assessing these other vendors' production capabilities. There is, however, no assurance that these vendors will be suitable for reliable supply arrangements or that the Company will be able to enter into agreements with these additional vendors or with other reliable, quality faceting providers on terms acceptable to the Company. Even if these agreements can be reached, the Company intends during some or all of 1999 to source faceting services primarily from its two existing suppliers and will be dependent on their ability to provide an adequate quantity of quality faceted moissanite gemstones. There is no assurance that they will be able to expand and continue to produce the Company's quality specifications for faceting and within the Company's quantity and time requirements.

The Company has entered into a multi-year agreement with its primary supplier of faceting services, John M. Bachman, Inc. (JMB). Pursuant to this agreement and related amendments thereto, the Company has

advanced \$180,000 to JMB to expand the production facilities of its affiliate which facets the Company's moissanite gemstone preforms. These funds are being repaid through reductions to the per piece cutting charges through approximately December 31, 1999. The Company has 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 term of the Company's agreement with JMB is through December 31, 2000; however, the Company has the right to terminate the agreement at any time after January 1, 2000 upon 90 days written notice. Under this agreement, JMB has agreed to grant, and to cause its affiliates to grant, to the Company a perpetual, non-exclusive, royalty-free license to use any inventions or proprietary information developed by or for JMB or its affiliates that is useful in the faceting of moissanite gemstones.

INSPECTION, SORTING AND GRADING. Faceted moissanite gemstones are currently returned to the Company for inspection, sorting and grading. During this stage, specially trained personnel individually examine and grade each moissanite gemstone against certain quality parameters. This phase of manufacturing is relatively labor-intensive and requires skills not readily available in the general work force. In the future, the Company may elect to outsource certain portions of this stage of the manufacturing process to an independent third party. Any third parties to which these processes are outsourced will be required to adhere to the same rigorous quality control and monitoring standards presently used at the Company. There can be no assurance that the Company will be able to hire or retain sufficient numbers of appropriately skilled personnel for this phase of manufacturing, find and enter into acceptable agreements with third party vendors or that such vendors will be able to provide accurate inspection, sorting and grading services on a timely basis.

MOISSANITE/DIAMOND TEST INSTRUMENT. The Company has contracted with an unaffiliated third party for the assembly of its moissanite/diamond test instrument from components produced by third parties. The Company believes that, other than with respect to a component containing a proprietary semiconductor chip that the Company obtains from Cree under the Instrument Agreement, the components and assembly functions would be readily available from a wide variety of other suppliers.

DISTRIBUTION, MARKETING AND SALES

The Company has entered into agreements with 139 independent retail jewelry stores primarily in the initial launch area of the Southeastern United States. The Company began shipping moissanite to its authorized retail jewelers 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 second half of 1998 the Company expanded the number of authorized retailers in the southeastern states of North Carolina, South Carolina, Georgia and Florida. In addition, the Company continued limited distribution and promotional activities in domestic locations outside this region.

The Company has also entered into 17 international agreements for distribution of moissanite gemstones in 23 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. Sales under these agreements aggregated approximately \$1.4 million during calendar 1998. All sales to international customers are denominated in U.S. dollars and the Company requires full payment before the merchandise is shipped.

The Company intends to continue to distribute moissanite gemstones in the U.S. through independent retail jewelry stores. The Company has targeted the United States because it believes that the United States represents a significant portion of the worldwide jewelry market and will be relatively accepting of a new gemstone that compares favorably to fine gemstones like diamond, ruby and emerald. The

Company continues to interview certain independent retail jewelry stores in its target markets and will seek to enter into agreements with retailers in these areas during the remainder of 1999. The Company currently grants selected retailers the right to be the exclusive retail store selling moissanite gemstones in a limited geographic territory. The Company sells its products to its authorized retail jewelers with terms requiring payment within 30 days. The Company continues to evaluate the most appropriate structure for exclusive retailing arrangements in the U.S. and may, in certain circumstances, enter into other types of arrangements.

The Company believes that exclusive distribution agreements will provide retailers with an opportunity to earn a profit margin that compares favorably to other jewelry products and will allow the retailer to distinguish its product line from other jewelers in the highly competitive retail jewelry market. The Company also believes that the profit margins associated with its products will create incentives for these retailers to maximize their sales and promotional efforts, resulting in additional consumer demand for the Company's moissanite gemstones. As the Company's supply of moissanite gemstones increases, the Company plans to increase the number of markets in which its products are available. The Company's sales staff divides its time between providing sales support to its existing network of retailers and entering new target markets and new arrangements.

The Company believes that marketing loose stones will allow its authorized retail jewelers to individually select the most appropriate jewelry settings for their individual market areas. The sale of round brilliant cut stones also provides the jeweler with a wide range of uses for the stones in rings, earrings, pendants and bracelets. When evaluating potential independent retailers, the Company reviews, among other criteria, the design and the quality of the materials and workmanship of the jewelry products offered by the retailer. Consumer perception and acceptance of the Company's products will be directly impacted by the quality, design and workmanship of the settings chosen by the retailers, however, the Company will have no control over these individual decisions.

The Company has positioned moissanite as a new gemstone, highlighting its beauty and other unique physical properties, to consumers and the jewelry industry. Market research indicates that this positioning will create the highest possible image for the product and provide the Company with the greatest pricing and marketing flexibility. Agreements with authorized retail jewelers and exclusive international distributors require that they sell moissanite as a lab-created product. In addition they agree to represent moissanite as a unique new gemstone in a very favorable and positive manner.

Domestically, marketing and advertising activities to date have consisted of "market launch" activities and cooperative advertising programs with the Company's exclusive retailers. As the Company develops a significant base of exclusive retailers in targeted areas, "market launches" are held. These market launches consist of focused local advertising efforts including newspaper, magazine and radio advertisements as well as direct mailings to the existing customer bases of the Company's exclusive retailers. The advertising efforts are supplemented by extensive public relations activities including in-store events with on-site local radio promotions and product give-aways during local radio shows. Additionally, the Company has contracted with the actress, Hunter Tylo, to make personal appearances at certain market launches. Expansion of current localized marketing and advertising activities on a nationwide basis will be dependent on the Company having sufficient quantities of moissanite gemstones in the quantities and sizes necessary to satisfy demand. Under its cooperative advertising programs, the Company reimburses its exclusive retailers for a portion of their moissanite specific advertising, up to predetermined spending limits.

Internationally, the Company works with its exclusive distributors to develop appropriate advertising and

marketing campaigns for the local marketplace, building on the marketing themes developed in the US. However, the exclusive distributors are responsible for all advertising and marketing efforts and expenses in their territories.

The Company is selling its moissanite/diamond test instrument directly to jewelers, gemologists and pawnbrokers through direct mailings, advertisements in trade publications and at trade shows. In addition, the Company has retained non-exclusive distributors to distribute the test instrument in some U.S. markets and through exclusive distribution agreements in certain territories internationally. The Company may enter into other distribution agreements, as it deems appropriate.

The Exclusive Supply Agreement prohibits the Company, without Cree's consent, from entering into an exclusive marketing or distribution agreement with DeBeers or any party that Cree reasonably believes is affiliated with DeBeers; the Central Selling Organization (the international cartel of diamond producers); any party whose primary business is the development, manufacture, marketing or sale of diamond gemstones; or any non-gemstone and non-jewelry industry competitor of Cree. These provisions may limit the avenues of distribution potentially available to the Company and could prevent the Company from entering into certain potentially profitable transactions.

COMPETITION

MOISSANITE GEMSTONES. Competition in the marketplace for gemstones is intense. Gemstone materials can be grouped into three types: (i) natural gemstone, which is found in nature; (ii) synthetic gemstone, which has the same chemical composition and characteristics of natural gemstone but is created in a lab; and (iii) simulated or substitute material, which is similar in appearance to natural gemstone but does not have the same chemical composition. The Company's moissanite gemstones, which are positioned as a unique new gemstone, may compete with fine gemstones such as ruby, sapphire, emerald and tanzanite as well as with natural and treated diamonds and existing synthetic gemstones such as synthetic cubic zirconia presently in commercial distribution. The Company may also face competition from additional gemstones such as synthetic diamonds, synthetic diamond films and other sources of synthetic moissanite not presently available in quantities, sizes and volumes suitable for use as gemstones. Most of the suppliers of diamonds and other fine gemstones, as well as the suppliers of synthetic gemstones, have substantially greater financial, technical, manufacturing and marketing resources and greater access to distribution channels than the Company.

The worldwide market for large, uncut high-quality diamonds is significantly consolidated through the Central Selling Organization, a cartel led by DeBeers. The cartel has a major impact on the worldwide supply and pricing of these diamonds at both the wholesale and retail levels. Although the Company believes that its gemstones will appeal primarily to the consumer who would not otherwise purchase comparable diamond jewelry, diamond producers may undertake additional marketing or other activities designed to protect the diamond jewelry market against sales erosion from consumer acceptance of moissanite gemstones.

The Company may also face competition from treated diamonds. Treated diamonds, which are natural diamonds with imperfections or flaws that have been altered in some manner to enhance their appearance, are presently available in the jewelry industry and are generally less expensive than diamonds of similar size, cut and color which have not been altered. Synthetic diamond in gemstones or film form may also become available in the marketplace and compete with the Company's gemstones. Synthetic diamonds are regularly produced for industrial applications, but the Company believes that gemstone quality synthetic diamonds presently cannot be produced at prices competitive with those currently offered for the Company's colorless moissanite gemstones. The primary producers of these

synthetic diamonds are DeBeers, Sumitomo and GE. There are also a number of Russian producers of synthetic diamonds for industrial uses. Synthetic diamond films can be grown at commercially viable prices in thicknesses that can be applied to other surfaces but these films adhere well to only a few minerals such as diamond, silicon and SiC (moissanite). There could, however, be technological advances that would enable competitively priced synthetic diamond in gemstone or film form to be offered.

Although the Company believes that its products have a proprietary position, it could face competition from other companies who develop competing SiC technologies. Some of these technologies could be spawned by producers of SiC used for other industrial applications. Manufacturers of industrial SiC products include The Carborundum Corporation, for abrasive uses, and Cree, Siemens AG, ABB and Northrup Grumman Corporation, for semiconductor uses. The Company believes that Cree is presently the only supplier of SiC crystals in colors, sizes and volumes suitable for gemstone applications and believes that the patents owned or pending by Cree or the Company provide substantial technological, legal and cost barriers to other companies' development of colorless moissanite gemstones. It is possible, however, that these or other producers of SiC could develop SiC crystals suitable for gemstone applications and produce moissanite gemstones until the Company could obtain judicial enforcement of its patent rights.

The Company's products may also face competition from synthetic cubic zirconia, the principal existing diamond simulant and, to a lesser degree, other synthetic gemstones. Two of the largest producers of synthetic cubic zirconia gemstones are D. Swarovski & Co. and Golay Buchel. In addition, there are a significant number of other producers of jewelry containing synthetic gemstones. Three of the largest retailers of synthetic cubic zirconia jewelry in the United States are QVC, Home Shopping Network and Wal-Mart. Some of the major retailers of synthetic cubic zirconia, including QVC, have captive manufacturing divisions that produce synthetic cubic zirconia jewelry. These producers and sellers may see their markets being eroded by the introduction of the Company's moissanite gemstones. The Company believes that price is the primary basis upon which these products will compete with its moissanite gemstones.

The Company intends to compete primarily on the basis that the unique qualities of its moissanite gemstones compare favorably to diamond, ruby, emerald and other fine gemstones at a significant cost advantage, especially in the one carat size and larger. Its ability to compete successfully is dependent on its ability to: (i) achieve jeweler and consumer acceptance of its products; (ii) obtain quantities of lab-grown SiC crystals in acceptable qualities and prices; (iii) obtain reliable and high quality faceting services from third parties; (iv) respond to market entries of other gemstone materials with technological or cost improvements; and (v) meet consumer demand for its moissanite gemstones. There can be no assurance that the Company will be able to obtain the materials and services needed to deliver its products or to otherwise be able to compete successfully in the marketplace.

MOISSANITE/DIAMOND TEST INSTRUMENT. The Company's proprietary, patented moissanite/diamond test instrument, the Tester Model 590, faces competition from other devices that distinguish moissanite gemstones from diamond. The Tester Model 590, working in conjunction with existing thermal test instruments, readily distinguishes loose moissanite gemstones and moissanite gemstones set in jewelry from diamond in the colors and clarities most often sold by jewelers. The Presidium Corporation has recently begun to market a test instrument that is capable of distinguishing primarily loose moissanite gemstones from diamond. The Ceres and Moissketeer Corporations have released electrical conductivity measuring devices that they claim are capable of distinguishing moissanite from diamond. Another company has introduced a reflectivity meter that is capable of distinguishing primarily large loose moissanite gemstones from diamond, however, while the Company does not plan to sell such moissanite

gemstones, a certain process can permanently change the refractive index of moissanite such that moissanite would measure as a diamond on such reflectivity meters. Other competitors may also introduce devices that compete with the Company's Tester Model 590 or gemologists trained in the physical properties of moissanite gemstones may develop less expensive methods of distinguishing moissanite gemstones from diamond. There can be no assurance that a market for moissanite/diamond test instruments will develop or that the Company will be able to successfully compete in that market, if it develops.

GOVERNMENT REGULATION

The Company's products are subject to regulation by the Federal Trade Commission (FTC). The FTC has issued regulations and guidelines governing the marketing of synthetic gemstones and other gemstones that have physical properties similar to diamond that require synthetic gemstones and other gemstones to be clearly identified in any promotional or marketing materials. While the Company intends to comply fully with all FTC regulations, there can be no assurance that the FTC or a competitor will not challenge the Company's promotional or marketing activities. Such a challenge could result in significant expense to the Company and divert the efforts of the Company's management, whether or not such challenge is resolved in favor of the Company. If the Company's actions were found to be in violation of FTC regulations, the Company could be forced to suspend marketing and sales of its products and could incur significant expenses in developing new marketing strategies and materials that would not violate FTC regulations. There can be no assurance that the Company would be successful in developing new marketing strategies and materials that would comply with FTC regulations or that such strategies, once developed, would allow the Company to market its products profitably.

EMPLOYEES

At February 28, 1999, the Company had 49 employees. The Company believes that its future prospects will depend, in part, on its ability to obtain additional management, marketing, sales, manufacturing, scientific and technical personnel. Competition for such personnel is intense, and the number of persons with relevant experience is limited. None of the Company's employees is represented by a labor union. The Company believes that its employee relations are good.

BACKLOG

At February 28, 1999, the Company had orders for moissanite gemstones and jewelry which are anticipated to result in approximately \$130,000 of revenue.

BUSINESS RISKS

In addition to the other information in this Form 10-K, readers should carefully consider the following important factors that in some cases have affected, and in the future could affect, the Company's actual performance and results and could cause the Company's actual results of operations to differ materially from those expressed in any of the forward-looking statements made by, or on behalf of, the Company.

LIMITED RELEVANT OPERATING HISTORY

The Company, which was incorporated in June 1995, was in the development stage through June 30, 1998. The Company is now in the early stages of commercializing moissanite gemstones and building its distribution channels. The timing or existence of any significant revenues is dependent on continued

improvements in the yield of gemstones in the qualities, sizes and volumes desired from each SiC crystal and on market acceptance of moissanite gemstones. The Company's business is also subject to the risks inherent in the rapid increase in production levels. Likewise, the Company's products are subject to the risks inherent in the development and marketing of new products, including unforeseen design, manufacturing or other problems or failure to develop market acceptance. Failure by the Company to continue to develop the ability to produce its products in higher quantities and qualities would have a material adverse effect on the Company's business, operating results and financial condition. Accordingly, the Company's prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in their early stage of development, particularly technology-based companies operating in the early stages of manufacturing unproven products.

NEED FOR FURTHER PRODUCT DEVELOPMENT

Although the Company is selling initial production volumes of colorless moissanite gemstones and Cree, the Company's current supplier of SiC crystals, achieved a fully repeatable process in June 1998 for two-inch crystals, Cree has not yet established a manufacturing process for producing lab-grown SiC crystals in the qualities, sizes and volumes desired for the Company's products. If Cree is unable to improve crystal yields and develop a manufacturing process for growing SiC crystals in the desired qualities, sizes and volumes, the Company's business, operating results and financial condition would be materially adversely affected.

RELIANCE ON CREE RESEARCH, INC.

The Company is currently dependent on a single source, Cree, for development and supply of SiC crystals. Cree has certain proprietary rights relating to its process for growing large single crystals of SiC and its process for growing colorless SiC crystals. Under the Company's Exclusive Supply Agreement with Cree, the Company is obligated to buy from Cree, and Cree is obligated to sell to the Company, fifty percent (50%), by dollar volume, of the Company's requirements for SiC material for the production of gemstones in each calendar quarter. Although the Company is only required to purchase fifty percent (50%) of its SiC requirements from Cree, the Company does not currently believe that any other SiC producer could readily supply crystals in the qualities, sizes and volumes needed for the Company's products. Therefore, at the present time, the Company is dependent on Cree as its sole source for its principal raw material.

The Company's effort to develop colorless SiC crystals in qualities, sizes and volumes desired for use as gemstones is currently concentrated entirely with Cree and is dependent on Cree's expertise in SiC technology which Cree uses in connection with semiconductor, laser and other applications. A primary focus of the development programs with Cree has been to improve the yield of salable gemstones from each SiC crystal that the Company purchases from Cree. The yield of salable gemstones from each crystal is the most significant factor affecting the volume and cost of gemstones available for sale and is dependent on the quality of the crystals. Improvements in crystal quality increase the volume, or yield of gemstones from a crystal, and decrease the cost of each gemstone produced. The yields of salable gemstones increased during the first half of 1998 as Cree announced the repeatable process for two-inch diameter crystals and the Company expected yields to continue to improve throughout the year. Yields from the highest quality crystals did improve in the fourth quarter of 1998, however on average, net yields remained constant resulting largely from the Company cutting the highly demanded larger stones that require higher quality SiC crystals. To reach profitability the Company must receive increasingly higher quality SiC crystals from Cree that yield more salable gemstones. The Company intends to order quantities of SiC crystals that would require the purchase of additional growth systems as, on average, net yields of salable gemstones improve. Any delay in achieving higher quality crystals or any decline in average crystal quality could limit the Company's ability to expand distribution of its products and increase the cost of goods sold which would have a material adverse effect on the Company's business, operating results and financial condition. See "Business--Products and Product Development."

When the Company does elect to order quantities of crystals that would require additional crystal growth systems, Cree may, under the Exclusive Supply Agreement, elect to have the Company purchase the additional crystal growth systems that will be needed, and Cree would be obligated to supply the Company with one hundred percent (100%) of the output from systems funded by the Company. If, however, Cree elects to fund the cost of these additional growth systems on its own, then there can be no assurance that Cree will supply the Company with all of the output from these crystal growth systems or fill all of the Company's orders for SiC crystals. Any delay or reduction in the availability of SiC

crystals could delay or limit the Company's ability to deliver and sell its gemstones, which would have a material adverse effect on the Company's business, operating results and financial condition.

The Company also obtains from Cree a component proprietary to Cree used in the production of the Company's moissanite/diamond test instrument. See "Business--Products and Product Development--Moissanite/Diamond Test Instrument." If Cree were unable to deliver this component in the quantities and at the times needed by the Company, the Company's ability to provide the market with its test instrument would be adversely affected.

As a result of the Company's reliance on Cree, Cree's failure to complete the desired development objectives under the Development Agreement and to supply the Company with SiC crystals or components for its moissanite/diamond test instrument would have a material adverse effect on the Company's business, operating results and financial condition and could result in a curtailment, suspension, cessation or significant change in the strategic direction of the Company's business. See "Business--Products and Product Development."

UNDEVELOPED MARKETS; UNPROVEN ACCEPTANCE OF THE COMPANY'S PRODUCTS

The market for colorless moissanite gemstones among retail jewelers and consumers is in the early stages of development as the Company shipped approximately 18,000 carats in 1998. The Company believes that many retail jewelers and most consumers are generally unaware of the existence and attributes of these gemstones. As is the case with any new product, market acceptance and demand are subject to a significant amount of uncertainty. The Company's future financial performance will depend upon consumer acceptance of the Company's gemstones as a unique product that rivals diamond, ruby, emerald and other fine gemstones in brilliance, fire and luster, which may be impacted by jewelers' acceptance of gemstones. The Company has conducted limited market tests to predict retail jeweler and consumer reaction to its products. Although retail jewelers typically purchase finished jewelry rather than loose gemstones, the Company plans to market loose gemstones to retailers. The retailers will then select the jewelry into which the stones will be set and will be responsible for completing the setting. The quality, design and workmanship of the jewelry settings selected by retail jewelers, which will not be within the Company's control, could impact the consumer's perception and acceptance of the Company's gemstones. Thus, the Company's future financial performance may be impacted by (i) the willingness of retail jewelers to purchase loose stones and undertake setting of the loose stones, (ii) the ability of retail jewelers to select jewelry settings that encourage consumer acceptance of and demand for the Company's gemstones (iii) the ability of retail jewelers to set loose gemstones in jewelry with high quality workmanship and (iv) the ability of retail jewelers to effectively market and sell moissanite jewelry.

The market for the Company's gemstones may develop at a slower pace than expected as a result of lack of acceptance of gemstones by retail jewelers or by consumers. If the market fails to develop or develops more slowly than expected, or if the Company's products do not achieve significant market acceptance, the Company's business, operating results and financial condition would be materially adversely affected. See "Business--Products and Product Development" and " Business--Distribution, Marketing and Sales."

LIMITED DISTRIBUTION CHANNELS

The Company began shipping moissanite to jewelry retailers in Atlanta and Miami/Ft. Lauderdale during the second quarter of 1998 and expanded sales to authorized domestic retail jewelers in other areas of the U.S. as well as through exclusive international distributors during the second half of the year. While the Company grants to selected retail jewelry stores the right to be the exclusive retailer of moissanite

gemstones in a limited geographic territory, there can be no assurance that the Company will be able to enter into additional exclusive agreements with retail jewelers or other distributors on terms acceptable to the Company or that such retail jewelers or other distributors will be successful in their efforts to market the Company's gemstones to consumers. The inability of the Company to enter into favorable arrangements with retail jewelers or other distributors or to achieve its desired distribution of its moissanite gemstones or the inability of the Company's distributors to successfully market moissanite gemstones to consumers would have a material adverse effect on the Company's business, operating results and financial condition. See "Business--Distribution, Marketing and Sales."

DEPENDENCE ON INTELLECTUAL PROPERTY

The Company has been issued U.S. product and method patents for moissanite gemstones under which the Company has broad, exclusive rights to manufacture, use and sell moissanite gemstones in the United States. The Company has applications pending in a number of foreign jurisdictions for these same patents. In addition, the Company has been issued a U.S. apparatus and method patent for the Tester Model 590 that covers the physical structure and the testing techniques so employed. This patent gives the Company exclusive rights to manufacture and sell the Tester Model 590 in the United States. The Company believes that these patents create substantial technological barriers to its potential competitors. The Company also has applications pending related to certain methods of producing moissanite gemstones and related technologies. There can be no assurance that any other patents will be granted or that any issued patent will have any commercial or competitive value.

At the present time, the Company is also dependent on Cree's technology for the production of SiC crystals. Cree is exclusively licensed to use a patent concerning a process for growing large single crystals of SiC, has certain patents of its own relating to growth of large single crystals of SiC and has a patent for a process for growing colorless SiC crystals.

There can be no assurance that any patents issued to or licensed by or to the Company or Cree will provide any significant commercial protection to the Company or Cree, that the Company or Cree will have sufficient resources to prosecute its respective patents or that any patents will be upheld by a court should the Company, Cree or Cree's licensor seek to enforce their respective rights against an infringer. The existence of valid patents does not prevent other companies from independently developing competing technologies. Existing producers of SiC or others may refine existing processes for growing SiC crystals or develop new technologies for growing large single crystals of SiC or colorless SiC crystals in a manner that does not infringe patents owned or licensed by or to the Company or Cree. In addition, existing producers of SiC, existing producers of other synthetic or natural gemstones or other parties may develop new technologies for producing moissanite gemstones in a manner that does not infringe patents owned or licensed by or to the Company or Cree.

As a result of the foregoing factors, existing and potential competitors may be able to develop products that are competitive with or superior to the Company's products, and such competition could have a material adverse effect on the Company's business, operating results and financial condition. See "Business--Competition."

DEPENDENCE ON THIRD PARTIES

In addition to its current dependence on Cree and on third party distribution channels, the Company's prospects depend upon its ability to identify, reach agreements with and work successfully with other third parties. In particular, the Company relies on third parties to facet its gemstones. Faceting moissanite gemstones requires different techniques than faceting diamond and other gemstones. There

can be no assurance that the Company can enter into additional contracts with faceting vendors on terms satisfactory to the Company or that faceting vendors will be able to provide faceting services in the quality and quantities required by the Company. In addition, the Company relies on third parties to manufacture components for and assemble its moissanite/diamond test instrument. There can be no assurance that the Company will be successful in maintaining its relationships with these component manufacturers and assemblers or that the Company will be able to find suitable replacements if the Company is unable to maintain such relationships. Failure by the Company to achieve any of the above would have a material adverse effect on the Company's business, operating results and financial condition. See "Business--Manufacturing."

COMPETITION

See "Business--Competition."

INTERNATIONAL OPERATIONS

The Company has entered into 17 international agreements for distribution of moissanite gemstones in 23 countries and various areas in the Caribbean. The Company intends to expand the number of international markets for its products. In addition, it expects to continue to use certain companies based outside the United States to facet its moissanite gemstone products. Due to the Company's reliance on development of foreign markets and use of foreign vendors, the Company is subject to the risks of conducting business outside of the United States. These risks include unexpected changes in, or impositions of, legislative or regulatory requirements, delays resulting from difficulty in obtaining export licenses, tariffs and other trade barriers and restrictions and the burdens of complying with a variety of foreign laws and other factors beyond the Company's control. Additionally, while all foreign transactions are denominated in U.S. dollars, foreign currency fluctuations could impact demand for the Company's products or the ability of the Company's foreign suppliers to continue to perform. The Company is also subject to general geopolitical risks in connection with its international operations, such as political, social and economic instability, potential hostilities and changes in diplomatic and trade or business relationships. There can be no assurance that such factors will not adversely affect the Company's operations in the future or require the Company to modify its anticipated business practices.

GOVERNMENTAL REGULATION

The Company is subject to governmental regulations in the manufacture and sale of moissanite gemstones and the moissanite/diamond test instrument. In particular, the FTC has the power to restrict the offer and sale of products that could deceive or have the tendency or effect of misleading or deceiving purchasers or prospective purchasers with regard to the type, kind, quality, character, origin or other characteristics of a diamond. The Company may be under close scrutiny both by governmental agencies and by competitors in the gemstone industry, any of which may challenge the Company's promotion and marketing of its gemstone products. If the Company's production or marketing of its lab-created gemstones is challenged by governmental agencies or competitors, or if regulations are issued that restrict the ability of the Company to produce and market its products, the Company's business, operating results and financial condition could be materially adversely affected. See "Business--Government Regulation."

IMITATION MOISSANITE

If market acceptance of the Company's products continues to grow, it is possible that low-quality gemstones or synthetics could be marketed as moissanite. The sale of low-quality products as moissanite

could damage the perception of moissanite as a unique gemstone that compares favorably to other fine gemstones like diamond, ruby and emerald. This could damage the Company's reputation among retail jewelers and consumers and result in a loss of consumer confidence in the Company's products. The introduction of low-quality imitation moissanite gemstones and the inability of the Company to limit the adverse effects thereof could have a material adverse effect on the Company's business, operating results and financial condition.

MANAGEMENT OF RAPID GROWTH

The Company has recently experienced a period of rapid and significant growth and expects such growth to continue in the future with the commercialization of moissanite gemstones. Periods of rapid growth place a significant strain on the Company's resources. The Company's ability to manage its growth effectively will require it to implement and improve operational and financial systems and to expand, train and manage its employee base. The Company also will be required to manage multiple relationships with various suppliers, customers and other third parties. The Company's future operating results will also depend on its ability to expand its sales and marketing, research and development and administrative support organizations. The Company's executive officers have no significant experience in managing rapidly growing businesses. If the Company is unable to manage growth effectively, the Company's business, financial condition and results of operations would be materially adversely affected.

DEPENDENCE UPON KEY PERSONNEL; NEED FOR ADDITIONAL PERSONNEL

The Company's success depends in part upon retaining the services of certain executive officers and other key employees. The Company has entered into employment agreements with the Company's Chief Executive Officer, Jeff N. Hunter, President and Chief Operating Officer, Robert S. Thomas, Chief Financial Officer, Mark W. Hahn, Director of Technology, Dr. Mark Kellam, and Director of Manufacturing, Earl R. Hines. The Company does not maintain "key man" life insurance policies on any of its executive officers or key employees. The loss of the services of the Company's executive officers or other key employees could have a material adverse effect on the Company's business, operating results and financial condition.

Because of the Company's early stage of development, the Company is also dependent on its ability to recruit, retain and motivate personnel with technical, manufacturing and gemological skills. There are a limited number of personnel with these qualifications and competition for such personnel is intense. The inability of the Company to attract and retain additional qualified personnel would materially adversely affect the Company's business, operating results and financial condition.

OPERATING LOSSES

Since its inception the Company has incurred net losses aggregating approximately \$12.1 million. The Company expects to incur substantial additional costs building the manufacturing capacity of its products and expanding its efforts to market and distribute such products. The Company expects to incur losses through at least some of 1999, and there can be no assurance that the Company will ever achieve profitability or, if achieved, that such profitability will be sustained. See "Selected Financial Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

POTENTIAL FOR FLUCTUATIONS IN QUARTERLY RESULTS

Because the Company has limited operating history, management has very little data upon which to estimate operating revenues and expenses. The Company's revenues will be affected by many factors,

including those discussed in "Business Risks." At the same time, the Company's expenses will be growing to support anticipated rapid expansion. The Company will likely experience substantial quarterly fluctuations in its operating results. As a result, the Company believes that period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as an indication of future performance. Moreover, it is likely that in some future quarters the Company's operating results will be below the expectations of public market analysts and investors. In such event, the price of the Company's common stock would likely be materially adversely affected.

VOLATILITY OF STOCK PRICE

Since its initial public offering, the trading price of the Common Stock has experienced significant volatility and substantial and sudden fluctuations. The trading price of the Common Stock may continue to be subject to wide fluctuations in response to quarterly variations in operating results, changes in financial estimates by securities analysts, announcements of technological innovations or new products by the Company or its competitors, or other events or factors. In addition, the stock market has experienced extreme price and volume fluctuations that have particularly affected the market prices for many technology and small capitalization companies. These broad market fluctuations may materially and adversely affect the market price of the Common Stock.

ANTI-TAKEOVER AND CERTAIN OTHER PROVISIONS

ARTICLES OF INCORPORATION AND BYLAWS

A number of provisions of the Company's articles of incorporation and bylaws deal with matters of corporate governance and the rights of shareholders. Certain of these provisions may be deemed to have an anti-takeover effect and may delay or prevent takeover attempts not first approved by the Board of Directors (including takeovers that certain shareholders may deem to be in their best interests). These provisions also could delay or frustrate the removal of incumbent directors or the assumption of control by shareholders. The Company believes that these provisions are appropriate to protect the interests of the Company and all of its shareholders.

EXCLUSIVE SUPPLY AGREEMENT

Under the terms of the Exclusive Supply Agreement, the Company is prohibited from entering into an exclusive marketing or distribution agreement with DeBeers or its affiliates or the Central Selling Organization (the international cartel of diamond producers) or any party whose primary business is the development, manufacture, marketing or sale of diamond gemstones or any non-gemstone and non-jewelry industry competitor of Cree (collectively, the "Prohibited Parties"). The agreement also prohibits the Company from entering into certain merger, acquisition, sale of assets or similar transactions with a Prohibited Party. These provisions of the Exclusive Supply Agreement could limit the price that third parties might be willing to pay in the future for some or all of the shares of the Company's Common Stock. In addition, this agreement could prevent the Company from entering into certain potentially profitable transactions with Prohibited Parties.

SHAREHOLDER RIGHTS PLAN

On February 21, 1999 the Company adopted a Shareholder Rights Plan under which all shareholders of record as of March 8, 1999, will receive rights to purchase shares of a new series of Preferred Stock.

The Rights Plan is designed to enable all C3 shareholders to realize the full value of their investment and to provide for fair and equal treatment for all shareholders in the event that an unsolicited attempt is made to acquire C3. The adoption of the Rights Plan is intended as a means to guard against abusive takeover tactics and is not in response to any particular proposal.

The rights will be distributed as a non-taxable dividend and will expire in ten years. The rights will be exercisable only if a person or group acquires 20 percent or more of the C3 Common Stock or announces a tender offer for 20 percent or more of the Common Stock.

If a person or group acquires 20 percent or more of C3's Common Stock, all shareholders except the purchaser will be entitled to acquire C3 Common Stock at a 50 percent discount. The effect will be to discourage acquisitions of more than 20 percent of C3 Common Stock without negotiations with the Board.

The rights will trade with C3's Common Stock, unless and until they are separated upon the occurrence of certain future events. The rights distribution is not taxable to the shareholders. C3's Board of Directors may redeem the rights prior to the expiration of a specified period following the acquisition of more than 20 percent of C3's Common Stock. Additional details regarding the Rights Plan will be outlined in a summary to be mailed to all shareholders following the Record Date.

ITEM 2. PROPERTIES

The Company leases approximately 12,700 square feet of mixed-use space (general office, light manufacturing and laboratory) in the Research Triangle Park area of North Carolina from an unaffiliated third party. This space houses the Company's executive offices, sales offices and research and development facilities. The Company believes that comparable mixed-use space could be obtained from other parties on terms substantially the same as the Company's current lease. This space is considered by management to be sufficient for the Company's foreseeable needs over the next 12 months. From February 1997 through January 1998, the Company leased approximately 3,000 square feet of mixed-use space from a subsidiary of Cree. This space previously housed the Company's offices and research and development facilities.

ITEM 3. LEGAL PROCEEDINGS

The Company is not a party to any material legal proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not Applicable.

EXECUTIVE OFFICERS OF THE REGISTRANT

NAME	AGE	POSITION WITH THE COMPANY
Jeff N. Hunter	42	Chief Executive Officer and Chairman of the Board
Robert S. Thomas	51	President and Chief Operating Officer
Mark W. Hahn	36	Chief Financial Officer, Treasurer and Secretary
Mark D. Kellam	42	Director of Technology

JEFF N. HUNTER, one of the founders of the Company, has served as the Company's Chief Executive Officer and Chairman of the Board since June 1996, and as a director since the Company's inception in June 1995. From June 1996 to June 1998, Mr. Hunter served as President of the Company and from June 1995 to June 1996 he served as Secretary and Treasurer of the Company. From July 1980 to May 1996, he was employed in various capacities with North Carolina State University, most recently as Director of Business, Finance and Research Administration for the College of Engineering. Mr. Hunter received his Master of Science degree in management science from North Carolina State University.

ROBERT S. THOMAS has served as the President and Chief Operating Officer of the Company since June 1998. From November 1996 to June 1998 Mr. Thomas served as a consultant to the Company on various financing and sales related matters. From October 1977 to November 1996 Mr. Thomas was employed with Morven Partners, one of the nations largest processors and distributors of both raw and processed edible nuts, and its predecessor companies in various capacities including President and Chief Executive Officer. Mr. Thomas earned his Bachelor of Science degree in Business Administration from West Virginia University.

MARK W. HAHN has served as the Chief Financial Officer of the Company since October 1996 and as Treasurer and Secretary since August 1997. From January 1984 to October 1996, Mr. Hahn was employed with Ernst & Young LLP, most recently as Senior Manager in the Entrepreneurial Services Group. He earned his Bachelor of Business Administration degree with concentrations in accounting and finance from the University of Wisconsin in Milwaukee and is a Certified Public Accountant.

MARK D. KELLAM has served as Director of Technology for the Company since May 1998. From August 1995 to May 1998, Dr. Kellam was employed in various capacities with the Microelectronics Center of North Carolina, most recently as Director of Manufacturing and Quality Assurance. Dr. Kellam earned his Ph.D. in Solid State Physics from the University of North Carolina at Chapel Hill.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

MARKET INFORMATION

The Company's Common Stock is traded on the NASDAQ National Market under the symbol "CTHR." The following table presents, for the periods indicated, the high and low sales prices of the Company's Common Stock, as reported by the NASDAQ National Market. As of March 1, 1999, there were 258 shareholders of record of the Common Stock.

	Sales Price Per Share	
	High	Low
1997		
- - - - -		
November 14, 1997 to December 31, 1997	\$ 15.63	\$ 11.00
1998		
- - - - -		
First Quarter	\$ 12.38	\$ 8.50
Second Quarter	10.00	7.25
Third Quarter	9.75	4.75
Fourth Quarter	14.50	5.25

The Company has never paid dividends on its capital stock. The Company intends to retain earnings, if any, for use in its business and does not anticipate paying any cash dividends in the foreseeable future.

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 December 31, 1998, the Company had approximately \$25,525,000 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 \$4,791,700 of the proceeds have been used in research and development, of which \$141,475 was paid to officers, directors or shareholders owning more than ten percent (10%) of the Common Stock outstanding. The Company has also used approximately \$4,492,600 to fund sales, marketing and administrative expenses, of which \$294,000 was paid to officers, directors or shareholders owning more than ten percent (10%) of the Common Stock outstanding. The Company also expended approximately \$2,386,400 to build inventory of its products. In addition, the Company acquired \$3,877,300 of production equipment, including \$3,375,000 of crystal growth systems from Cree, certain computerized wafering and preform development equipment, and other equipment.

RECENT SALES OF UNREGISTERED SECURITIES

Not Applicable

ITEM 6. SELECTED FINANCIAL DATA

The following selected statement of operations data for the years ended December 31, 1998, 1997 and 1996, and the selected balance sheet data at December 31, 1998 and 1997 have been derived from, and are qualified by reference to, the Company's financial statements included elsewhere in this report, which have been audited by Deloitte & Touche LLP, independent auditors. The selected statement of operations data for the period from inception through December 31, 1995 and the selected balance sheet data at December 31, 1996 and 1995 have been derived from audited financial statements not included herein. The selected financial data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Financial Statements and Notes thereto included elsewhere in this report.

C3, INC.

	Year Ended December 31			Period from Inception (June 28, 1995) to December 31, 1995
	1998	1997	1996	
STATEMENTS OF OPERATIONS DATA				
Net sales	\$ 4,026,309	\$ --	\$ --	\$ --
Cost of goods sold	2,913,208	--	--	--
Gross profit	1,113,101	--	--	--
Operating expenses:				
Marketing and sales	2,989,737	535,329	47,019	10,313
General and administrative (1)	2,671,445	2,744,898	134,715	10,822
Research and development	4,001,740	2,111,062	236,047	6,052
Total operating expenses	9,662,922	5,391,289	417,781	27,187
Operating loss	8,549,821	5,391,289	417,781	27,187
Interest income, net	(1,816,333)	(471,130)	(35,173)	--
Net loss	\$ 6,733,488	\$ 4,920,159	\$ 382,608	\$ 27,187
Basic and diluted net loss per share	\$ 0.97	\$ 1.73	\$ 0.19	\$.02
Shares used in computing basic and diluted net loss per share (2)	6,954,600	2,845,773	2,036,813	1,704,000
	December 31			
	1998	1997	1996	1995
BALANCE SHEET DATA				
Cash and equivalents	\$ 32,004,045	\$ 43,980,385	\$ 1,167,458	\$ 9,109
Working capital	33,887,496	43,687,405	1,161,603	8,355
Total assets	40,168,323	44,873,089	1,226,134	32,913
Shareholders' equity	37,996,332	44,046,281	1,213,279	22,813

1. Compensation expense related to the issuance of stock options for 1998 and 1997 was \$527,811 and \$1,632,804 respectively. In addition for the year ended December 31, 1997, general and administrative expense includes \$66,000 of compensation expense related to the January 2, 1997 issuance of Common Stock to Cree pursuant to a stock option. See Note 6 of Notes to Financial Statements.
2. The calculation of shares for all periods reflects a 2.13-for-1 common stock split effected in September 1997. The calculation also gives effect to the automatic conversion of the Series A Preferred Stock and Series B

Preferred Stock into 2.13 shares of Common Stock for each share of Preferred Stock effective upon completion of the Company's initial public offering. See Notes 2, 4 and 5 of Notes to Financial Statements.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

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 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 moissanite gemstones. Moissanite is being marketed as an exclusive new gemstone with properties, including brilliance, fire and hardness that rival other fine gemstones like diamond, sapphire, ruby and emerald.

The Company began shipping moissanite to authorized retail jewelers 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 and fourth quarters of 1998 the Company expanded the number of authorized retail jewelers primarily located in the southeastern states of North Carolina, South Carolina, Georgia and Florida and increased the number of exclusive international distributors. Marketing and promotion activities were focused primarily in these southeastern states. Domestically, during 1999, the Company will focus on the market introduction of moissanite in other areas of the United States. International efforts during the first half of 1999 will be focused primarily on managing existing relationships with the last half of 1999 being focused on efforts to expand the international distribution of moissanite.

The Company believes that its sales volumes will increase as the yield of salable gemstones from each crystal provided by Cree increases, additional crystal growth capacity is added, and as the market introduction of moissanite gemstones 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 and yields, 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 at least part 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. See "Business Risks--Limited Relevant Operating History."

RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 1998 COMPARED WITH YEAR ENDED DECEMBER 31, 1997.

Net sales for the year ended December 31, 1998, were \$4,026,309. The Company generated net sales of approximately \$3,174,000 from moissanite and approximately \$741,000 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 year ended December 31, 1997.

Gross profit was \$1,113,101 or 28% of net sales for the year ended December 31, 1998. During 1998, gross margins on sales of the Company's test instrument were higher than the gross margins on sales of moissanite. The Company will seek to increase gross margins for moissanite gemstones as the Company realizes improved yields from each SiC crystal produced by Cree. 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 from competitive test instruments.

Marketing and sales expenses increased by \$2,454,408 from \$535,329 for the year ended December 31, 1997 to \$2,989,737 for the year ended December 31, 1998. The increase was primarily due to development and execution of consumer-focused advertising and marketing expenses associated with the initial launch of moissanite, increased market research and compensation and travel expenses associated with the expansion of the Company's sales staff.

General and administrative expenses decreased by \$73,453 from \$2,744,898 for the year ended December 31, 1997 to \$2,671,445 for the year ended December 31, 1998. The decrease resulted primarily from an approximate \$1,200,000 decrease in compensation expense related to the issuance of stock options. Stock option compensation expense aggregated approximately \$530,000 in 1998 compared to approximately \$1,700,000 in 1997. This decrease was partially offset by an increase of approximately \$1,100,000 resulting from 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.

Research and development expenses increased by \$1,890,678 from \$2,111,062 for the year ended December 31, 1997 to \$4,001,740 for the year ended December 31, 1998. Approximately \$1,390,000 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. In addition, a portion of the increase resulted from net production costs for moissanite gemstones during the first half of 1998 while the Company was in the development stage. 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.

Net interest income increased by \$1,345,203 from \$471,130 for the year ended December 31, 1997 to \$1,816,333 for the year ended December 31, 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.

YEAR ENDED DECEMBER 31, 1997 COMPARED WITH YEAR ENDED DECEMBER 31, 1996.

Marketing and sales expenses increased by \$488,310 from \$47,019 for the year ended December 31, 1996 to \$535,329 for the year ended December 31, 1997. The increase was due to the compensation expense of additional sales staff hired since the prior period, increased market research expenditures and the development of preliminary advertising and marketing materials. Prior to May 1, 1996, the Company had no paid employees.

General and administrative expenses increased by \$2,610,183 from \$134,715 for the year ended December 31, 1996 to \$2,744,898 for the year ended December 31, 1997. Of this increase, approximately \$1,600,000 represented compensation expense related to the issuance of stock options to

employees and directors of the Company and an additional \$66,000 represented compensation expense related to the exercise of Cree's option to acquire 24,601 shares Common Stock on January 2, 1997. The balance of the increase was primarily attributable to the compensation expense of additional staff hired since the prior period and occupancy expenses. The Company had no paid employees before May 1, 1996. Prior to February 4, 1997, the Company conducted its operations from the home of two of its founders and did not incur any lease or rent expenses during that time.

Research and development expenses increased by \$1,875,015 from \$236,047 for the year ended December 31, 1996 to \$2,111,062 for the year ended December 31, 1997. The increase was attributable to expanded colorless SiC crystal development efforts at Cree, internal development of prototype gemstone pre-forming and faceting operations, qualifying of vendors for production and development of production-quality prototypes of the moissanite/diamond test instrument.

Net interest income increased by \$435,957 from \$35,173 for the year ended December 31, 1996 to \$471,130 for the year ended December 31, 1997. The increase generally reflected interest earned on cash and cash equivalents, consisting primarily of U.S. Treasury Bills and U.S. Treasury money market funds acquired by investing the proceeds from the Company's initial public offering of Common Stock in November 1997 and its Series B Preferred Stock offering in January, February and March 1997.

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. In 1998 the Company used \$8,158,400 to fund operations and \$3,973,668 to fund capital expenditures and patent expenses. At December 31, 1998, the Company had \$32,004,045 of cash and cash equivalents and \$33,887,496 of working capital.

In addition to the use of all of the crystal growth systems that Cree is required to provide at its expense under the Exclusive Supply Agreement, during 1998 the Company ordered a quantity of crystals that required additional crystal growth systems to be added. As permitted under the Exclusive Supply Agreement, Cree elected to have C3 purchase those systems. During 1998 the Company paid approximately \$3.4 million to Cree for these systems which were placed in operation at various dates from August through December. The Company is obligated to purchase all of the output of these growth systems through June 30, 1999. The Company routinely evaluates Cree's progress under the Development Agreement and the size and quality of SiC crystals being produced by Cree in assessing its plans for larger orders which will require the acquisition of additional crystal growth systems. Under the terms of the Exclusive Supply Agreement, Cree has the option, in its sole discretion, of building the growth systems at its own cost or requiring the Company to purchase the growth systems from Cree. The Company intends to order quantities of SiC crystals in amounts that would require the purchase of additional growth systems as, on average, net yields of salable gemstones improve. See "Business--Manufacturing--Growth of SiC Crystals". The Company plans to engage in increasingly substantial marketing activities to support the expanding distribution of moissanite gemstones. Such activities may include advertising campaigns, cooperative advertising with retail jewelers and distributors, point-of-purchase displays, educational materials and individualized jeweler training.

The 4-year Development Agreement between the Company and Cree requires the Company to fund a development program at Cree for \$2.88 million annually through June 30, 2002. Either party may terminate the agreement if Cree does not meet the annual performance milestone or if the Company and Cree do not mutually agree on the performance milestones for the ensuing year. See "Business-Products

and Product Development-Amended and Restated Development Agreement with Cree."

The Company has no committed external sources of capital. Based on its current operating plan, the Company anticipates that its existing capital resources will be adequate to satisfy its capital requirements for at least the remainder of 1999. There may be circumstances, however, particularly a delay in obtaining improvements in the yield of salable gemstones from each SiC crystal or lower than anticipated sales, that might accelerate the use of the Company's existing capital resources. In those circumstances, the Company may be required to raise substantial additional funds in the future, through public or private sources or other relationships. No assurance can be given that additional financing will be available, or if available, that it will be available on terms acceptable to the Company.

NET OPERATING LOSS CARRYFORWARD

As of December 31, 1998 the Company had a net operating loss ("NOL") carryforward of approximately \$9,500,000, which expires between 2010 and 2013. In accordance with Section 382 of the Internal Revenue Code of 1986, as amended, a change in equity ownership of greater than 50% of the Company within a three-year period results in an annual limitation on the Company's ability to utilize its NOL carryforwards that were created during tax periods prior to the change in ownership. As a result of various equity offerings and certain shareholder transactions, the utilization of the Company's NOL carryforwards has become limited, however, the Company does not believe this limitation will have a material effect on the Company's ability to utilize the NOL carryforward.

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 mid 1999 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 not material.

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 the Company's 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. Cree has confirmed to the Company that it has evaluated the crystal growth systems and determined that they are fully Year 2000 compliant. Cree is also evaluating and remediating its other business systems which rely on microprocessors. According to Cree's Form S-3 dated February 8, 1999, Cree expects to have completed all Year 2000 compliance efforts by April 1999. To the extent that they are not remediated, Year 2000 issues could cause delays in the receipt of silicon carbide crystals which would, in turn, delay deliveries of moissanite gemstones to the Company's customers. Any significant delay in the Company's receipt of SiC crystals or resulting delay in delivery of moissanite gemstones 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 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.

NEWLY ISSUED ACCOUNTING PRONOUNCEMENTS

In 1998 the Company adopted Statement of Financial Accounting Standards No. 130 Comprehensive Income. 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. Reclassification of financial statements for earlier periods is required. There was no impact from adoption of this Statement on the financial statements of the Company since it has no items of other comprehensive income in any period presented.

In 1998 the Company adopted Statement of Financial Accounting Standards No. 131 Disclosures about Segments of an Enterprise and Related Information. This Statement establishes standards for reporting and disclosing selected information regarding operating segments, products and services, geographic areas, and major customers. The application of this standard did not have a material impact on the financial statements of the Company since all activities are within a single business segment and no significant disclosures were required.

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 financial statements.

ITEM 7A. 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 December 31, 1998 the Company has approximately \$31.6 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.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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All other schedules are omitted due to the absence of the conditions under which they are required or because the required information is included within the financial statements or the notes thereto included in Item 8.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of C3, Inc.
Research Triangle Park, North Carolina

We have audited the accompanying balance sheets of C3, Inc. (the "Company") as of December 31, 1998 and 1997, and the related statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. Our audits also included the financial statement schedule listed in the Index at Item 8. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company at December 31, 1998 and 1997, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1998 in conformity with generally accepted accounting principles. Also, in our opinion, such financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the financial statements, the Company changed its method of computing earnings per share effective January 1, 1997 in accordance with Statement of Financial Accounting Standards No. 128.

DELOITTE & TOUCHE LLP

Raleigh, North Carolina
February 18, 1999

C3, INC.
STATEMENTS OF OPERATIONS

	Year Ended December 31		
	1998	1997	1996
Net sales	\$ 4,026,309	\$ ----	\$ ----
Cost of goods sold	2,913,208	----	----
Gross profit	1,113,101	----	----
Operating expenses:			
Marketing and sales	2,989,737	535,329	47,019
General and administrative	2,671,445	2,744,898	134,715
Research and development	4,001,740	2,111,062	236,047
Total operating expenses	9,662,922	5,391,289	417,781
Operating loss	8,549,821	5,391,289	417,781
Interest income, net	(1,816,333)	(471,130)	(35,173)
Net loss	\$ 6,733,488	\$ 4,920,159	\$ 382,608
Basic and diluted net loss per share (Note 2)	\$ 0.97	\$ 1.73	\$ 0.19
Weighted-average common shares, basic and diluted (Note 2)	6,954,600	2,845,773	2,036,813

SEE NOTES TO FINANCIAL STATEMENTS.

C3, INC.
BALANCE SHEETS

	December 31	
	1998	1997
ASSETS		
Current Assets:		
Cash and equivalents	\$ 32,004,045	\$ 43,980,385
Accounts receivables, net of allowance for doubtful accounts of \$77,000 at December 31, 1998	546,921	4,298
Interest receivable	121,276	177,654
Inventory, net (Note 2)	3,092,448	278,602
Prepaid expenses and other assets	294,797	73,274
	-----	-----
Total current assets	36,059,487	44,514,213
Equipment, net (Note 3)	3,832,019	214,990
Patent and license rights, net (Note 3)	276,817	143,886
	-----	-----
	\$ 40,168,323	\$ 44,873,089
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable:		
Cree Research, Inc. (Note 8)	\$ 1,679,600	\$ 567,110
Other	250,157	237,186
Accrued expenses and other liabilities	223,248	--
Deferred revenue	18,986	22,512
	-----	-----
Total current liabilities	2,171,991	826,808
Commitments (Note 8)		
Shareholders' Equity (Notes 4, 5, and 6):		
Common stock, no par value; 50 million shares authorized; 6,993,309 and 6,938,476 shares issued and outstanding at December 31, 1998 and 1997, respectively	48,149,406	47,743,431
Additional paid-in capital--stock options	1,910,368	1,632,804
Accumulated deficit	(12,063,442)	(5,329,954)
	-----	-----
Total shareholders' equity	37,996,332	44,046,281
	-----	-----
	\$ 40,168,323	\$ 44,873,089
	=====	=====

SEE NOTES TO FINANCIAL STATEMENTS.

C3, INC.
STATEMENTS OF SHAREHOLDERS' EQUITY

	1996 Series A Preferred Stock		1997 Series B Preferred Stock		Common Stock		Additional Paid-in Capital Stock Options	Accumulated Deficit	Total Shareholders' Equity
	Number Of Shares	Amount	Number Of Shares	Amount	Number Of Shares	Amount			
Balance at December 31, 1995	----	\$ ----	----	\$ ----	1,704,000	\$ 50,000	\$ ----	\$ (27,187)	\$ 22,813
Issuance of common stock, net of offering costs of \$20,197	----	----	----	----	532,500	979,803	----	----	979,803
Issuance of 1996 Series A preferred stock, net of offering costs of \$10,479	105,000	593,271	----	----	----	----	----	----	593,271
Net loss	----	----	----	----	----	----	----	(382,608)	(382,608)
Balance at December 31, 1996	105,000	593,271	----	----	2,236,500	1,029,803	----	(409,795)	1,213,279
Exercise of stock option	----	----	----	----	24,601	66,000	----	----	66,000
Issuance of 1997 Series B preferred stock, net of offering costs of \$34,999	----	----	682,500	4,981,375	----	----	----	----	4,981,375
Compensation expense related to stock options	----	----	----	----	----	----	1,632,804	----	1,632,804
Proceeds from IPO, net of offering costs of \$3,927,018	----	----	----	----	3,000,000	41,072,982	----	----	41,072,982
Conversion of preferred stock to common stock	(105,000)	(593,271)	(682,500)	(4,981,375)	1,677,375	5,574,646	----	----	----
Net loss	----	----	----	----	----	----	----	(4,920,159)	(4,920,159)
Balance at December 31, 1997	----	----	----	----	6,938,476	47,743,431	1,632,804	(5,329,954)	44,046,281
Exercise of stock options	----	----	----	----	54,833	405,975	(250,247)	----	155,728
Compensation expense related to stock options	----	----	----	----	----	----	527,811	----	527,811
Net loss	----	----	----	----	----	----	----	(6,733,488)	(6,733,488)
Balance at December 31, 1998	----	\$ ----	----	\$ ----	6,993,309	\$48,149,406	\$1,910,368	\$(12,063,442)	\$37,996,332

SEE NOTES TO FINANCIAL STATEMENTS.

C3, INC.
STATEMENTS OF CASH FLOWS

	Year Ended December 31		
	1998	1997	1996
OPERATING ACTIVITIES			
Net loss	\$ (6,733,488)	\$ (4,920,159)	\$ (382,608)
Adjustments:			
Depreciation and amortization	223,708	26,154	3,618
Compensation expense related to exercise and issuance of stock options	527,811	1,698,804	----
Changes in assets and liabilities:			
Accounts receivable	(542,623)	(4,298)	----
Interest receivable	56,378	(177,654)	----
Inventory	(2,813,846)	(278,602)	----
Prepaid expenses and other assets	(221,523)	(66,274)	2,346
Accounts payable	1,125,461	791,441	12,855
Accrued expenses and other liabilities	223,248	----	----
Deferred revenue	(3,526)	22,512	----
Net cash used in operating activities	(8,158,400)	(2,908,076)	(363,789)
INVESTING ACTIVITIES			
Purchases of equipment	(3,827,322)	(221,177)	(10,331)
Patent costs	(146,346)	(112,177)	(30,505)
Net cash used in investing activities	(3,973,668)	(333,354)	(40,836)
FINANCING ACTIVITIES			
Proceeds from notes payable	----	----	53,000
Repayment of notes payable	----	----	(63,100)
Stock options exercised	155,728	----	----
Proceeds from common stock offerings, net of costs	----	41,072,982	979,803
Proceeds from preferred stock offerings, net of costs	----	4,981,375	593,271
Net cash provided by financing activities	155,728	46,054,357	1,562,974
Net change in cash and equivalents	(11,976,340)	42,812,927	1,158,349
Cash and equivalents at beginning of year	43,980,385	1,167,458	9,109
Cash and equivalents at end of year	\$ 32,004,045	\$ 43,980,385	\$ 1,167,458

SEE NOTES TO FINANCIAL STATEMENTS.

1. ORGANIZATION AND BASIS OF PRESENTATION

C3, Inc. ("C3" or the "Company"), was incorporated in North Carolina on June 28, 1995, and manufactures, markets and distributes lab-created moissanite gemstones (hereinafter referred to as moissanite or moissanite gemstones) for sale in the jewelry market. Moissanite, also known by its chemical name, silicon carbide (SiC), is a rare, naturally occurring mineral found primarily in meteorites. Moissanite is being marketed as an exclusive new gemstone with properties, including brilliance, fire, luster and hardness that rival other fine gemstones like diamonds, rubies and emeralds. In addition to moissanite gemstones, the Company has developed and began selling, in 1998, a test instrument which distinguishes colorless moissanite gemstones from diamond.

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 moissanite gemstones, market research, developing initial consumer marketing themes and assembling a management team and did not, through June 30, 1998, generate significant revenues from its planned principal operations. The Company began shipping moissanite during the second quarter of 1998, and, in July 1998, launched consumer-focused advertising and promotion activities in the introductory areas. During the second half of 1998 the Company expanded the number of authorized retail jewelers in the southeastern states of North Carolina, South Carolina, Georgia and Florida. In addition, the Company continued limited distribution and promotional activities in domestic locations outside this region. The Company also entered into exclusive distribution agreements with a number of international distributors.

The ability of the Company to successfully develop, manufacture and market its proprietary products is dependent upon many factors, and during the period required to develop and market these products, the Company may require additional funds which may not be available to it. Accordingly, there can be no assurance of the Company's future success.

All the Company's activities are within a single business segment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CASH AND EQUIVALENTS

The Company considers all money market accounts, debt instruments purchased with an original maturity of three months or less, and other highly liquid investments to be cash equivalents.

INVENTORY

Inventory is stated at the lower of cost or market, and is determined on a first-in, first-out basis. At December 31, 1998 finished goods includes \$1,018,465 of test instruments, net of a \$132,000 reserve for excess inventory. Inventories consist of the following:

	December 31	
	1998	1997
Raw materials	\$ 140,411	\$ 14,108
Work in process	819,953	167,294
Finished goods	2,132,084	97,200
	<u>\$ 3,092,448</u>	<u>\$ 278,602</u>
	=====	=====

EQUIPMENT

Equipment is recorded at cost and depreciated on the straight-line method based on estimated useful lives of three to 12 years. Leasehold improvements are amortized on the straight-line method over the life of the related lease.

PATENTS AND LICENSE RIGHTS

The Company capitalizes costs associated with obtaining patents issued or pending for inventions and license rights related to the manufacture of moissanite gemstones and moissanite gemstone test instruments. Such costs are amortized over 17 years.

ACCOUNTING FOR LONG-LIVED ASSETS

The Company accounts for long-lived assets in accordance with Statement of Financial Accounting Standards No. 121 ("FAS 121"), Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of. The Company evaluates the recoverability of its long-lived assets for financial impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be fully recoverable. Based on these evaluations, there were no adjustments to the carrying value of long-lived assets in 1998 or 1997.

CONCENTRATIONS OF CREDIT RISK

Financial instruments which potentially subject the Company to concentrations of credit risk are primarily cash equivalents and trade receivables. The Company places its cash equivalents with high quality financial institutions and invests in low risk securities including U.S. Treasury bills and money market funds, government agency notes and commercial paper.

Trade receivables are generated from a broad and diverse group of customers, primarily independent retail jewelry stores. The Company extends credit to its customers based upon an evaluation of the customer's financial condition and credit history and generally does not require collateral. No customer has accounted for 10% or more of the Company's revenue.

INCOME TAXES

From the date of inception (June 28, 1995) to December 31, 1995, the Company was treated as a C Corporation for federal and state income tax purposes. Effective January 1, 1996, the Company elected to change its tax status from a C Corporation to an S Corporation. On September 4, 1996, in connection with the closing of the 1996 Series A preferred stock offering, the Company's number of shareholders exceeded the maximum 35 shareholder limitation for S Corporations and, as a result, the Company's S Corporation status was automatically terminated. Losses of the Company for the period January 1, 1996 through September 4, 1996 (totaling \$259,533) are included in the personal income tax returns of the common shareholders as of that date. The tax effect of losses for the years ended December 31, 1998 and 1997, the period September 5, 1996 to December 31, 1996 and the seven-month period ending December 31, 1995 are recorded under the provisions of Statement of Financial Accounting Standards No. 109 ("FAS 109"), Accounting for Income Taxes. Pro forma income tax benefit is not presented to reflect the impact of losses incurred by the Company during its S Corporation tax status since a valuation allowance would have been provided for any net operating losses incurred. Accordingly, no pro forma tax benefit would be recognized.

RESEARCH AND DEVELOPMENT

All research and development costs are expensed when incurred.

STOCK COMPENSATION

The Company's stock option plans are accounted for in accordance with Accounting Principles Board Opinion No. 25 ("APB 25"), Accounting for Stock Issued to Employees. In January 1996, the Company adopted the disclosure requirements of Statement of Financial Accounting Standards No. 123 ("FAS 123"), Accounting for Stock Based Compensation.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NET LOSS PER SHARE

In 1997, the Company adopted Statement of Financial Accounting Standards No. 128 ("FAS 128"), Earnings Per Share. FAS 128 requires the presentation of both basic and diluted earnings per share, regardless of materiality unless per share amounts are equal. Basic loss per share computations are based on the weighted-average common shares outstanding. Diluted loss per share computations include the dilutive effect, if any, of stock options and warrants using the treasury stock method.

Warrants to purchase 300,000 shares of common stock at \$18 per share, options outstanding at December 31, 1998 to purchase 1,215,774 shares of common stock (exercise prices ranging from \$1.88 - \$15.00), and retroactive conversion of the Series A and Series B preferred stock into common shares as of the date of issuance were excluded from the computation of diluted loss per share because either the options' exercise price was greater than the average market price of the common shares or the effect of inclusion of such amounts would be anti-dilutive to loss per share.

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 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 financial statements.

RECLASSIFICATION

Certain 1997 and 1996 amounts have been reclassified to conform with the 1998 presentation.

3. EQUIPMENT AND PATENT AND LICENSE RIGHTS

Equipment balances are summarized as follows:

	December 31	
	1998	1997
Machinery and equipment	\$ 3,614,984	\$ 173,438
Computer equipment	310,054	----
Furniture and fixtures	55,209	----
Leasehold improvements	44,345	15,496
Construction in progress	39,440	47,776
Total	4,064,032	236,710
Accumulated depreciation and amortization	(232,013)	(21,720)
Total equipment, net	\$ 3,832,019	\$ 214,990

Depreciation expense for 1998, 1997 and 1996 was \$210,293, \$20,268 and \$1,810, respectively.

Patent and license rights balances are summarized as follows:

	December 31	
	----- 1998	1997 -----
Patent and license rights	\$ 298,182	\$ 151,836
Accumulated amortization	(21,365)	(7,950)
Patent and license rights, net	\$ 276,817	\$ 143,886
	=====	=====

4. COMMON STOCK

On April 2, 1996 the Company declared an eight-for-one common stock split. On September 25, 1997, the Company effected a 2.13-for-1 stock split of its common stock. The effect of these stock splits are reflected as if they had occurred at the beginning of the earliest period presented.

In May 1996, the Company issued 532,500 shares of common stock with net proceeds of approximately \$979,800 (net of offering costs of \$20,197).

On November 14, 1997, the Company completed an initial public offering of 3,000,000 shares of its Common Stock with net proceeds of \$41,072,982 (net of offering costs of \$3,927,018).

5. PREFERRED STOCK

The Company has authorized 10 million shares of preferred stock, no par value. The preferred stock may be issued from time to time in one or more series.

1996 Series A Preferred Stock--The Board designated 105,000 shares of its preferred stock as 1996 Series A preferred stock. In September 1996, the Company issued 105,000 shares of Series A preferred stock with net proceeds of approximately \$593,000 (net of offering costs of \$10,479). All of the 1996 Series A preferred stock was converted to common stock concurrent with the initial public offering at a ratio of 2.13 common shares for each share of preferred stock.

1997 Series B Preferred Stock--The Company designated 682,500 shares of its preferred stock as 1997 Series B preferred stock. Effective March 7, 1997, the Company completed the offering of 682,500 shares of its 1997 Series B preferred stock with net proceeds of approximately \$5 million. All of the 1997 Series B preferred stock was converted to common stock concurrent with the initial public offering at a ratio of 2.13 common shares for each share of preferred stock.

6. STOCK OPTION PLANS

In 1996, the Company adopted the 1996 Stock Option Plan of C3, Inc. ("1996 Option Plan") under which options to acquire 777,450 common shares, reduced by the number of options granted outside the 1996 Option Plan, may be granted to key employees, directors and independent consultants. Under the 1996 Option Plan, both incentive and non-qualified options may be granted under terms and conditions

established by the compensation committee of the board of directors. The exercise price for incentive options will be the fair market value of the related common stock on the date the option is granted. Options granted under the 1996 Option Plan generally vest equally over a three-year period and have terms of 10 years. The company currently has no plans to award additional options under the 1996 Option Plan.

In September 1997, the Company adopted the 1997 Omnibus Stock Plan of C3, Inc. (the "1997 Omnibus Plan"). The 1997 Omnibus Plan authorizes the Company to grant stock options, stock appreciation rights and restricted awards (collectively, "awards") to selected employees, independent contractors and directors of the Company and related corporations in order to promote a closer identification of their interests with those of the Company and its shareholders. The maximum number of shares of Common Stock for which awards may be granted under the 1997 Omnibus Plan may be increased from time to time to a number of shares equal to (i) 20% of the shares of common stock outstanding as of that time less (ii) the number of shares of common stock subject to outstanding options under the 1996 Option Plan. The number of shares reserved for issuance under the 1997 Omnibus Plan may also be adjusted upon certain events affecting the Company's capitalization. Options granted under the 1997 Omnibus Plan generally vest over three to five-year periods and have terms of 10 years. The Board of Directors has reserved 677,979 shares for the 1997 Omnibus Plan.

The following is a summary of activity for the Company's two stock option plans:

	1996 Option Plan		1997 Omnibus Plan	
	Number Of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
1996				
Granted and outstanding at end of year	200,220	\$ 2.37	----	\$ ----
1997				
Granted	461,571	4.64	477,000	14.61
Outstanding at end of year	661,791	3.95	477,000	14.61
1998				
Granted	----	----	195,000	8.94
Exercised	93,379	4.97	----	----
Canceled	13,547	3.66	48,366	14.67
Outstanding at end of year	554,865	\$ 3.78	623,634	\$12.83

During 1996, the Company granted options to acquire 37,275 shares of common stock to certain consultants. These options are immediately exercisable, have a term of five years, and an exercise price of \$1.88 per share.

During 1995, the Company issued Cree Research, Inc. ("Cree"), a related company, an option to acquire one percent (1%) of the outstanding shares of common stock on the date of exercise at an exercise price of \$500 at any time through July 1, 1997. However, the Company retained the right to waive the \$500 option fee and issue the stock at any time during the option period. The Company issued 24,601 shares of common stock to Cree pursuant to this right on January 2, 1997. The Company recorded compensation expense of approximately \$66,000 in 1997 related to this transaction.

The following summarizes information about stock options outstanding at December 31, 1998:

OPTIONS OUTSTANDING				OPTIONS EXERCISABLE	
Range of Exercise Price	Outstanding as of 12/31/1998	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Exercisable as of 12/31/1998	Weighted-Average Exercise Price
\$1.5001- \$3.0000	224,715	7.6	\$2.3100	187,085	\$2.3319
\$3.0001- \$4.5000	89,034	8.3	\$3.4500	71,994	\$3.4500
\$4.5001- \$6.0000	278,391	8.5	\$4.8100	262,061	\$4.8100
\$6.0001- \$7.5000	10,500	9.8	\$7.5000	0	\$0.0000
\$7.5001- \$9.0000	141,900	9.6	\$8.6211	15,000	\$8.1250
\$9.0001- \$10.5000	18,000	7.7	\$9.8100	0	\$0.0000
\$10.5001-\$12.0000	21,234	8.9	\$10.8100	16,038	\$10.8100
\$13.5001-\$15.0000	432,000	8.9	\$14.5632	104,767	\$14.3996
	1,215,774	8.6	\$8.3608	656,945	\$5.7067

In accordance with APB 25, the Company recorded compensation expense of approximately \$530,000 and \$1,633,000 during 1998 and 1997, respectively, relating to stock options granted with exercise prices less than market value or granted to consultants. Had compensation expense for stock options been determined consistent with FAS 123, (which was effective as of January 1, 1996), rather than APB 25, the Company's net loss and loss per share for the years ended December 31, 1998, 1997 and 1996 would have been increased to the pro forma amounts indicated below:

	1998	1997	1996
Net loss, as reported	\$ 6,733,488	\$ 4,920,159	\$ 382,608
Pro forma net loss	\$ 7,525,000	\$ 5,561,000	\$ 404,000
Basic and diluted net loss per share:			
As reported	\$ 0.97	\$ 1.73	\$ 0.19
Pro forma	\$ 1.08	\$ 1.95	\$ 0.20

The fair value of each option grant is estimated on the grant date. Options granted during 1996 and 1997 were valued using the minimum value method and 1998 grants were valued using a Black-Scholes option pricing model. The valuations for the years ended December 31, 1998, 1997 and 1996 were based on the following assumptions:

	1998	1997	1996
Weighted-average grant date fair value	\$ 7.46	\$ 10.28	\$ 4.88
Weighted-average expected lives (in years)	9.98	3.04	1.80
Risk-free interest rate	5.13%	5.50%	6.00%
Dividend yield	0%	0%	0%
Volatility factor	.782	0%	0%

In connection with the Company's initial public offering on November 14, 1997, the Company granted the underwriters options to purchase 450,000 shares of common stock at \$15 per share solely to cover over-allotments in the sale of common stock in the offering. The options had an exercise term of 45 days and expired as of December 31, 1997. Also in connection with the offering, the Company issued

warrants to the underwriter to purchase 300,000 shares of common stock at a price of \$18 per share. The warrants are exercisable for a period of four years beginning November 14, 1998.

7. INCOME TAXES

The Company accounts for income taxes under the liability method in accordance with FAS 109. Under the liability method, deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities.

Significant components of the Company's deferred tax assets and liabilities are as follows:

	December 31	
	----- 1998 -----	----- 1997 -----
Federal and state loss carryforwards	\$ 3,716,000	\$ 1,319,000
Benefit of research tax credits	234,000	----
Reserves and accruals	131,000	----
Depreciation	(168,000)	(9,000)
	-----	-----
Total deferred tax assets	3,913,000	1,310,000
	-----	-----
Less valuation allowance	(3,913,000)	(1,310,000)
	-----	-----
Net deferred tax assets	\$ ----- =====	\$ ---- =====

A reconciliation between expected income taxes, computed at the statutory federal income tax rate applied to pretax accounting income, and the income taxes included in the statements of operations for the years ended December 31, 1998, 1997 and 1996 follows:

	----- 1998 -----	----- 1997 -----	----- 1996 -----
Anticipated income tax benefit at the statutory federal rate	\$(2,290,000)	\$(1,673,400)	\$ (40,600)
State income tax benefit, net of federal tax effect	(344,000)	(252,000)	(6,300)
Research tax credits	(142,000)	----	----
Compensation expense--stock options	164,000	640,000	----
Other	9,000	33,000	----
Increase in valuation allowance	2,603,000	1,252,400	46,900
	-----	-----	-----
Income tax (benefit) expense	\$ ---- =====	\$ ---- =====	\$ ---- =====

At December 31, 1998, the Company has operating and economic loss carryforwards of approximately \$9,500,000 expiring through 2013, which can be offset against future federal and state taxable income. In accordance with Section 382 of the Internal Revenue Code of 1986, as amended, a change in equity ownership of greater than 50% of the Company within a three-year period results in an annual limitation on the Company's ability to utilize its NOL carryforwards that were created during tax periods prior to the change in ownership. As a result of various equity offerings and certain shareholder transactions, the utilization of the Company's NOL carryforwards has become limited, however, the Company does not believe this limitation will have a material effect on the Company's ability to utilize the NOL carryforward.

8. COMMITMENTS

OPERATING LEASE

In August 1997, the Company entered into an agreement to lease approximately 12,700 square feet of mixed use space from an unaffiliated third party at a base cost of approximately \$9,800 per month, plus contingent rentals based on the Company's proportionate share of the lessor's operating costs, as defined in the lease agreement. The lease expires August 31, 2004. The Company may cancel the lease effective as of the last day of the 38th month by delivering to the lessor written notice nine months prior to the cancellation date and by paying a cancellation fee of \$66,300. The lease provides for escalations of the base rent throughout the lease term, up to \$11,706 at November 1, 2003. The future minimum lease payments, including the \$66,300 cancellation fee, are as follows: \$122,400 in 1999, \$170,925 in 2000, totaling \$293,325.

Rental expense incurred for operating leases and leases whose terms are less than one year in duration for 1998 and 1997 was approximately \$153,000 and \$69,000, respectively. There was no rental expense prior to 1997.

PURCHASE COMMITMENT

On June 6, 1997, the Company entered into an Amended and Restated Exclusive Supply Agreement ("Supply Agreement") and a Development Agreement with Cree, a related company. The Supply Agreement has an initial term of ten years which may be extended for an additional ten years by either party if the Company orders in any 36-month period SiC crystals with an aggregate purchase price in excess of \$1 million. The Company has met this order threshold and expects to extend the term of the Supply Agreement. In connection with the Supply Agreement, the Company has committed to purchase a minimum of fifty percent (50%) (by dollar volume) of its requirements for SiC crystals from Cree. If the Company's orders require Cree to expand beyond specified production levels, the Company must commit to purchase certain minimum quantities. Through June 30, 1999 the Company has agreed to purchase all crystals produced by existing crystal growers and the Company and Cree have agreed that the price paid to Cree for SiC crystals will be based on a sliding scale depending on the quality of each crystal received. The Company is totally dependent on Cree to supply SiC crystals for its production process. If the Company is unable to obtain SiC crystals from Cree, its operations would be adversely affected.

The July 1, 1998 Development Agreement, which replaces the June 1997 Development Agreement and the 1998 Supplemental Development Agreement, provides for a four-year development effort by Cree to increase the yield of usable material in each SiC crystal manufactured by Cree for use by C3 in the production of moissanite gemstones. The Company is obligated to pay Cree approximately \$2.88 million annually through June 30, 2002 under this agreement, however, either party may terminate the agreement if Cree does not meet the annual performance milestones or if the Company and Cree do not mutually agree on the performance milestones for the ensuing year.

During 1998, 1997, and 1996, the Company made purchases from Cree of approximately \$7,568,500, \$2,022,700 and \$189,600, respectively, for SiC materials and research and development costs.

SCHEDULE II

C3, INC.

VALUATION AND QUALIFYING ACCOUNTS

Year ended December 31	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Collections of Accounts Previously Written Off	Deductions Write Offs	Balance at End of Period
Allowance for Doubtful Accounts 1998	\$ ----	\$ 77,607	\$ ----	\$ 607	\$ 77,000
Reserve for Excess Inventory 1998	\$ ----	\$ 132,000	\$ ----	\$ ----	\$ 132,000

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

ITEM 11. EXECUTIVE COMPENSATION

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information called for in items 10 through 13 is incorporated by reference from the Company's definitive proxy statement relating to its annual meeting of shareholders, which will be filed with the Securities and Exchange Commission within 120 days after the end of fiscal 1998.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) (1) and (2) Financial statements and financial statement schedule--the financial statements, financial statements schedule, and report of independent accountants are filed as part of this report (see Index to Financial Statements at Part II Item 8 on page 30 of this Form 10-K).

(a) (3) The following exhibits have been or are being filed herewith and are numbered in accordance with Item 601 of Regulation S-K:

Exhibit Number	Description
- - - - -	- - - - -
3.1	Amended and Restated Articles of Incorporation of C3, Inc. which is hereby incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).
3.2	Articles of Amendment of C3, Inc., as filed with the Secretary of State of North Carolina on February 23, 1999.
3.3	Amended and Restated Bylaws of C3, Inc. which is hereby incorporated by reference to Exhibit 3.2 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333- 36809).
4.1	Specimen Certificate of Common Stock.

- 4.2 Form of Representative's Warrant which is hereby incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333- 36809).
- 4.3 Rights Agreement dated as of February 22, 1999 between C3, Inc. and First Union National Bank as Rights Agent which includes the Form of Rights Certificate as Exhibit A.
- 10.1 Consulting Agreement, dated May 1, 1997, between Kurt Nassau and C3, Inc. which is hereby incorporated by reference to Exhibit 10.1 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.2 Letter Agreement, dated May 17, 1997, between Kurt Nassau and C3, Inc. which is hereby incorporated by reference to Exhibit 10.2 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.3 Letter Agreement, dated February 17, 1997, between Howard Rubin and C3, Inc. which is hereby incorporated by reference to Exhibit 10.3 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.4 Independent Contractor Agreement, dated May 1, 1997, between Paula K. Berardinelli and C3, Inc. which is hereby incorporated by reference to Exhibit 10.4 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.5 Independent Contractor Agreement, dated September 3, 1997, between C. Eric Hunter and C3, Inc. which is hereby incorporated by reference to Exhibit 10.5 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).
- 10.6 Independent Contractor Agreement dated July 10, 1997 between Ollin B. Sykes and C3, Inc. which is hereby incorporated by reference to Exhibit 10.6 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.7 Employment Agreement, dated June 1, 1997, between Jeff N. Hunter and C3, Inc. which is hereby incorporated by reference to Exhibit 10.7 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.8 Employment Agreement, dated July 30, 1997, between Mark W. Hahn and C3, Inc. which is hereby incorporated by reference to Exhibit 10.8 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.9 Employment Agreement, dated September 15, 1997, between Martin J. DeRoy and C3, Inc. which is hereby incorporated by reference to Exhibit 10.9 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.10 Employment Agreement, dated March 1, 1997, between Thomas G. Coleman and C3, Inc. which is hereby incorporated by reference to Exhibit 10.10 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.11 Amended and Restated Exclusive Supply Agreement, dated June 6, 1997, between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.11 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*

- 10.12 Development Agreement, dated as of June 6, 1997, between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.12 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*
- 10.13 Letter Agreement, dated July 14, 1997, between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.13 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*
- 10.14 Letter Agreement, dated January 31, 1996, between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.14 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*
- 10.15 1996 Stock Option Plan of C3, Inc. (as amended October 27, 1997) which is hereby incorporated by reference to Exhibit 10.15 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.16 1997 Omnibus Stock Plan of C3, Inc. which is hereby incorporated by reference to Exhibit 10.16 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333- 36809).
- 10.17 Restricted Stock Agreement, dated June 30, 1995, between Jeff N. Hunter and Paula K. Berardinelli and C3, Inc. which is hereby incorporated by reference to Exhibit 10.17 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.18 Shareholders Agreement, dated March 18, 1997, between General Electric Pension Trust, C. Eric Hunter and C3, Inc. which is hereby incorporated by reference to Exhibit 10.18 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).
- 10.19 Registrations Rights Agreement, dated March 18, 1997, between General Electric Pension Trust and C3, Inc. which is hereby incorporated by reference to Exhibit 10.19 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).
- 10.20 Agreement, dated September 24, 1997, between John M. Bachman, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.20 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*
- 10.21 Agreement, dated September 12, 1997, between QMD, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.21 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*
- 10.22 1997 Declaration of Amendment to 1997 Omnibus Stock Plan of C3, Inc. which is hereby incorporated by reference to Exhibit 99.3 to the Registration Statement on Form S-8 of C3, Inc. (File No. 333-43613).+
- 10.23 Supplemental Development Agreement, dated January 8, 1998, between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.23 to the Annual Report on Form 10-K of C3, Inc. for the fiscal year ended December 31, 1997.*
- 10.24 Letter Agreement, dated January 8, 1998, between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.24 to the Annual Report on Form 10-K of C3, Inc. for the Fiscal year ended December 31, 1997.*

- 10.25 Amended and Restated Development Agreement, dated July 1, 1998 between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.25 to the Quarterly Report on Form 10-Q of C3, Inc. for the quarter ended June 30, 1998.*
- 10.26 Letter Agreement dated, July 14, 1998, between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.26 to the Quarterly Report on Form 10-Q of C3, Inc. for the quarter ended June 30, 1998.*
- 10.27 Employment Agreement, dated April 6, 1998, between Mark Kellam and C3, Inc. which is hereby incorporated by reference to Exhibit 10.27 to the Quarterly Report on Form 10-Q of C3, Inc. for the quarter ended September 30, 1998.+
- 10.28 First Amendment to Agreement, dated March 23, 1998 between John M. Bachman, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.28 to the Quarterly Report on Form 10-Q of C3, Inc. for the quarter ended September 30, 1998.*
- 10.29 Second Amendment to Agreement, dated September 28, 1998 between John M. Bachman, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.29 to the Quarterly Report on Form 10-Q of C3, Inc. for the quarter ended September 30, 1998.*
- 10.30 1998 Declaration of Amendment to 1996 Stock Option Plan of C3, Inc.+
- 10.31 1998 Declaration of Amendment to 1997 Omnibus Stock Plan of C3, Inc.+
- 10.32 Employment Agreement, dated March 1, 1999, between Robert Thomas and C3, Inc.+
- 23.1 Consent of Deloitte & Touche LLP
- 27.1 Financial Data Schedule - Fiscal year ended December 31, 1998.

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

+ Denotes a management contract or compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

By: /s/ Robert S. Thomas Date: 3/16/99

Robert S. Thomas, President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ Jeff N. Hunter Date: 3/16/99

Jeff N. Hunter
Chairman of the Board and Director
(Principal executive officer)

By: /s/ Mark W. Hahn Date: 3/16/99

Mark W. Hahn
Chief Financial Officer
(Principal financial and accounting officer)

By: /s/ Richard Hartigan, Jr. Date: 3/18/99

Richard Hartigan, Jr.
Director

By: /s/ Barbara Kotlikoff Date: 3/16/99

Barbara Kotlikoff
Director

By: /s/ Kurt Leutzinger Date: 3/16/99

Kurt Leutzinger
Director

By: /s/ Joel N. Levy Date: 3/17/99

Joel N. Levy
Director

By: /s/ Kurt Nassau Date: 3/16/99

Kurt Nassau
Director

By: /s/ Howard Rubin Date: 3/16/99

Howard Rubin
Director

By: /s/ Frederick A. Russ Date: 3/17/99

Frederick A. Russ
Director

By: /s/ Ollin B. Sykes Date: 3/16/99

Ollin B. Sykes
Director

EXHIBIT INDEX

TO
ANNUAL REPORT ON FORM 10-K
OF
C3, INC.

Exhibit Number - - - - -	Description - - - - -
3.1	Amended and Restated Articles of Incorporation of C3, Inc. which is hereby incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).
3.2	Articles of Amendment of C3, Inc., as filed with the Secretary of State of North Carolina on February 23, 1999.
3.3	Amended and Restated Bylaws of C3, Inc. which is hereby incorporated by reference to Exhibit 3.2 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333- 36809).
4.1	Specimen Certificate of Common Stock.
4.2	Form of Representative's Warrant which is hereby incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333- 36809).
4.3	Rights Agreement dated as of February 22, 1999 between C3, Inc. and First Union National Bank as Rights Agent which includes the Form of Rights Certificate as Exhibit A.
10.1	Consulting Agreement, dated May 1, 1997, between Kurt Nassau and C3, Inc. which is hereby incorporated by reference to Exhibit 10.1 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
10.2	Letter Agreement, dated May 17, 1997, between Kurt Nassau and C3, Inc. which is hereby incorporated by reference to Exhibit 10.2 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
10.3	Letter Agreement, dated February 17, 1997, between Howard Rubin and C3, Inc. which is hereby incorporated by reference to Exhibit 10.3 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
10.4	Independent Contractor Agreement, dated May 1, 1997, between Paula K. Berardinelli and C3, Inc. which is hereby incorporated by reference to Exhibit 10.4 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
10.5	Independent Contractor Agreement, dated September 3, 1997, between C. Eric Hunter and C3, Inc. which is hereby incorporated by reference to Exhibit 10.5 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).

- 10.6 Independent Contractor Agreement dated July 10, 1997 between Ollin B. Sykes and C3, Inc. which is hereby incorporated by reference to Exhibit 10.6 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.7 Employment Agreement, dated June 1, 1997, between Jeff N. Hunter and C3, Inc. which is hereby incorporated by reference to Exhibit 10.7 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.8 Employment Agreement, dated July 30, 1997, between Mark W. Hahn and C3, Inc. which is hereby incorporated by reference to Exhibit 10.8 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.9 Employment Agreement, dated September 15, 1997, between Martin J. DeRoy and C3, Inc. which is hereby incorporated by reference to Exhibit 10.9 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.10 Employment Agreement, dated March 1, 1997, between Thomas G. Coleman and C3, Inc. which is hereby incorporated by reference to Exhibit 10.10 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.11 Amended and Restated Exclusive Supply Agreement, dated June 6, 1997, between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.11 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*
- 10.12 Development Agreement, dated as of June 6, 1997, between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.12 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*
- 10.13 Letter Agreement, dated July 14, 1997, between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.13 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*
- 10.14 Letter Agreement, dated January 31, 1996, between Cree Research, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.14 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*
- 10.15 1996 Stock Option Plan of C3, Inc. (as amended October 27, 1997) which is hereby incorporated by reference to Exhibit 10.15 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.16 1997 Omnibus Stock Plan of C3, Inc. which is hereby incorporated by reference to Exhibit 10.16 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333- 36809).
- 10.17 Restricted Stock Agreement, dated June 30, 1995, between Jeff N. Hunter and Paula K. Berardinelli and C3, Inc. which is hereby incorporated by reference to Exhibit 10.17 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).+
- 10.18 Shareholders Agreement, dated March 18, 1997, between General Electric Pension Trust, C. Eric Hunter and C3, Inc. which is hereby incorporated by reference to Exhibit 10.18 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).

- 10.19 Registrations Rights Agreement, dated March 18, 1997, between General Electric Pension Trust and C3, Inc. which is hereby incorporated by reference to Exhibit 10.19 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).
- 10.20 Agreement, dated September 24, 1997, between John M. Bachman, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.20 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*
- 10.21 Agreement, dated September 12, 1997, between QMD, Inc. and C3, Inc. which is hereby incorporated by reference to Exhibit 10.21 to the Registration Statement on Form S-1 of C3, Inc. (File No. 333-36809).*
- 10.22 1997 Declaration of Amendment to 1997 Omnibus Stock Plan of C3, Inc. which is hereby incorporated by reference to Exhibit 99.3 to the Registration Statement on Form S-8 of C3, Inc. (File No. 333-43613).+
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23.1 Consent of Deloitte & Touche LLP

27.1 Financial Data Schedule - Fiscal year ended December 31, 1998.

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

+ Denotes a management contract or compensatory plan or arrangement.

ARTICLES OF AMENDMENT
OF C3, INC.

C3, Inc., a North Carolina corporation (the "Corporation"), hereby submits these Articles of Amendment for the purpose of amending its Amended and Restated Articles of Incorporation to determine the preferences, limitations, and relative rights of a new series of Preferred Stock, no par value per share:

(1) The name of the Corporation is C3, Inc.

(2) Pursuant to authority granted by Article II, Paragraph B of the Amended and Restated Articles of Incorporation of the Corporation and in accordance with the provisions of Section 55-6-02 of the North Carolina Business Corporation Act, the Board of Directors of the Corporation duly adopted on February 21, 1999, the following amendment to the Amended and Restated Articles of Incorporation of the Corporation:

Article II of the Corporation's Amended and Restated Articles of Incorporation are hereby amended by adding the following as Paragraph E:

E. Series A Junior Participating Preferred Stock. There is hereby created a new series of Preferred Stock designated "Series A Junior Participating Preferred Stock." The number of shares constituting such series initially shall be one million (1,000,000). Such number of shares may be increased or decreased by the Board of Directors; provided, however, that no decrease shall reduce the number of shares of Series A Junior Participating Preferred Stock to a number less than the number of shares then outstanding plus the number of shares reserved for issuance upon the exercise of outstanding options, rights or warrants or upon the conversion of any outstanding securities issued by the Corporation convertible into Series A Junior Participating Preferred Stock. The Series A Junior Participating Preferred Stock shall have the preferences, limitations and relative rights set forth below:

(a) Dividends and Distributions.

(i) Subject to the prior and superior rights of the holders of any shares of any series of Preferred Stock ranking prior and superior to the shares of Series A Junior Participating Preferred Stock with respect to dividends, the holders of shares of Series A Junior Participating Preferred Stock, in preference to the holders of Common Stock and of any other junior stock, shall be entitled to receive, when, as and if declared by the Board of Directors out of funds legally available therefor, quarterly dividends payable in cash on the first day of February, May, August and November in each year (each such date being referred to herein as a "Quarterly Dividend Payment Date"), commencing on the first Quarterly Dividend Payment Date after the

first issuance of a share or fraction of a share of Series A Junior Participating Preferred Stock, in an amount per share (rounded to the nearest cent) equal to the greater of (a) \$1.00 or (b) subject to the provision for adjustment hereinafter set forth, 100 times the aggregate per share amount of all cash dividends, and 100 times the aggregate per share amount (payable in kind) of all non-cash dividends or other distributions, other than a dividend payable in shares of Common Stock or a subdivision of the outstanding shares of Common Stock (by reclassification or otherwise), declared on the Common Stock since the immediately preceding Quarterly Dividend Payment Date, or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of any share or fraction of a share of Series A Junior Participating Preferred Stock. In the event the Corporation shall on or at any time after February 21, 1999 (the "Rights Declaration Date") (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding Common Stock, or (iii) combine or consolidate the outstanding shares of Common Stock into a smaller number of shares, then in each such case the amount to which holders of shares of Series A Junior Participating Preferred Stock were entitled immediately prior to such event under clause (b) of the preceding sentence shall be adjusted by multiplying such amount by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(ii) The Corporation shall declare a dividend or distribution on the Series A Junior Participating Preferred Stock as provided in paragraph (i) above immediately after it declares a dividend or distribution on the Common Stock (other than a dividend payable in shares of Common Stock); provided that, subject to the requirements of applicable law and the Amended and Restated Articles of Incorporation, in the event no dividend or distribution shall have been declared on the Common Stock during the period between any Quarterly Dividend Payment Date and the next subsequent Quarterly Dividend Payment Date, a dividend of \$1.00 per share on the Series A Junior Participating Preferred Stock shall nevertheless be payable on such subsequent Quarterly Dividend Payment Date.

(iii) Dividends shall begin to accrue and be cumulative on

outstanding shares of Series A Junior Participating Preferred Stock from the Quarterly Dividend Payment Date next preceding the date of issue of such shares of Series A Junior Participating Preferred Stock, unless the date of issue of such shares is prior to the record date for the first Quarterly Dividend Payment Date, in which case dividends on such shares shall begin to accrue

from the date of issue of such shares, or unless the date of issue is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of shares of Series A Junior Participating Preferred Stock entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in either of which events such dividends shall begin to accrue and be cumulative from such Quarterly Dividend Payment Date. Accrued but unpaid dividends shall not bear interest. Dividends paid on the shares of Series A Junior Participating Preferred Stock in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding. The Board of Directors may fix a record date for the determination of holders of shares of Series A Junior Participating Preferred Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be no more than 60 days prior to the date fixed for the payment thereof.

(b) Voting Rights. The holders of shares of Series A Junior Participating Preferred Stock shall have the following voting rights:

(i) Subject to the provision for adjustment hereinafter set forth, each share of Series A Junior Participating Preferred Stock shall entitle the holder thereof to 100 votes on all matters submitted to a vote of the shareholders of the Corporation. In the event the Corporation shall at any time on or after the Rights Declaration Date (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding Common Stock, or (iii) combine or consolidate the outstanding Common Stock into a smaller number of shares, then in each such case the number of votes per share to which holders of shares of Series A Junior Participating Preferred Stock were entitled immediately prior to such event shall be adjusted by multiplying such number by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(ii) Except as otherwise provided herein, in any other amendment to the Amended and Restated Articles of Incorporation of the Corporation or bylaw, the holders of shares of Series A Junior Participating Preferred Stock and the holders of shares of Common Stock shall vote together as one group on all matters submitted to a vote of shareholders of the Corporation.

(iii) Except as set forth herein, holders of Series A Junior Participating Preferred Stock shall have no special voting rights and their

consent shall not be required (except to the extent they are entitled to vote with holders of Common Stock as set forth herein) for taking any corporate action.

(c) Certain Restrictions.

(i) Whenever quarterly dividends or other dividends or distributions payable on the Series A Junior Participating Preferred Stock as provided in Paragraph (a) are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series A Junior Participating Preferred Stock outstanding shall have been paid in full, the Corporation shall not:

(A) declare or pay dividends on, redeem or purchase or otherwise acquire for consideration, or make any other distributions on any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Junior Participating Preferred Stock;

(B) declare or pay dividends on, redeem or purchase or otherwise acquire for consideration, or make any other distributions on any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Junior Participating Preferred Stock, provided that there may be declared and paid ratably dividends on the Series A Junior Participating Preferred Stock and all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled; and, provided further, that the Corporation may at any time redeem or purchase or otherwise acquire shares of any such parity stock in exchange for shares of any stock of the Corporation ranking junior (either as to dividends or upon dissolution, liquidation or winding up) to the Series A Junior Participating Preferred Stock; or

(C) purchase or otherwise acquire for consideration any shares of Series A Junior Participating Preferred Stock, or redeem or purchase or otherwise acquire any shares of stock ranking on a parity with the Series A Junior Participating Preferred Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board of Directors) to all holders of such shares upon such terms as the Board of Directors, after consideration of the respective annual dividend rates and other relative rights and

preferences of the respective series and classes, shall determine in good faith will result in fair and equitable treatment among the respective series or classes.

(ii) The Corporation shall not permit any subsidiary of the Corporation (for the account of such subsidiary) to purchase or otherwise acquire for consideration any shares of stock of the Corporation unless the Corporation could, under paragraph (i) of this Paragraph (c), purchase or otherwise acquire such shares at such time and in such manner.

(iii) No dividend shall be declared and paid, or set apart for payment on, any share of the Series A Junior Participating Preferred Stock or any share of any other series of Preferred Stock or any share of any class of stock, or series thereof, ranking on a parity with the Series A Junior Participating Preferred Stock as to dividends, for any dividend period unless at the same time a like proportionate dividend for the same dividend period, ratably in proportion to the respective dividends applicable thereto, shall be declared and paid, or set apart for payment on, all shares of the Series A Junior Participating Preferred Stock and all shares of all other series of Preferred Stock and all shares of any class, or series thereof, ranking on a parity with the Series A Junior Participating Preferred Stock as to dividends, then issued and outstanding and entitled to receive dividends.

(d) Reacquired Shares. Any shares of Series A Junior Participating Preferred Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall be retired and canceled promptly after the acquisition thereof. All such shares shall upon their cancellation become authorized but unissued shares of Preferred Stock and may be reissued as part of a new series of Preferred Stock, subject to the conditions and restrictions on issuance set forth herein, in the Amended and Restated Articles of Incorporation of the Corporation (including Articles of Amendment duly adopted in accordance with the North Carolina Business Corporation Act) creating a series of Preferred Stock or any similar stock, or as otherwise required by law.

(e) Liquidation, Dissolution or Winding Up.

(i) Upon any liquidation (voluntary or otherwise), dissolution or winding up of the Corporation, no distribution shall be made to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Junior Participating Preferred Stock unless, prior thereto, the holders of shares of Series A Junior Participating Preferred Stock shall have received \$100 per share, plus an

amount equal to all accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment (the "Series A Liquidation Preference"). Following the payment of the full amount of the Series A Liquidation Preference, no additional distributions shall be made to the holders of shares of Series A Junior Participating Preferred Stock unless, prior thereto, the holders of shares of Common Stock shall have received an amount per share (the "Common Adjustment") equal to the quotient obtained by dividing (a) the Series A Liquidation Preference by (b) 100 (as appropriately adjusted as set forth in subparagraph (iii) below to reflect such events as stock splits, stock dividends and recapitalizations with respect to the Common Stock) (such number in clause (b), the "Adjustment Number"). Following the payment of the full amount of the Series A Liquidation Preference and the Common Adjustment in respect of all outstanding shares of Series A Junior Participating Preferred Stock and Common Stock, respectively, holders of Series A Junior Participating Preferred Stock and holders of shares of Common Stock shall receive their ratable and proportionate share of the remaining assets to be distributed in the ratio of the Adjustment Number to one (1) with respect to such Series A Junior Participating Preferred Stock and Common Stock, on a per share basis, respectively.

(ii) In the event, however, that there are not sufficient assets available to permit payment in full of the Series A Liquidation Preference and the liquidation preferences of all other series of Preferred Stock, if any, which rank on a parity with the Series A Junior Participating Preferred Stock, then such remaining assets shall be distributed ratably to the holders of the Series A Junior Participating Preferred Stock and such parity shares in proportion to their respective liquidation preferences. In the event that there are not sufficient assets available to permit payment in full of the Common Adjustment, then such remaining assets shall be distributed ratably to the holders of Common Stock.

(iii) In the event the Corporation shall at any time on or after the Rights Declaration Date (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding Common Stock, or (iii) combine the outstanding Common Stock into a smaller number of shares, then in each such case the Adjustment Number in effect immediately prior to such event shall be adjusted by multiplying such Adjustment Number by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(iv) Neither the sale, lease or conveyance of all or substantially all of the property or business of the Corporation, nor the merger, consolidation or statutory share exchange of the Corporation into or with any other corporation or the merger, consolidation or statutory share exchange of any other corporation into or with the Corporation, shall be deemed to be a liquidation, dissolution or winding-up, voluntary or involuntary, for the purposes of this Paragraph (e).

(f) Statutory Share Exchange, Merger Consolidation, etc. In case the Corporation shall enter into any statutory share exchange, merger, consolidation, combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case the shares of Series A Junior Participating Preferred Stock shall at the same time be similarly exchanged or changed in an amount per share (subject to the provision for adjustment hereinafter set forth) equal to 100 times the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is changed or exchanged. In the event the Corporation shall at any time on or after the Rights Declaration Date (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding Common Stock, or (iii) combine or consolidate the outstanding Common Stock into a smaller number of shares, then in each such case the amount set forth in the preceding sentence with respect to the exchange or change of shares of Series A Junior Participating Preferred Stock shall be adjusted by multiplying such amount by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(g) No Redemption. The shares of Series A Junior Participating Preferred Stock shall not be redeemable.

(h) Ranking. The Series A Junior Participating Preferred Stock shall rank junior to all other series of the Corporation's Preferred Stock as to the payment of dividends and the distribution of assets, unless the terms of any such series shall provide otherwise.

(i) Amendment. The Amended and Restated Articles of Incorporation of the Corporation shall not be further amended in any manner which would materially alter or change the powers, preferences or special rights of the Series A Junior Participating Preferred Stock so as to affect them adversely, except in accordance with the provisions of Section 55-10-04 of the North Carolina Business Corporation Act, or as otherwise permitted by law.

(j) Fractional Shares. Series A Junior Participating Preferred Stock may be issued in fractions of a share (which shall be integral multiples of one one-hundredth of a share of Series A Junior Participating Preferred Stock), which shall entitle the holder, in proportion to such holder's fractional shares, to exercise voting rights, receive dividends, participate in distributions and to have the benefit of all other rights of holders of Series A Junior Participating Preferred Stock.

This 23rd day of February, 1999.

C3, INC.

By: /s/ Robert S. Thomas

Name: Robert S. Thomas
Title: President

[STOCK CERTIFICATE APPEARS WITH THE FOLLOWING INFORMATION:]

NUMBER		SHARES
CTHR 2001	[C3, INC. LOGO APPEARS HERE]	

INCORPORATED UNDER THE LAWS OF THE STATE OF NORTH CAROLINA

THIS CERTIFICATE IS TRANSFERABLE IN THE CITY OF NEW YORK OR IN CHARLOTTE, NORTH CAROLINA

COMMON STOCK	SEE REVERSE FOR CERTAIN DEFINITIONS
NO PAR VALUE	CUSIP 22942P 10 9

THIS CERTIFIES THAT

IS THE OWNER OF

FULLY PAID AND NONASSESSABLE SHARES OF THE COMMON STOCK OF

C3, INC.

transferable on the books of the Corporation by the registered holder hereof in person or by duly authorized attorney upon surrender of this Certificate properly endorsed. This Certificate is not valid until countersigned by the Transfer Agent and registered by the Registrar. WITNESS the facsimile seal of the Corporation and the facsimile signatures of its duly authorized officers.

Dated:

CERTIFICATE OF STOCK

[SIGNATURE]	[SIGNATURE]
SECRETARY	PRESIDENT

[C3, INC. CORPORATE SEAL APPEARS HERE]

[THE FOLLOWING INFORMATION APPEARS ON RIGHT SIDE OF PAGE ROTATED 90 DEGREES:]

COUNTERSIGNED AND REGISTERED:

FIRST UNION NATIONAL BANK
(CHARLOTTE, N.C.)

TRANSFER AGENT
AND REGISTRAR
BY
AUTHORIZED SIGNATURE

This certificate also evidences and entitles the holder hereof to certain Rights as set forth in the Rights Agreement between C3, Inc. (the "Company") and First Union National Bank (the "Rights Agent") dated as of February 22, 1999 (the "Rights Agreement"), the terms of which are hereby incorporated herein by reference and a copy of which is on file at the principal office of the Company. Under certain circumstances, as set forth in the Rights Agreement, such Rights will be evidenced by separate certificates and will no longer be evidenced by this certificate. The Company will mail to the holder of this certificate a copy of the Rights Agreement, as in effect on the date of mailing, without charge promptly after receipt of a written request therefor. Under certain circumstances set forth in the Rights Agreement, Rights issued to, or held by, any Person who is, was or becomes an Acquiring Person or any Affiliate or Associate thereof (as such terms are defined in the Rights Agreement), whether currently held by or on behalf of such Person or by any subsequent holder, may become null and void.

C3, INC.

THE CORPORATION IS AUTHORIZED TO ISSUE COMMON STOCK, NO PAR VALUE, AND PREFERRED STOCK, NO PAR VALUE. PURSUANT TO THE CORPORATION'S ARTICLES OF INCORPORATION, THE BOARD OF DIRECTORS MAY DETERMINE THE RELATIVE RIGHTS, PREFERENCES AND LIMITATIONS OF THE PREFERRED STOCK OR ANY CLASS THEREOF OR ANY SERIES OF ANY SUCH CLASS. UPON REQUEST, THE CORPORATION WILL FURNISH TO ANY SHAREHOLDER WITHOUT CHARGE INFORMATION IN WRITING REGARDING THE DESIGNATIONS, RELATIVE RIGHTS, PREFERENCES AND LIMITATIONS APPLICABLE TO THE COMMON STOCK AND PREFERRED STOCK, INCLUDING THE AUTHORITY OF THE BOARD OF DIRECTORS TO DETERMINE THE RELATIVE RIGHTS, PREFERENCES AND LIMITATIONS OF THE PREFERRED STOCK.

The following abbreviations, when used in the inscription on the face of this Certificate, shall be construed as though they were written out in full according to applicable laws or regulations:

TEN COM - as tenants in common	UNIF GIFT MIN ACT -	Custodian for
TEN ENT - as tenants by the entireties		-----
JT TEN - as joint tenants with rights of survivorship and not as tenants in common		(Cust) (Minor)
		under Uniform Gifts to Minors Act

		(State)

Additional abbreviations may also be used though not in the above list.

For value received, _____ hereby sell, assign and transfer unto

PLEASE INSERT SOCIAL SECURITY OR OTHER IDENTIFYING NUMBER OF ASSIGNEE

 (PLEASE PRINT OR TYPE NAME AND ADDRESS, INCLUDING ZIP CODE OF ASSIGNEE)

----- Shares

 of the Common Stock represented by the within Certificate and do hereby irrevocably constitute and appoint

----- Attorney

to transfer the said stock on the books of the within-named Corporation with full power of substitution in the premises.

Dated: _____

Signature: _____

NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME(S) AS WRITTEN UPON THE FACE OF THE CERTIFICATE IN EVERY PARTICULAR, WITHOUT ALTERATION OR ENLARGEMENT OR ANY CHANGE WHATEVER.

SIGNATURE(S) GUARANTEED: _____
 THE SIGNATURE(S) SHOULD BE GUARANTEED BY AN ELIGIBLE GUARANTOR INSTITUTION (BANKS, STOCKBROKERS, SAVINGS AND LOAN ASSOCIATIONS AND CREDIT UNIONS WITH MEMBERSHIP IN AN APPROVED SIGNATURE GUARANTEE MEDALLION PROGRAM), PURSUANT TO S.E.C. RULE 17Ad-15.

KEEP THIS CERTIFICATE IN A SAFE PLACE. IF IT IS LOST, STOLEN, MUTILATED OR DESTROYED, THE CORPORATION WILL REQUIRE A BOND OF INDEMNITY AS A CONDITION TO THE ISSUANCE OF A REPLACEMENT CERTIFICATE.

RIGHTS AGREEMENT

by and between

C3, INC.

and

First Union National Bank

as Rights Agent

Dated as of February 22, 1999

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EXHIBITS

Exhibit A -- Form of Rights Certificate
Exhibit B -- Form of Summary of Rights
Exhibit C -- Form of Articles of Amendment

RIGHTS AGREEMENT

THIS RIGHTS AGREEMENT, dated as of February 22, 1999 (the "Agreement"), between C3, Inc., a North Carolina corporation (the "Company"), and First Union National Bank (the "Rights Agent").

W I T N E S S E T H:

WHEREAS, on February 21, 1999 the Board of Directors of the Company authorized and declared a dividend of one preferred share purchase right (each, a "Right" and, collectively, the "Rights") for each share of Common Stock of the Company outstanding at the close of business on March 8, 1999 (the "Record Date"), each Right representing the right to purchase one one-hundredth (1/100) of a share of Preferred Stock, upon the terms and subject to the conditions set forth in this Agreement, and further authorized and directed the issuance of one Right with respect to each share of Common Stock that shall become outstanding between the Record Date and the earlier of the Distribution Date and the Expiration Date.

NOW, THEREFORE, in consideration of the premises and the mutual agreements herein set forth, the parties hereby agree as follows:

1. Certain Definitions. For purposes of this Agreement, the following terms have the meanings indicated:

(a) "Acquiring Person" shall mean any Person who or which, together with all Affiliates and Associates of such Person, shall be the Beneficial Owner of 20% or more of the shares of Common Stock then outstanding, but shall not include (i) the Company, (ii) any Subsidiary of the Company, (iii) any employee benefit plan of the Company or of any Subsidiary of the Company, or (iv) any Person organized, appointed or established by the Company for or pursuant to the terms of any such plan. Notwithstanding the foregoing, no person shall be deemed to be an "Acquiring Person" as a result of the acquisition of shares of Common Stock by the Company which, by reducing the number of shares of Common Stock outstanding, increases the proportional number of shares beneficially owned by such Person together with all Affiliates and Associates of such Person; provided, however, that if a Person becomes the Beneficial Owner of 20% or more of the shares of Common Stock then outstanding by reason of the Company's acquisition of shares of Common Stock, and thereafter becomes the Beneficial Owner of additional shares of Common Stock, then such Person shall be deemed an "Acquiring Person." Notwithstanding the first sentence of this Section 1(a), no person shall be deemed to be an "Acquiring Person" if the Board of Directors of the Company determines in good faith that such Person became the Beneficial Owner of 20% or more of the shares of Common Stock then outstanding inadvertently and such Person divests, as promptly as practicable after receipt of a written notice from the Company, a sufficient number of shares of Common Stock so that such Person is no longer the Beneficial Owner of 20% or more of the shares of Common Stock then outstanding.

(b) "Act" shall mean the Securities Act of 1933, as amended and as in effect on the date of this Agreement.

(c) "Affiliate" and "Associate" shall have the respective meanings ascribed to such terms in Rule 12b-2 of the General Rules and Regulations under the Exchange Act.

(d) A Person shall be deemed the "Beneficial Owner" of, and shall be deemed to "beneficially own," any securities:

(i) which such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to acquire (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding (whether or not in writing) or upon the exercise of conversion rights, exchange rights, rights (other than the Rights), warrants or options, or otherwise; provided, however, that a Person shall not be deemed the "Beneficial Owner" of, or to "beneficially own," securities tendered pursuant to a tender or exchange offer made by such Person or any of such Person's Affiliates or Associates until such tendered securities are accepted for purchase or exchange;

(ii) which such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to vote or dispose of or has "beneficial ownership" of (as determined pursuant to Rule 13d-3 of the General Rules and Regulations under the Exchange Act), including pursuant to any agreement, arrangement or understanding, whether or not in writing; provided, however, that a Person shall not be deemed the "Beneficial Owner" of, or to "beneficially own," any security under this subparagraph (ii) as a result of an agreement, arrangement or understanding to vote such security if such agreement, arrangement or understanding: (A) arises solely from a revocable proxy given in response to a public proxy or consent solicitation made pursuant to, and in accordance with, the applicable provisions of the General Rules and Regulations under the Exchange Act, and (B) is not also then reportable by such Person on Schedule 13D under the Exchange Act (or any comparable or successor report); or

(iii) which are beneficially owned, directly or indirectly, by any other Person (or any Affiliate or Associate thereof) with which such Person (or any of such Person's Affiliates or Associates) has any agreement, arrangement or understanding (whether or not in writing), for the purpose of acquiring, holding, voting (except pursuant to a revocable proxy as described in the proviso to subparagraph (ii) of this paragraph (d)) or disposing of any voting securities of the Company; provided, however, that nothing in this paragraph (d) shall cause a person engaged in business as an underwriter of securities to be the "Beneficial Owner" of, or to "beneficially own," any securities acquired through such person's participation in good faith in a firm commitment underwriting until the expiration of forty days after the date of such acquisition.

(e) "Agreement" shall mean this Rights Agreement.

(f) "Business Day" shall mean any day other than a Saturday, Sunday or United States federal holiday.

(g) "Close of Business" on any given date shall mean 5:00 P.M., Morrisville, North Carolina time on such date; provided, however, that if such date is not a Business Day it shall mean 5:00 P.M., Morrisville, North Carolina time on the next succeeding Business Day.

(h) "Common Stock" shall mean the common stock, no par value, of the Company, except that "Common Stock" when used with reference to any Person other than the Company shall mean the capital stock of such Person with the greatest aggregate voting power, or the equity securities or other equity interests having power to control or direct the management, of such Person.

(i) "Company" shall mean C3, Inc., a North Carolina corporation.

(j) "Common Stock Equivalents" shall have the meaning set forth in Section 11(a)(iii) hereof.

(k) "Current Market Price" shall have the meaning set forth in Section 11(d)(i) hereof.

(l) "Current Value" shall have the meaning set forth in Section 11(a)(iii) hereof.

(m) "Distribution Date" shall have the meaning set forth in Section 3(a) hereof.

(n) "Equivalent Preferred Stock" shall have the meaning set forth in Section 11(b) hereof.

(o) "Exchange Act" shall mean the Securities Exchange Act of 1934, as amended and as in effect on the date of this Agreement.

(p) "Exchange Ratio" shall have the meaning set forth in Section 24 hereof.

(q) "Expiration Date" shall mean the earlier of (i) the Final Expiration Date or (ii) the Redemption Date.

(r) "Final Expiration Date" shall mean the Close of Business on February 22, 2009, unless extended by the Board of Directors of the Company as provided in Section 27 hereof.

(s) "Person" shall mean any individual, firm, corporation, partnership, company or other entity.

(t) "Preferred Stock" shall mean shares of the Company's Series A Junior Participating Preferred Stock, having the relative rights, preferences and limitations set forth in the Articles of Amendment attached as Exhibit C hereto, and, to the extent that there is not a sufficient number of shares of Preferred Stock authorized to permit the full exercise of the Rights, any other series of the Preferred Stock of the Company designated for such purpose containing terms substantially similar to the terms of the Series A Junior Participating Preferred Stock.

(u) "Principal Party" shall have the meaning set forth in Section 13(b) hereof.

(v) "Purchase Price" shall have the meaning set forth in Section 4(a) hereof.

(w) "Record Date" shall have the meaning set forth in the WHEREAS clause at the beginning of this Agreement.

(x) "Redemption Date" shall mean the time at which the Rights are redeemed as provided in Section 23 of this Agreement.

(y) "Redemption Price" shall have the meaning set forth in Section 23(a) hereof.

(z) "Rights" shall have the meaning set forth in the WHEREAS clause at the beginning of this Agreement.

(aa) "Rights Agent" shall mean First Union National Bank or any Person that succeeds or replaces it in accordance with the provisions of Section 21 of this Agreement.

(bb) "Rights Certificates" shall have the meaning set forth in Section 3(a) hereof.

(cc) "Section 11(a)(ii) Event" shall mean any event described in Section 11(a)(ii) hereof.

(dd) "Section 11(a)(ii) Trigger Date" shall have the meaning set forth in Section 11(a)(iii) hereof.

(ee) "Section 13 Event" shall mean any event described in clause (x), (y) or (z) of Section 13(a) hereof.

(ff) "Spread" shall have the meaning set forth in Section 11(a)(iii) hereof.

(gg) "Stock Acquisition Date" shall mean the first date of a public announcement (which, for purposes of this definition, shall include, without limitation, a report filed pursuant to Section 13(d) under the Exchange Act) by the Company or an Acquiring Person that an Acquiring Person has become such.

(hh) "Subsidiary" shall mean, with reference to any Person, any corporation, partnership, company or other entity of which an amount of voting securities sufficient to elect at least a majority of the directors, managers, trustees or similar persons, of such entity is beneficially owned, directly or indirectly, by such Person, or otherwise controlled by such Person.

(ii) "Substitution Period" shall have the meaning set forth in Section 11(a)(iii) hereof.

(jj) "Trading Day" shall have the meaning set forth in Section 11(d)(i) hereof.

(kk) "Triggering Event" shall mean any Section 11(a)(ii) Event or any Section 13 Event.

2. Appointment of Rights Agent. The Company hereby appoints the Rights Agent to act as agent for the Company and the holders of the Rights (who, in accordance with Section 3 hereof, shall, prior to the Distribution Date, also be the holders of the Common Stock) in accordance with the terms and conditions hereof, and the Rights Agent hereby accepts such appointment. The Company may from time to time appoint such co-Rights Agents as it may deem necessary or desirable.

3. Issuance of Rights Certificates.

(a) Until the earliest of (i) the Close of Business on the tenth Business Day after the Stock Acquisition Date, (ii) the Close of Business on the tenth Business Day after the date that a tender or exchange offer by any Person (other than the Company, any Subsidiary of the Company, any employee benefit plan of the Company or of any Subsidiary of the Company, or any Person organized, appointed or established by the Company for or pursuant to the terms of any such plan) is first published or sent or given within the meaning of Rule 14d-2(a) of the General Rules and Regulations under the Exchange Act, if upon consummation thereof, such Person would be an Acquiring Person (the earliest of (i) and (ii) being herein referred to as the "Distribution Date"), (x) the Rights will be evidenced (subject to the provisions of paragraph (b) of this Section 3) by the certificates for the Common Stock registered in the names of the holders of the Common Stock (which certificates for Common Stock shall be deemed also to be certificates for Rights) and not by separate certificates, and (y) the Rights will be transferable only in connection with the transfer of the underlying shares of Common Stock (including a transfer to the Company); provided, however, that if a tender or exchange offer is terminated prior to the occurrence of a Distribution Date, then no Distribution Date shall occur as a result of such tender or exchange offer. As soon as practicable after the Distribution Date, the Rights Agent will send by first-class, insured, postage prepaid mail, to each record holder of the Common Stock as of the Close of Business on the Distribution Date, at the address of such holder shown on the records of the Company, a certificate in substantially the form of Exhibit A attached hereto (a "Rights Certificate"), evidencing one Right for each share of Common Stock so held, subject to adjustment as provided herein. In the event that an adjustment in the number of Rights per share of Common Stock has been made pursuant to Section 11(o) hereof,

at the time of distribution of the Right Certificates, the Company shall make the necessary and appropriate rounding adjustments (in accordance with Section 14(a) hereof) so that Rights Certificates representing only whole numbers of Rights are distributed and cash is paid in lieu of any fractional Rights. As of and after the Distribution Date, the Rights will be evidenced solely by such Rights Certificates.

(b) As promptly as practicable following the Record Date, the Company will send a copy of the Summary of Rights to Purchase Preferred Stock, in substantially the form attached hereto as Exhibit B, by first-class, postage prepaid mail, to each record holder of the Common Stock as of the Close of Business on the Record Date, at the address of such holder shown on the records of the Company. With respect to certificates for the Common Stock outstanding as of the Record Date, until the earlier of the Distribution Date or the Expiration Date, the Rights will be evidenced by such certificates for the Common Stock and the registered holders of the Common Stock shall also be the registered holders of the associated Rights. Until the earlier of the Distribution Date or the Expiration Date, the transfer of any certificates representing shares of Common Stock in respect of which Rights have been issued shall also constitute the transfer of the Rights associated with such shares of Common Stock.

(c) Rights shall be issued in respect of all shares of Common Stock which are issued after the Record Date but prior to the earlier of the Distribution Date or the Expiration Date. Certificates representing such shares of Common Stock shall also be deemed to be certificates for Rights, and certificates issued after the Record Date shall bear the following legend:

This certificate also evidences and entitles the holder hereof to certain Rights as set forth in the Rights Agreement between C3, Inc. (the "Company") and First Union National Bank (the "Rights Agent") dated as of February 22, 1999 (the "Rights Agreement"), the terms of which are hereby incorporated herein by reference and a copy of which is on file at the principal office of the Company. Under certain circumstances, as set forth in the Rights Agreement, such Rights will be evidenced by separate certificates and will no longer be evidenced by this certificate. The Company will mail to the holder of this certificate a copy of the Rights Agreement, as in effect on the date of mailing, without charge promptly after receipt of a written request therefor. Under certain circumstances set forth in the Rights Agreement, Rights issued to, or held by, any Person who is, was or becomes an Acquiring Person or any Affiliate or Associate thereof (as such terms are defined in the Rights Agreement), whether currently held by or on behalf of such Person or by any subsequent holder, may become null and void.

With respect to such certificates containing the foregoing legend, until the earlier of (i) the Distribution Date or (ii) the Expiration Date, the Rights associated with the Common Stock represented by such certificates shall be evidenced by such Certificates alone and registered holders of Common Stock shall also be the registered holders of the associated Rights, and the transfer of

any of such certificates shall also constitute the transfer of the Rights associated with the Common Stock represented by such certificates.

4. Form of Rights Certificates.

(a) The Rights Certificates (and the forms of election to purchase shares and of assignment to be printed on the reverse thereof) shall each be substantially in the form set forth in Exhibit A hereto and may have such marks of identification or designation and such legends, summaries or endorsements printed thereon as the Company may deem appropriate and as are not inconsistent with the provisions of this Agreement, or as may be required to comply with any applicable law or with any rule or regulation made pursuant thereto or with any rule or regulation of any stock exchange on which the Rights may from time to time be listed, or to conform to usage. Subject to the provisions of Section 11 and Section 22 hereof, the Rights Certificates, whenever distributed, shall be dated as of the Record Date and on their face shall entitle the holders thereof to purchase such number of one one-hundredths of a share of Preferred Stock as shall be set forth therein at the price set forth therein (such exercise price per one one-hundredths of a share, the "Purchase Price"), but the amount and type of securities purchasable upon the exercise of each Right and the Purchase Price thereof shall be subject to adjustment as provided herein.

(b) Any Rights Certificate issued pursuant to Section 3(a) or Section 22 hereof that represents Rights beneficially owned by any Person known to be: (i) an Acquiring Person or any Associate or Affiliate of an Acquiring Person; (ii) a transferee of an Acquiring Person or of any Associate or Affiliate of an Acquiring Person who becomes a transferee after the Acquiring Person becomes such; or (iii) a transferee of an Acquiring Person or of any Associate or Affiliate of an Acquiring Person who becomes a transferee prior to or concurrently with the Acquiring Person becoming such and receives such Rights pursuant to either (A) a transfer (whether or not for consideration) from the Acquiring Person or any Associate or Affiliate of an Acquiring Person to holders of equity interests in such Acquiring Person or any Associate or Affiliate of an Acquiring Person or to any Person with whom such Acquiring Person or any Associate or Affiliate of an Acquiring Person has any continuing agreement, arrangement or understanding regarding the transferred Rights or (B) a transfer which the Board of Directors of the Company has determined is part of a plan, arrangement or understanding which has as a primary purpose or effect avoidance of Section 7(e) hereof, and any Rights Certificate issued pursuant to Section 6 or Section 11 hereof upon transfer, exchange, replacement or adjustment of any other Rights Certificate referred to in this sentence, shall when issued contain (to the extent feasible in the circumstances) the following legend:

The Rights represented by this Rights Certificate are or were beneficially owned by a Person who was or became an Acquiring Person or an Affiliate or Associate of an Acquiring Person (as such terms are defined in the Rights Agreement). Accordingly, this Rights Certificate and the Rights represented hereby may become null and void in the circumstances specified in Section 7(e) of the Rights Agreement.

5. Countersignature and Registration.

(a) The Rights Certificates shall be executed on behalf of the Company by its President or any Vice President, either manually or by facsimile signature, and shall have affixed thereto the Company's seal or a facsimile thereof which shall be attested by the Secretary or an Assistant Secretary of the Company, either manually or by facsimile signature. The Rights Certificates shall be countersigned by the Rights Agent, manually or by facsimile signature, and shall not be valid for any purpose unless so countersigned. In case any officer of the Company who shall have signed any of the Rights Certificates shall cease to be such officer of the Company before countersignature by the Rights Agent and issuance and delivery by the Company, such Rights Certificates, nevertheless, may be countersigned by the Rights Agent and issued and delivered by the Company with the same force and effect as though the person who signed such Rights Certificates had not ceased to be such officer of the Company; and any Rights Certificates may be signed on behalf of the Company by any person who, at the actual date of the execution of such Rights Certificate, shall be a proper officer of the Company to sign such Rights Certificate, although at the date of the execution of this Rights Agreement any such person was not such an officer.

(b) Following the Distribution Date, the Rights Agent will keep or cause to be kept, at its office designated as the appropriate place for surrender of such Rights Certificates or transfer, books for registration and transfer of the Rights Certificates issued hereunder. Such books shall show the names and addresses of the respective holders of the Rights Certificates, the number of Rights evidenced on its face by each of the Rights Certificates and the certificate number and the date of each of the Rights Certificates.

6. Transfer, Splitup, Combination and Exchange of Rights Certificates; Mutilated, Destroyed, Lost or Stolen Rights Certificates.

(a) Subject to the provisions of Section 4(b), Section 7(e) and Section 14 hereof, at any time after the Close of Business on the Distribution Date, and at or prior to the Close of Business on the Expiration Date, any Rights Certificate or Certificates may be transferred, split up, combined or exchanged for another Rights Certificate or Certificates, entitling the registered holder to purchase a like number of one one-hundredths of a share of Preferred Stock (or, following a Triggering Event, Common Stock, other securities, cash or other assets, as the case may be) as the Rights Certificate or Certificates surrendered then entitled such holder (or former holder in the case of a transfer) to purchase. Any registered holder desiring to transfer, split up, combine or exchange any Rights Certificate or Certificates shall make such request in writing delivered to the Rights Agent, and shall surrender the Rights Certificate or Certificates to be transferred, split up, combined or exchanged at the office of the Rights Agent designated for such purpose. Neither the Rights Agent nor the Company shall be obligated to take any action whatsoever with respect to the transfer of any such surrendered Rights Certificate until the registered holder shall have completed and signed the certificate contained in the form of assignment on the reverse side of such Rights Certificate and shall have provided such additional evidence of the identity of the Beneficial Owner (or former Beneficial Owner) or Affiliates or Associates thereof as the Company shall reasonably

request. Thereupon the Rights Agent shall, subject to Section 4(b), Section 7(e) and Section 14 hereof, countersign and deliver to the Person entitled thereto a Rights Certificate or Rights Certificates, as the case may be, as so requested. The Company may require payment of a sum sufficient to cover any tax or governmental charge that may be imposed in connection with any transfer, splitup, combination or exchange of Rights Certificates.

(b) Upon receipt by the Company and the Rights Agent of evidence reasonably satisfactory to them of the loss, theft, destruction or mutilation of a Rights Certificate, and, in case of loss, theft or destruction, of indemnity or security reasonably satisfactory to them, and reimbursement to the Company and the Rights Agent of all reasonable expenses incidental thereto, and upon surrender to the Rights Agent and cancellation of the Rights Certificate if mutilated, the Company will execute and deliver a new Rights Certificate of like tenor to the Rights Agent for countersignature and delivery to the registered owner in lieu of the Rights Certificate so lost, stolen, destroyed or mutilated.

7. Exercise of Rights; Purchase Price; Expiration Date of Rights.

(a) Subject to Section 7(e) hereof, the registered holder of any Rights Certificate may exercise the Rights evidenced thereby (except as otherwise provided herein) in whole or in part at any time after the Distribution Date upon surrender of the Rights Certificate, with the form of election to purchase and the certificate on the reverse side thereof duly executed, to the Rights Agent at the office of the Rights Agent designated for such purpose, together with payment of the aggregate Purchase Price with respect to the total number of one one-hundredths of a share of Preferred Stock (or other securities, cash or other assets, as the case may be) as to which such surrendered Rights are then exercisable, at or prior to the Expiration Date.

(b) The Purchase Price for each one-hundredths of a share of Preferred Stock pursuant to the exercise of a Right shall initially be \$125.00 and shall be subject to adjustment from time to time as provided in Sections 11 and 13(a) hereof and shall be payable in accordance with paragraph (c) below.

(c) Upon receipt of a Rights Certificate representing exercisable Rights, with the form of election to purchase and the certificate duly executed, accompanied by payment, with respect to each Right so exercised, of the Purchase Price per one one-hundredths of a share of Preferred Stock (or other shares, securities, cash or other assets, as the case may be) to be purchased as set forth below and an amount equal to any applicable transfer tax, the Rights Agent shall, subject to Section 20(k), hereof thereupon promptly (i)(A) requisition from any transfer agent of the shares of Preferred Stock (or make available, if the Rights Agent is the transfer agent for such shares) certificates for the total number of one one-hundredths of a share of Preferred Stock to be purchased and the Company hereby irrevocably authorizes its transfer agent to comply with all such requests, or (B) if the Company, in its sole discretion, shall have elected to deposit the total number of shares of Preferred Stock issuable upon exercise of the Rights hereunder with a depositary agent, requisition from the depositary agent depositary receipts representing such number of one one-hundredths of

a share of Preferred Stock as are to be purchased (in which case certificates for the shares of Preferred Stock represented by such receipts shall be deposited by the transfer agent with the depository agent) and the Company will direct the depository agent to comply with such request, (ii) requisition from the Company the amount of cash, if any, to be paid in lieu of fractional shares in accordance with Section 14 hereof, (iii) after receipt of such certificates or depository receipts, cause the same to be delivered to or upon the order of the registered holder of such Rights Certificate, registered in such name or names as may be designated by such holder, and (iv) after receipt thereof, deliver such cash, if any, to or upon the order of the registered holder of such Rights Certificate. The payment of the Purchase Price (as such amount may be reduced pursuant to Section 11(a)(iii) hereof) may be made in cash or by certified bank check or money order payable to the order of the Company. In the event that the Company is obligated to issue other securities (including Common Stock) of the Company, pay cash and/or distribute other property pursuant to Section 11(a) hereof, the Company will make all arrangements necessary so that such other securities, cash and/or other property are available for distribution by or on behalf of the Rights Agent, if and when appropriate. In the case of an exercise of the Rights by a holder pursuant to Section 11(a)(ii), the Rights Agent shall return such Rights Certificate to the registered holder thereof after imprinting, stamping or otherwise indicating thereon that the rights represented by such Rights Certificate no longer include the rights provided by Section 11(a)(ii) of the Rights Agreement and, if less than all the Rights represented by such Rights Certificate were so exercised, the Rights Agent shall indicate on the Rights Certificate the number of Rights represented thereby which continue to include the rights provided by Section 11(a)(ii).

(d) In case the registered holder of any Rights Certificate shall exercise less than all the Rights evidenced thereby, a new Rights Certificate evidencing Rights equivalent to the Rights remaining unexercised shall be issued by the Rights Agent and delivered to, or upon the order of, the registered holder of such Rights Certificate, registered in such name or names as may be designated by such holder, subject to the provisions of Section 14 hereof, or the Rights Agent shall place an appropriate notation on the Rights Certificate with respect to those Rights exercised.

(e) Notwithstanding anything in this Agreement to the contrary, from and after the first occurrence of a Section 11(a)(ii) Event, any Rights beneficially owned by (i) an Acquiring Person or an Associate or Affiliate of an Acquiring Person, (ii) a transferee of an Acquiring Person (or of any Associate or Affiliate of an Acquiring Person) who becomes a transferee after the Acquiring Person becomes such, or (iii) a transferee of an Acquiring Person (or of any Associate or Affiliate of an Acquiring Person) who becomes a transferee prior to or concurrently with the Acquiring Person becoming such and receives such Rights pursuant to either (A) a transfer (whether or not for consideration) from the Acquiring Person (or from any Associate or Affiliate of an Acquiring Person) to holders of equity interests in such Acquiring Person or in any Associate or Affiliate of any Acquiring Person or to any Person with whom the Acquiring Person or any Associate or Affiliate of an Acquiring Person has any continuing agreement, arrangement or understanding regarding the transferred Rights or (B) a transfer which the Board of Directors of the Company has determined (whether before or after such transfer) is part of a plan, arrangement or understanding which has as a primary purpose or effect the avoidance of this Section 7(e), shall

become null and void without any further action and no holder of such Rights shall have any rights whatsoever with respect to such Rights, whether under any provision of this Agreement or otherwise. The Company shall use all reasonable efforts to insure that the provisions of this Section 7(e) and Section 4(b) hereof are complied with, but shall have no liability to any holder of Rights Certificates or any other Person as a result of its failure to make any determinations with respect to an Acquiring Person or any Affiliate, Associate or transferee of an Acquiring Person hereunder.

(f) Notwithstanding anything in this Agreement to the contrary, neither the Rights Agent nor the Company shall be obligated to undertake any action with respect to a registered holder upon the occurrence of any purported exercise as set forth in this Section 7 unless such registered holder shall have (i) completed and signed the certificate contained in the form of election to purchase set forth on the reverse side of the Rights Certificate surrendered for such exercise, and (ii) provided such additional evidence of the identity of the Beneficial Owner (or former Beneficial Owner) or Affiliates or Associates thereof as the Company shall reasonably request.

8. Cancellation and Destruction of Rights Certificates. All Rights Certificates surrendered for the purpose of exercise, transfer, splitup, combination or exchange shall, if surrendered to the Company or any of its agents, be delivered to the Rights Agent for cancellation or in canceled form, or, if surrendered to the Rights Agent, shall be canceled by it, and no Rights Certificates shall be issued in lieu thereof except as expressly permitted by any of the provisions of this Agreement. The Company shall deliver to the Rights Agent for cancellation and retirement, and the Rights Agent shall so cancel and retire, any other Rights Certificate purchased or acquired by the Company otherwise than upon the exercise thereof. The Rights Agent shall deliver all cancelled Rights Certificates to the Company, or shall, at the written request of the Company, destroy such cancelled Rights Certificates, and in such case shall deliver a certificate of destruction thereof to the Company.

9. Reservation and Availability of Capital Stock.

(a) The Company covenants and agrees that it will cause to be reserved and kept available out of its authorized and unissued shares of Preferred Stock (and, following the occurrence of a Section 11(a)(ii) Event, out of its authorized and unissued shares of Common Stock and/or other securities or out of its authorized and issued shares held in its treasury), the number of shares of Preferred Stock (and, following the occurrence of a Section 11(a)(ii) Event, Common Stock and/or other securities) that, as provided in this Agreement, including Section 11(a)(iii) hereof, will be sufficient to permit the exercise in full of all outstanding Rights.

(b) So long as the shares of Preferred Stock (and, following the occurrence of a Section 11(a)(ii) Event, Common Stock and/or other securities) issuable and deliverable upon the exercise of the Rights may be listed on any national securities exchange, the Company shall use its best efforts to cause, from and after such time as the Rights become exercisable, all shares reserved for such issuance to be listed on such exchange upon official notice of issuance upon such exercise.

(c) The Company shall use its best efforts to (i) file, as soon as practicable following the earliest date after the first occurrence of a Section 11(a)(ii) Event on which the consideration to be delivered by the Company upon exercise of the Rights has been determined in accordance with Section 11(a)(iii) hereof, or as soon as is required by law following the Distribution Date, as the case may be, a registration statement under the Act, with respect to the securities purchasable upon exercise of the Rights on an appropriate form, (ii) cause such registration statement to become effective as soon as practicable after such filing, and (iii) cause such registration statement to remain effective (with a prospectus at all times meeting the requirements of the Act) until the earlier of (A) the date as of which the Rights are no longer exercisable for such securities, and (B) the Expiration Date. The Company will also take such action as may be appropriate under, or to ensure compliance with, the securities or "blue sky" laws of the various states in connection with the exercisability of the Rights. Notwithstanding any provision of this Agreement to the contrary, the Rights shall not be exercisable in any jurisdiction, unless the requisite qualification in such jurisdiction shall have been obtained and until a registration statement has been declared effective.

(d) The Company covenants and agrees that it will take all such action as may be necessary to ensure that all one one-hundredths of a share of Preferred Stock (and, following the occurrence of a Section 11(a)(ii) Event, Common Stock and/or other securities) delivered upon exercise of the Rights shall, at the time of delivery of the certificates for such shares (subject to payment of the Purchase Price), be duly and validly authorized and issued and fully paid and nonassessable.

(e) The Company further covenants and agrees that it will pay when due and payable any and all federal and state transfer taxes and charges which may be payable in respect of the issuance or delivery of the Rights Certificates and of any certificates for a number of one one-hundredths of a share of Preferred Stock (or Common Stock and/or other securities, as the case may be) upon the exercise of Rights. The Company shall not, however, be required to pay any transfer tax which may be payable in respect of any transfer or delivery of Rights Certificates to a Person other than, or the issuance or delivery of any certificate for a number of one one-hundredths of a share of Preferred Stock (or Common Stock and/or other securities, as the case may be) in respect of a name other than that of, the registered holder of the Rights Certificates evidencing Rights surrendered for exercise, or to issue or deliver any certificates or depository receipts for a number of one one-hundredths of a share of Preferred Stock (or Common Stock and/or other securities, as the case may be) in a name other than that of, the registered holder upon the exercise of any Rights, until such tax shall have been paid (any such tax being payable by the holder of such Rights Certificate at the time of surrender) or until it has been established to the Company's satisfaction that no such tax is due.

10. Preferred Stock Record Date. Each person in whose name any certificate for a number of one one-hundredths of a share of Preferred Stock (or Common Stock and/or other securities, as the case may be) is issued upon the exercise of Rights shall for all purposes be deemed to have become the holder of record of such fractional shares of Preferred Stock (or Common Stock and/or other securities, as the case may be) represented thereby on, and such certificate shall be

dated, the date upon which the Rights Certificate evidencing such Rights was duly surrendered and payment of the Purchase Price (and all applicable transfer taxes) was made; provided, however, that if the date of such surrender and payment is a date upon which the Preferred Stock (or Common Stock and/or other securities, as the case may be) transfer books of the Company are closed, such Person shall be deemed to have become the record holder of such shares (fractional or otherwise) on, and such certificate shall be dated, the next succeeding Business Day on which the Preferred Stock (or Common Stock and/or other securities, as the case may be) transfer books of the Company are open. Prior to the exercise of the Rights evidenced thereby, the holder of a Rights Certificate, as such, shall not be entitled to any rights of a shareholder of the Company with respect to shares for which the Rights shall be exercisable, including, without limitation, the right to vote, to receive dividends or other distributions or to exercise any preemptive rights, and shall not be entitled to receive any notice of any proceedings of the Company, except as provided herein.

11. Adjustment of Purchase Price, Number and Kind of Shares or Number of Rights. The Purchase Price, the number and kind of shares covered by each Right and the number of Rights outstanding are subject to adjustment from time to time as provided in this Section 11.

(a) (i) In the event the Company shall at any time after the date of this Agreement (A) declare a dividend on the Preferred Stock payable in shares of Preferred Stock, (B) subdivide the outstanding Preferred Stock, (C) combine the outstanding Preferred Stock into a smaller number of shares, or (D) issue any shares of its capital stock in a reclassification of the Preferred Stock (including any such reclassification in connection with a consolidation, statutory share exchange or merger in which the Company is the continuing or surviving corporation), except as otherwise provided in this Section 11(a) and Section 7(e) hereof, the Purchase Price in effect at the time of the record date for such dividend or of the effective date of such subdivision, combination or reclassification, and the number and kind of shares of Preferred Stock or capital stock, as the case may be, issuable on such date, shall be proportionately adjusted so that the holder of any Right exercised after such time shall be entitled to receive, upon payment of the Purchase Price then in effect, the aggregate number and kind of shares of Preferred Stock or capital stock, as the case may be, which, if such Right had been exercised immediately prior to such date and at a time when the Preferred Stock transfer books of the Company were open, he would have owned upon such exercise and been entitled to receive by virtue of such dividend, subdivision, combination or reclassification. If an event occurs which would require an adjustment under both this Section 11(a)(i) and Section 11(a)(ii) hereof, the adjustment provided for in this Section 11(a)(i) shall be in addition to, and shall be made prior to, any adjustment required pursuant to Section 11(a)(ii) hereof.

(ii) In the event (A) any Person (other than the Company, any Subsidiary of the Company, any employee benefit plan of the Company or of any Subsidiary of the Company, or any Person organized, appointed or established by the Company for or pursuant to the terms of any such plan), alone or together with its Affiliates and Associates, shall, at any time after the date of this Agreement, become an Acquiring Person, proper provision shall be made so that each holder of a Right (except as provided below and in Section 7(e) hereof) shall thereafter have the right to receive, upon exercise thereof at the then current Purchase Price in accordance with the terms of this

Agreement, in lieu of a number of one one-hundredths of a share of Preferred Stock, such number of shares of Common Stock of the Company as shall equal the result obtained by (x) multiplying the then-current Purchase Price by the then number of one one-hundredths of a share of Preferred Stock for which a Right would have been exercisable immediately prior to the first occurrence of a Section 11(a)(ii) Event assuming the Distribution Date had already occurred, and (y) dividing that product (which, following such first occurrence, shall thereafter be referred to as the "Purchase Price" for each Right and for all purposes of this Agreement) by 50% of the Current Market Price (determined pursuant to Section 11(d) hereof) per share of Common Stock on the date of such first occurrence (such number of shares, the "Adjustment Shares"); provided, however, that if the transaction that would otherwise give rise to the foregoing adjustment is also subject to the provision of Section 13(a) hereof, then only the provisions of Section 13(a) hereof shall apply and no adjustment shall be made pursuant to this Section 11(a)(ii).

(iii) In the event that the number of shares of Common Stock which are authorized by the Company's Amended and Restated Articles of Incorporation but not outstanding or reserved for issuance for purposes other than upon exercise of the Rights are not sufficient to permit the exercise in full of the Rights in accordance with the foregoing subparagraph (ii) of this Section 11(a), the Company, by resolution of its Board of Directors, shall: (A) determine the excess of (1) the value of the Adjustment Shares issuable upon the exercise of a Right (the "Current Value") over (2) the Purchase Price (such excess, the "Spread"), and (B) with respect to each Right, make adequate provision to substitute for the Adjustment Shares, upon the exercise of a Right and payment of the applicable Purchase Price, (1) cash, (2) a reduction in the Purchase Price, (3) Common Stock or other equity securities of the Company (including, without limitation, shares, or units of shares, of preferred stock which the Board of Directors of the Company has deemed to have substantially the same value as shares of Common Stock (such shares of preferred stock, "Common Stock Equivalents")), (4) debt securities of the Company, (5) other assets, or (6) any combination of the foregoing, having an aggregate value equal to the Current Value, where such aggregate value has been determined by the Board of Directors of the Company based upon the advice of one or more investment or financial advisors selected by the Board of Directors of the Company; provided, however, if the Company shall not have made adequate provision to deliver value pursuant to clause (B) above within thirty (30) days following the later of (x) the first occurrence of a Section 11(a)(ii) Event and (y) the date on which the Company's right of redemption pursuant to Section 23(a) expires (the later of (x) and (y) being referred to herein as the "Section 11(a)(ii) Trigger Date"), then the Company shall be obligated to deliver, upon the surrender for exercise of a Right and without requiring payment of the Purchase Price, shares of Common Stock (to the extent available) and then, if necessary, cash, which shares and/or cash shall have an aggregate value equal to the Spread. If the Board of Directors of the Company shall determine in good faith that it is likely that sufficient additional shares of Common Stock could be authorized for issuance upon exercise in full of the Rights, the thirty (30) day period set forth above may be extended to the extent necessary, but not more than ninety (90) days after the Section 11(a)(ii) Trigger Date, in order that the Company may seek shareholder approval for the authorization of such additional shares (such period, as it may be extended, the "Substitution Period"). To the extent that the Company determines that some action need be taken pursuant to the first and/or second sentences of this Section 11(a)(iii), the Company

(x) shall provide, subject to Section 7(e) hereof, that such action shall apply uniformly to all outstanding Rights, and (y) may suspend the exercisability of the Rights until the expiration of the Substitution Period in order to seek any authorization of additional shares and/or to decide the appropriate form of distribution to be made pursuant to the first sentence of this Section 11(a)(iii) and to determine the value thereof. In the event of any such suspension, the Company shall issue a public announcement stating that the exercisability of the Rights has been temporarily suspended, as well as a public announcement at such time as the suspension is no longer in effect. For purposes of this Section 11(a)(iii), the value of the Common Stock shall be the Current Market Price (as determined pursuant to Section 11(d) hereof) per share of the Common Stock on the Section 11(a)(ii) Trigger Date and the value of any "Common Stock Equivalent" shall be deemed to have the same value as the Common Stock on such date.

(iv) In lieu of issuing shares of Common Stock in accordance with subparagraph (ii) of this Section 11(a), the Company, by resolution of the Board of Directors, may, with respect to each Right, determine that such action is in the best interests of the Company and not contrary to the interests of the holders of Rights, make adequate provision to substitute for the Adjustment Shares, (x) upon the surrender for exercise of a Right and payment of the applicable Purchase Price, (1) cash, (2) a reduction in the Purchase Price, (3) Common Stock, or other equity securities of the Company (including without limitation Common Stock Equivalents), (4) debt securities of the Company, (5) other assets or (6) any combination of the foregoing having an aggregate value equal to the Current Value where such aggregate value has been determined by the Board of Directors of the Company based upon the advice of one or more investment or financial advisers selected by the Board of Directors of the Company or (y) upon the surrender for exercise of a Right and without requiring payment of the Purchase Price, (1) cash, (2) Common Stock or other equity securities of the Company (including, without limitation, Common Stock Equivalents), (3) debt securities of the Company, (4) other assets or (5) any combination of the foregoing, having an aggregate value equal to the Spread where such aggregate value has been determined by the Board of Directors of the Company based upon the advice of one or more investment or financial advisors selected by the Board of Directors of the Company.

(b) In case the Company shall fix a record date for the issuance of rights, options or warrants to all holders of Preferred Stock entitling them to subscribe for or purchase (for a period expiring within forty-five (45) calendar days after such record date) Preferred Stock (or shares having the same rights, privileges and preferences as the shares of Preferred Stock ("Equivalent Preferred Stock")) or securities convertible into Preferred Stock or Equivalent Preferred Stock at a price per share of Preferred Stock or per share of Equivalent Preferred Stock (or having a conversion price per share, if a security convertible into Preferred Stock or Equivalent Preferred Stock) less than the Current Market Price (as determined pursuant to Section 11(d) hereof) per share of Preferred Stock on such record date, the Purchase Price to be in effect after such record date shall be determined by multiplying the Purchase Price in effect immediately prior to such record date by a fraction, the numerator of which shall be the number of shares of Preferred Stock outstanding on such record date, plus the number of shares of Preferred Stock which the aggregate offering price of the total number of shares of Preferred Stock and/or Equivalent Preferred Stock so to be offered

(and/or the aggregate initial conversion price of the convertible securities so to be offered) would purchase at such Current Market Price, and the denominator of which shall be the number of shares of Preferred Stock outstanding on such record date, plus the number of additional shares of Preferred Stock and/or Equivalent Preferred Stock to be offered for subscription or purchase (or into which the convertible securities so to be offered are initially convertible). In case such subscription price may be paid by delivery of consideration part or all of which may be in a form other than cash, the value of such consideration shall be as determined in good faith by the Board of Directors of the Company, whose determination shall be described in a statement filed with the Rights Agent and shall be binding on the Rights Agent and the holders of the Rights. Shares of Preferred Stock owned by or held for the account of the Company shall not be deemed outstanding for the purpose of any such computation. Such adjustment shall be made successively whenever such a record date is fixed, and in the event that such rights or warrants are not so issued, the Purchase Price shall be adjusted to be the Purchase Price which would then be in effect if such record date had not been fixed.

(c) In case the Company shall fix a record date for a distribution to all holders of Preferred Stock (including any such distribution made in connection with a consolidation, statutory share exchange or merger in which the Company is the continuing corporation) of evidences of indebtedness, cash (other than a regular quarterly cash dividend out of the earnings or retained earnings of the Company), assets (other than a dividend payable in Preferred Stock, but including any dividend payable in stock other than Preferred Stock) or subscription rights or warrants (excluding those referred to in Section 11(b) hereof), the Purchase Price to be in effect after such record date shall be determined by multiplying the Purchase Price in effect immediately prior to such record date by a fraction, the numerator of which shall be the Current Market Price (as determined pursuant to Section 11(d) hereof) per share of Preferred Stock on such record date, less the fair market value (as determined in good faith by the Board of Directors of the Company, whose determination shall be described in a statement filed with the Rights Agent) of the portion of the cash, assets or evidences of indebtedness so to be distributed or of such subscription rights or warrants applicable to a share of Preferred Stock and the denominator of which shall be such Current Market Price (as determined pursuant to Section 11(d) hereof) per share of Preferred Stock. Such adjustments shall be made successively whenever such a record date is fixed, and in the event that such distribution is not so made, the Purchase Price shall be adjusted to be the Purchase Price which would have been in effect if such record date had not been fixed.

(d) (i) For the purpose of any computation hereunder, other than computations made pursuant to Section 11(a)(iii) and Section 11(a)(iv) hereof, the "Current Market Price" per share of Common Stock on any date shall be deemed to be the average of the daily closing prices per share of such Common Stock for the thirty (30) consecutive Trading Days (as such term is hereinafter defined) immediately prior to such date, and for purposes of computations made pursuant to Section 11(a)(iii) and Section 11(a)(iv) hereof, the "Current Market Price" per share of Common Stock on any date shall be deemed to be the average of the daily closing prices per share of such Common Stock for the ten (10) consecutive Trading Days immediately following such date; provided, however, that in the event that the Current Market Price per share of the Common Stock is determined during a period following the announcement by the issuer of such Common Stock of

(A) a dividend or distribution on such Common Stock payable in shares of such Common Stock or securities convertible into shares of such Common Stock (other than the Rights), or (B) any subdivision, combination or reclassification of such Common Stock, and prior to the expiration of the requisite thirty (30) Trading Day or ten (10) Trading Day period, as set forth above, after the ex-dividend date for such dividend or distribution, or the record date for such subdivision, combination or reclassification, then, and in each such case, the "Current Market Price" shall be properly adjusted to take into account ex-dividend trading. The closing price for each day shall be the last sale price, regular way, or, in case no such sale takes place on such day, the average of the closing bid and asked prices, regular way, in either case as reported in the principal consolidated transaction reporting system with respect to securities listed or admitted to trading on the New York Stock Exchange or, if the shares of Common Stock are not listed or admitted to trading on the New York Stock Exchange, as reported in the principal consolidated transaction reporting system with respect to securities listed on the principal national securities exchange on which the shares of Common Stock are listed or admitted to trading or, if the shares of Common Stock are not listed or admitted to trading on any national securities exchange, the last quoted price or, if not so quoted, the average of the high bid and low asked prices in the over-the-counter market, as reported by the National Association of Securities Dealers, Inc. Automated Quotation System ("NASDAQ") or such other system then in use, or, if on any such date the shares of Common Stock are not quoted by any such organization, the average of the closing bid and asked prices as furnished by a professional market maker making a market in the Common Stock selected by the Board of Directors of the Company. If on any such date no market maker is making a market in the Common Stock, the fair value of such shares on such date as determined in good faith by the Board of Directors of the Company shall be used. The term "Trading Day" shall mean a day on which the principal national securities exchange on which the shares of Common Stock are listed or admitted to trading is open for the transaction of business or, if the shares of Common Stock are not listed or admitted to trading on any national securities exchange, a Business Day. If the Common Stock is not publicly held or not so listed or traded, "Current Market Price" per share shall mean the fair value per share as determined in good faith by the Board of Directors of the Company, whose determination shall be described in a statement filed with the Rights Agent and shall be conclusive for all purposes.

(ii) For the purpose of any computation hereunder, the "Current Market Price" per share of Preferred Stock shall be determined in the same manner as set forth above for the Common Stock in clause (i) of this Section 11(d) (other than the last sentence thereof). If the Current Market Price per share of Preferred Stock cannot be determined in the manner provided above or if the Preferred Stock is not publicly held or listed or traded in a manner described in clause (i) of this Section 11(d), the "Current Market Price" per share of Preferred Stock shall be conclusively deemed to be an amount equal to 100 (as such number may be appropriately adjusted for such events as stock splits, stock dividends and recapitalizations with respect to the Common Stock occurring after the date of this Agreement) multiplied by the Current Market Price per share of the Common Stock. If neither the Common Stock nor the Preferred Stock is publicly held or so listed or traded, "Current Market Price" per share of the Preferred Stock shall mean the fair value per share as determined in good faith by the Board of Directors of the Company, whose determination shall be described in a statement filed with the Rights Agent and shall be conclusive for all purposes.

For all purposes of this Agreement, the "Current Market Price" of one one-hundredth of a share of Preferred Stock shall be equal to the "Current Market Price" of one share of Preferred Stock divided by 100.

(e) Anything herein to the contrary notwithstanding, no adjustment in the Purchase Price shall be required unless such adjustment would require an increase or decrease of at least one percent (1%) in the Purchase Price; provided, however, that any adjustments which by reason of this Section 11(e) are not required to be made shall be carried forward and taken into account in any subsequent adjustment. All calculations under this Section 11 shall be made to the nearest cent or to the nearest ten-thousandth of a share of Common Stock or other share or one-millionth of a share of Preferred Stock, as the case may be. Notwithstanding the first sentence of this Section 11(e), any adjustment required by this Section 11 shall be made no later than the earlier of (i) three (3) years from the date of the transaction which mandates such adjustment, or (ii) the Expiration Date.

(f) If as a result of an adjustment made pursuant to Section 11(a)(ii) or Section 13(a) hereof, the holder of any Right thereafter exercised shall become entitled to receive any shares of capital stock other than Preferred Stock, thereafter the number of such other shares so receivable upon exercise of any Right and the Purchase Price thereof shall be subject to adjustment from time to time in a manner and on terms as nearly equivalent as practicable to the provisions with respect to the Preferred Stock contained in Sections 11(a), (b), (c), (e), (g), (h), (i), (j) and (l), and the provisions of Sections 7, 9, 10, 13 and 14 hereof with respect to the Preferred Stock shall apply on like terms to any such other shares.

(g) All Rights originally issued by the Company subsequent to any adjustment made to the Purchase Price hereunder shall evidence the right to purchase, at the adjusted Purchase Price, the number of one one-hundredths of a share of Preferred Stock purchasable from time to time hereunder upon exercise of the Rights, all subject to further adjustment as provided herein.

(h) Unless the Company shall have exercised its election as provided in Section 11(i), upon each adjustment of the Purchase Price as a result of the calculations made in Sections 11(b) and (c), each Right outstanding immediately prior to the making of such adjustment shall thereafter evidence the right to purchase, at the adjusted Purchase Price, that number of one one-hundredths of a share of Preferred Stock (calculated to the nearest one-millionth) obtained by (i) multiplying (x) the number of one one-hundredths of a share covered by a Right immediately prior to this adjustment, by (y) the Purchase Price in effect immediately prior to such adjustment of the Purchase Price, and (ii) dividing the product so obtained by the Purchase Price in effect immediately after such adjustment of the Purchase Price.

(i) The Company may elect on or after the date of any adjustment of the Purchase Price to adjust the number of Rights, in lieu of any adjustment in the number of one one-hundredths of a share of Preferred Stock purchasable upon the exercise of a Right. Each of the Rights outstanding after the adjustment in the number of Rights shall be exercisable for the number of one

one-hundredths of a share of Preferred Stock for which a Right was exercisable immediately prior to such adjustment. Each Right held of record prior to such adjustment of the number of Rights shall become that number of Rights (calculated to the nearest one ten-thousandth) obtained by dividing the Purchase Price in effect immediately prior to adjustment of the Purchase Price by the Purchase Price in effect immediately after adjustment of the Purchase Price. The Company shall make a public announcement of its election to adjust the number of Rights, indicating the record date for the adjustment, and, if known at the time, the amount of the adjustment to be made. This record date may be the date on which the Purchase Price is adjusted or any day thereafter, but, if the Rights Certificates have been issued, shall be at least ten (10) days later than the date of the public announcement. If Rights Certificates have been issued, upon each adjustment of the number of Rights pursuant to this Section 11(i), the Company shall, as promptly as practicable, cause to be distributed to holders of record of Rights Certificates on such record date Rights Certificates evidencing, subject to Section 14 hereof, the additional Rights to which such holders shall be entitled as a result of such adjustment, or, at the option of the Company, shall cause to be distributed to such holders of record in substitution and replacement for the Rights Certificates held by such holders prior to the date of adjustment, and upon surrender thereof, if required by the Company, new Rights Certificates evidencing all the Rights to which such holders shall be entitled after such adjustment. Rights Certificates so to be distributed shall be issued, executed and countersigned in the manner provided for herein (and may bear, at the option of the Company, the adjusted Purchase Price) and shall be registered in the names of the holders of record of Rights Certificates on the record date specified in the public announcement.

(j) Irrespective of any adjustment or change in the Purchase Price or the number of one one-hundredths of a share of Preferred Stock issuable upon the exercise of the Rights, the Rights Certificates theretofore and thereafter issued may continue to express the Purchase Price per one one-hundredth of a share and the number of one one-hundredths of a share which were expressed in the initial Rights Certificates issued hereunder.

(k) In any case in which this Section 11 shall require that an adjustment in the Purchase Price be made effective as of a record date for a specified event, the Company may elect to defer until the occurrence of such event the issuance to the holder of any Right exercised after such record date of the number of one one-hundredths of a share of Preferred Stock and other capital stock or securities of the Company, if any, issuable upon such exercise over and above the number of one one-hundredths of a share of Preferred Stock and other capital stock or securities of the Company, if any, issuable upon such exercise on the basis of the Purchase Price in effect prior to such adjustment; provided, however, that the Company shall deliver to such holder a due bill or other appropriate instrument evidencing such holder's right to receive such additional shares (fractional or otherwise) or securities upon the occurrence of the event requiring such adjustment.

(l) Anything in this Section 11 to the contrary notwithstanding, the Company shall be entitled to make such reductions in the Purchase Price, in addition to those adjustments expressly required by this Section 11, as and to the extent that in their good faith judgment the Board of Directors of the Company shall determine to be advisable in order that any (i) consolidation or

subdivision of the Preferred Stock, (ii) issuance wholly for cash of any shares of Preferred Stock at less than the Current Market Price, (iii) issuance wholly for cash of shares of Preferred Stock or securities which by their terms are convertible into or exchangeable for shares of Preferred Stock, (iv) stock dividends or (v) issuance of rights, options or warrants referred to in this Section 11, hereafter made by the Company to holders of its Preferred Stock shall not be taxable to such shareholders.

(m) The Company covenants and agrees that it shall not, at any time after the Distribution Date, (i) consolidate with any other Person (other than a Subsidiary of the Company in a transaction which complies with Section 11(n) hereof), (ii) merge with or into or enter into a statutory share exchange with any other Person (other than a Subsidiary of the Company in a transaction which complies with Section 11(n) hereof), or (iii) sell or transfer (or permit any Subsidiary to sell or transfer), in one transaction, or a series of related transactions, assets or earning power aggregating more than 50% of the assets or earning power of the Company and its Subsidiaries (taken as a whole) to any other Person or Persons (other than the Company and/or any of its Subsidiaries in one or more transactions each of which complies with Section 11(n) hereof), if (x) at the time of or immediately after such consolidation, merger, statutory share exchange, sale or transfer there are any rights, warrants or other instruments or securities outstanding or agreements in effect which would substantially diminish or otherwise eliminate the benefits intended to be afforded by the Rights or (y) prior to, simultaneously with or immediately after such consolidation, merger, sale or transfer, the shareholders of the Person who constitutes, or would constitute, the "Principal Party" for purposes of Section 13(a) hereof shall have received a distribution of Rights previously owned by such Person or any of its Affiliates and Associates.

(n) The Company covenants and agrees that, after the Distribution Date, it will not, except as permitted by Section 23 or Section 27 hereof, take (or permit any Subsidiary to take) any action if at the time such action is taken it is reasonably foreseeable that such action will diminish substantially or otherwise eliminate the benefits intended to be afforded by the Rights.

(o) Anything in this Agreement to the contrary notwithstanding, in the event that the Company shall at any time on or after the date of this Agreement and prior to the Distribution Date (i) declare a dividend on the outstanding shares of Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding shares of Common Stock, or (iii) combine the outstanding shares of Common Stock into a smaller number of shares, the number of Rights associated with each share of Common Stock then outstanding, or issued or delivered thereafter but prior to the Distribution Date, shall be proportionately adjusted so that the number of Rights thereafter associated with each share of Common Stock following any such event shall equal the result obtained by multiplying the number of Rights associated with each share of Common Stock immediately prior to such event by a fraction the numerator of which shall be the total number of shares of Common Stock outstanding immediately prior to the occurrence of the event and the denominator of which shall be the total number of shares of Common Stock outstanding immediately following the occurrence of such event.

(p) Before taking any action that would cause an adjustment reducing the Purchase Price below the then par value, if any, of the Common Stock issuable upon exercise of the Rights, the Company shall take any corporate action which may, in the opinion of its counsel, be necessary in order that the Company may validly and legally issue fully paid and nonassessable shares of Common Stock at such adjusted Purchase Price.

(q) The exercise of Rights under Section 11(a)(ii) shall only result in the loss of Rights under Section 11(a)(ii) to the extent so exercised and shall not otherwise affect the rights represented by the Rights under this Agreement, including the rights represented by Section 13.

12. Certificate of Adjusted Purchase Price or Number of Shares. Whenever an adjustment is made as provided in Section 11 and Section 13 hereof, the Company shall (a) promptly prepare a certificate setting forth such adjustment and a brief statement of the facts accounting for such adjustment, (b) promptly file with the Rights Agent, and with each transfer agent for the Preferred Stock and the Common Stock, a copy of such certificate, and (c) mail a brief summary thereof to each holder of a Rights Certificate (or, if prior to the Distribution Date, to each holder of a certificate representing shares of Common Stock) in accordance with Section 26 hereof. The Rights Agent shall be fully protected in relying on any such certificate and on any adjustment therein contained and shall not be deemed to have knowledge of such adjustment unless and until it shall have received such certificate.

13. Consolidation, Merger or Sale or Transfer of Assets or Earning Power.

(a) In the event that, on or following the Stock Acquisition Date, directly or indirectly, (x) the Company shall consolidate with, enter into a statutory share exchange or merge with and into, any other Person (other than a Subsidiary of the Company in a transaction which complies with Section 11(n) hereof), and the Company shall not be the continuing or surviving corporation of such consolidation, statutory share exchange or merger, (y) any Person (other than a Subsidiary of the Company in a transaction which complies with Section 11(n) hereof) shall consolidate with, enter into a statutory share exchange with, or merge with or into, the Company, and the Company shall be the continuing or surviving corporation of such consolidation, statutory share exchange or merger and, in connection with such consolidation, statutory share exchange or merger, all or part of the outstanding shares of Common Stock shall be changed into or exchanged for stock or other securities of any other Person or cash or any other property, or (z) the Company shall sell or otherwise transfer (or one or more of its Subsidiaries shall sell or otherwise transfer), in one transaction or a series of related transactions, assets or earning power aggregating more than 50% of the assets or earning power of the Company and its Subsidiaries (taken as a whole) to any Person or Persons (other than the Company or any Subsidiary of the Company in one or more transactions each of which complies with Section 11(n) hereof), then, and in each such case, proper provision shall be made so that: (i) each holder of a Right, except holders described in Section 7(e) hereof, shall thereafter have the right to receive, upon the exercise thereof at the then-current Purchase Price in accordance with the terms of this Agreement, such number of validly authorized and issued, fully paid, nonassessable and freely tradeable shares of Common Stock of the Principal

Party (as such term is hereinafter defined), not subject to any liens, encumbrances, rights of first refusal or other adverse claims, as shall be equal to the result obtained by (1) multiplying the then-current Purchase Price by the number of one one-hundredths of a share of Preferred Stock for which a Right is exercisable immediately prior to the first occurrence of a Section 13 Event (or, if a Section 11(a)(ii) Event has occurred prior to the first occurrence of a Section 13 Event, multiplying the number of such one one-hundredths of a share of Preferred Stock for which a Right was exercisable immediately prior to the first occurrence of a Section 11(a)(ii) Event by the Purchase Price in effect immediately prior to such first occurrence), and dividing that product (which, following the first occurrence of a Section 13 Event, shall be referred to as the "Purchase Price" for each Right and for all purposes of this Agreement) by (2) 50% of the Current Market Price (determined pursuant to Section 11(d)(i) hereof) per share of the Common Stock of such Principal Party on the date of consummation of such Section 13 Event; (ii) such Principal Party shall thereafter be liable for, and shall assume, by virtue of such Section 13 Event, all the obligations and duties of the Company pursuant to this Agreement; (iii) the term "Company" shall thereafter be deemed to refer to such Principal Party, it being specifically intended that the provisions of Section 11 hereof shall apply only to such Principal Party following the first occurrence of a Section 13 Event; (iv) such Principal Party shall take such steps (including, but not limited to, the reservation of a sufficient number of shares of its Common Stock) in connection with the consummation of any such transaction as may be necessary to assure that the provisions hereof shall thereafter be applicable, as nearly as reasonably may be, in relation to its shares of Common Stock thereafter deliverable upon the exercise of the Rights; and (v) the provisions of Section 11(a)(ii) hereof shall be of no effect following the first occurrence of any Section 13 Event.

(b) "Principal Party" shall mean

(i) in the case of any transaction described in clause (x) or (y) of the first sentence of Section 13(a), the Person that is the issuer of any securities into which shares of Common Stock of the Company are converted in such merger, statutory share exchange or consolidation, and if no securities are so issued, the Person that is the other party to such merger, statutory share exchange or consolidation; and

(ii) in the case of any transaction described in clause (z) of the first sentence of Section 13(a), the Person that is the party receiving the greatest portion of the assets or earning power transferred pursuant to such transaction or transactions; provided, however, that in any such case, (1) if the Common Stock of such Person is not at such time and has not been continuously over the preceding twelve (12) month period registered under Section 12 of the Exchange Act, and such Person is a direct or indirect Subsidiary of another Person the Common Stock of which is and has been so registered, "Principal Party" shall refer to such other Person; and (2) in case such Person is a Subsidiary, directly or indirectly, of more than one Person, the Common Stocks of two or more of which are and have been so registered, "Principal Party" shall refer to whichever of such Persons is the issuer of the Common Stock having the greatest aggregate market value.

(c) The Company shall not consummate any such consolidation, statutory share exchange, merger, sale or transfer unless the Principal Party shall have a sufficient number of authorized shares of its Common Stock which have not been issued or reserved for issuance to permit the exercise in full of the Rights in accordance with this Section 13 and unless prior thereto the Company and such Principal Party shall have executed and delivered to the Rights Agent a supplemental agreement providing for the terms set forth in paragraphs (a) and (b) of this Section 13 and further providing that, as soon as practicable after the date of any consolidation, statutory share exchange, merger, sale or transfer mentioned in paragraph (a) of this Section 13, the Principal Party will:

(i) prepare and file a registration statement under the Act, with respect to the Rights and the securities purchasable upon exercise of the Rights on an appropriate form, and will use its best efforts to cause such registration statement to (A) become effective as soon as practicable after such filing and (B) remain effective (with a prospectus at all times meeting the requirements of the Act) until the Final Expiration Date;

(ii) use its best efforts to qualify or register the Rights and the securities purchasable upon exercise of the Rights under the blue sky laws of such jurisdictions as may be necessary or appropriate; and

(iii) deliver to holders of the Rights historical financial statements for the Principal Party and each of its Affiliates which comply in all respects with the requirements for registration on Form 10 under the Exchange Act.

The provisions of this Section 13 shall similarly apply to successive mergers, statutory share exchanges or consolidations or sales or other transfers. The rights under this Section 13 shall be in addition to the rights to exercise Rights under Section 11(a)(ii) and shall survive any exercise thereof.

14. Fractional Rights and Fractional Shares.

(a) The Company shall not be required to issue fractions of Rights, except prior to the Distribution Date as provided in Section 11(o) hereof, or to distribute Rights Certificates which evidence fractional Rights. In lieu of such fractional Rights, there may be paid to the registered holders of the Rights Certificates with regard to which such fractional Rights would otherwise be issuable, an amount in cash equal to the same fraction of the Current Market Value of a whole Right. For purposes of this Section 14(a), the Current Market Value of a whole Right shall be the closing price of the Rights for the Trading Day immediately prior to the date on which such fractional Rights would have been otherwise issuable. The closing price of the Rights for any day shall be the last sale price, regular way, or in case no such sale takes place on such day, the average of the closing bid and asked prices, regular way, in either case as reported in the principal consolidated transaction reporting system with respect to securities listed or admitted to trading on the New York Stock Exchange or, if the Rights are not listed or admitted to trading on the New York

Stock Exchange, as reported in the principal consolidated transaction reporting system with respect to securities listed on the principal national securities exchange on which the Rights are listed or admitted to trading, or, if the Rights are not listed or admitted to trading, on any national securities exchange, the last quoted price or if not so quoted, the average of the high bid and low asked prices in the over-the-counter market, as reported by NASDAQ or such other system then in use or, if on any such date the Rights are not quoted by any such organization, the average of the closing bid and asked prices as furnished by a professional market maker making a market in the Rights selected by the Board of Directors of the Company. If on any such date no such market maker is making a market in the Rights, the fair value of the Rights on such date as determined in good faith by the Board of Directors of the Company shall be used.

(b) The Company shall not be required to issue fractions of shares of Preferred Stock (other than fractions which are integral multiples of one one-hundredth of a share of Preferred Stock) upon exercise of the Rights or to distribute certificates which evidence fractional shares of Preferred Stock (other than fractions which are integral multiples of one one-hundredths of a share of Preferred Stock). In lieu of fractional shares of Preferred Stock that are not integral multiples of one one-hundredths of a share of Preferred Stock, the Company may pay to the registered holders of Rights Certificates at the time such Rights are exercised as herein provided an amount in cash equal to the same fraction of the Current Market Value of one one-hundredths of a share of Preferred Stock. For purposes of this Section 14(b), the Current Market Value of one one-hundredths of a share of Preferred Stock shall be one one-hundredths of the closing price of a share of Preferred Stock (as determined pursuant to Section 11(d)(ii) hereof) for the Trading Day immediately prior to the date of such exercise.

(c) Following the occurrence of a Triggering Event, the Company shall not be required to issue fractions of shares of Common Stock upon exercise of the Rights or to distribute certificates which evidence fractional shares of Common Stock. In lieu of fractional shares of Common Stock, the Company may pay to the registered holders of Rights Certificates at the time such Rights are exercised as herein provided an amount in cash equal to the same fraction of the Current Market Value of one (1) share of Common Stock. For purposes of this Section 14(c), the Current Market Value of one share of Common Stock shall be the closing price of one share of Common Stock (as determined pursuant to Section 11(d)(i) hereof) for the Trading Day immediately prior to the date of such exercise.

(d) The holder of a Right by the acceptance of the Rights expressly waives his right to receive any fractional Rights or any fractional shares upon exercise of a Right, except as permitted by this Section 14.

15. Rights of Action. All rights of action in respect of this Agreement, other than rights of action vested in the Rights Agent pursuant to Section 18 hereof, are vested in the respective registered holders of the Rights Certificates (and, prior to the Distribution Date, the registered holders of the Common Stock); and any registered holder of any Rights Certificate (or, prior to the Distribution Date, of the Common Stock), without the consent of the Rights Agent or of the holder

of any other Rights Certificate (or, prior to the Distribution Date, of the Common Stock), may, in his own behalf and for his own benefit, enforce, and may institute and maintain any suit, action or proceeding against the Company to enforce, or otherwise act in respect of, his right to exercise the Rights evidenced by such Rights Certificate in the manner provided in such Rights Certificate and in this Agreement. Without limiting the foregoing or any remedies available to the holders of Rights, it is specifically acknowledged that the holders of Rights would not have an adequate remedy at law for any breach of this Agreement and shall be entitled to specific performance of the obligations hereunder and injunctive relief against actual or threatened violations of the obligations hereunder of any Person subject to this Agreement.

16. Agreement of Rights Holders. Every holder of a Right by accepting the same consents and agrees with the Company and the Rights Agent and with every other holder of a Right that:

(a) prior to the Distribution Date, the Rights will be transferable only in connection with the transfer of Common Stock;

(b) after the Distribution Date, the Rights Certificates are transferable only on the registry books of the Rights Agent if surrendered at the principal office or offices of the Rights Agent designated for such purposes, duly endorsed or accompanied by a proper instrument of transfer and with the appropriate forms and certificates fully executed;

(c) subject to Section 6(a) and Section 7(f) hereof, the Company and the Rights Agent may deem and treat the person in whose name a Rights Certificate (or, prior to the Distribution Date, the associated Common Stock certificate) is registered as the absolute owner thereof and of the Rights evidenced thereby (notwithstanding any notations of ownership or writing on the Rights Certificates or the associated Common Stock certificate made by anyone other than the Company or the Rights Agent) for all purposes whatsoever, and neither the Company nor the Rights Agent, subject to the last sentence of Section 7(e) hereof, shall be required to be affected by any notice to the contrary; and

(d) notwithstanding anything in this Agreement to the contrary, neither the Company nor the Rights Agent shall have any liability to any holder of a Right or other Person as a result of its inability to perform any of its obligations under this Agreement by reason of any preliminary or permanent injunction or other order, decree or ruling issued by a court of competent jurisdiction or by a governmental, regulatory or administrative agency or commission, or any statute, rule, regulation or executive order promulgated or enacted by any governmental authority, prohibiting or otherwise restraining performance of such obligation; provided, however, the Company must use its best efforts to have any such order, decree or ruling lifted or otherwise overturned as soon as possible.

17. Rights Certificate Holder Not Deemed a Shareholder. No holder, as such, of any Rights Certificate shall be entitled to vote, receive dividends or be deemed for any purpose the

holder of the number of one one-hundredths of a share of Preferred Stock or any other securities of the Company which may at any time be issuable on the exercise of the Rights represented thereby, nor shall anything contained herein or in any Rights Certificate be construed to confer upon the holder of any Rights Certificate, as such, any of the rights of a shareholder of the Company or any right to vote for the election of directors or upon any matter submitted to shareholders at any meeting thereof, or to give or withhold consent to any corporate action, or to receive notice of meetings or other actions affecting shareholders (except as provided in Section 25 hereof), or to receive dividends or subscription rights, or otherwise, until the Right or Rights evidenced by such Rights Certificate shall have been exercised in accordance with the provisions hereof.

18. Concerning the Rights Agent.

(a) The Company agrees to pay to the Rights Agent reasonable compensation for all services rendered by it hereunder and, from time to time, on demand of the Rights Agent, its reasonable expenses and counsel fees and disbursements and other disbursements incurred in the administration and execution of this Agreement and the exercise and performance of its duties hereunder. The Company also agrees to indemnify the Rights Agent, its directors, officers, employees and agents for, and to hold each of them harmless against, any loss, liability, or expense, incurred without gross negligence, bad faith or willful misconduct on the part of the Rights Agent, for anything done or omitted by the Rights Agent or such other indemnified party in connection with the acceptance and administration of this Agreement or the performance of the Rights Agent's duties hereunder, including the costs and expenses of defending against any claim of liability in the premises.

(b) The Rights Agent shall be protected and shall incur no liability for or in respect of any action taken, suffered or omitted by it in connection with its administration of this Agreement or the performance of the Rights Agent's duties hereunder in reliance upon any Rights Certificate or certificate for Common Stock or for other securities of the Company, instrument of assignment or transfer, power of attorney, endorsement, affidavit, letter, notice, direction, consent, certificate, statement, or other paper or document believed by it to be genuine and to be signed, executed and, where necessary, verified or acknowledged, by the proper Person or Persons.

(c) The indemnity provided in this Section 18 shall survive the expiration of the Rights and the termination of this Agreement.

19. Merger or Consolidation or Change of Name of Rights Agent.

(a) Any corporation into which the Rights Agent or any successor Rights Agent may be merged or with which it may be consolidated, or any corporation resulting from any merger or consolidation to which the Rights Agent or any successor Rights Agent shall be a party, or any corporation succeeding to the corporate trust or stock transfer business of the Rights Agent or any successor Rights Agent, shall be the successor to the Rights Agent under this Agreement without the execution or filing of any paper or any further act on the part of any of the parties hereto;

provided, however, that such corporation would be eligible for appointment as a successor Rights Agent under the provisions of Section 21 hereof. In case at the time such successor Rights Agent shall succeed to the agency created by this Agreement, any of the Rights Certificates shall have been countersigned but not delivered, any such successor Rights Agent may adopt the countersignature of a predecessor Rights Agent and deliver such Rights Certificates so countersigned; and in case at that time any of the Rights Certificates shall not have been countersigned, any successor Rights Agent may countersign such Rights Certificates either in the name of the predecessor or in the name of the successor Rights Agent; and in all such cases such Rights Certificates shall have the full force provided in the Rights Certificates and in this Agreement.

(b) In case at any time the name of the Rights Agent shall be changed and at such time any of the Rights Certificates shall have been countersigned but not delivered, the Rights Agent may adopt the countersignature under its prior name and deliver Rights Certificates so countersigned; and in case at that time any of the Rights Certificates shall not have been countersigned, the Rights Agent may countersign such Rights Certificates either in its prior name or in its changed name; and in all such cases such Rights Certificates shall have the full force provided in the Rights Certificates and in this Agreement.

20. Duties of Rights Agent. The Rights Agent undertakes the duties and obligations imposed by this Agreement upon the following terms and conditions, by all of which the Company and the holders of Rights Certificates, by their acceptance thereof, shall be bound:

(a) The Rights Agent may consult with legal counsel (who may be legal counsel for the Company), and the advice or opinion of such counsel shall be full and complete authorization and protection to the Rights Agent as to any action taken or omitted by it in good faith and in accordance with such advice or opinion.

(b) Whenever in the performance of its duties under this Agreement the Rights Agent shall deem it necessary or desirable that any fact or matter (including, without limitation, the identity of any Acquiring Person and the determination of "Current Market Price") be proved or established by the Company prior to taking or suffering any action hereunder, such fact or matter (unless other evidence in respect thereof be herein specifically prescribed) may be deemed to be conclusively proved and established by a certificate signed by the President, any Vice President, the Treasurer, any Assistant Treasurer, the Secretary or any Assistant Secretary of the Company and delivered to the Rights Agent; and such certificate shall be full authorization to the Rights Agent for any action taken or suffered in good faith by it under the provisions of this Agreement in reliance upon such certificate.

(c) The Rights Agent shall be liable hereunder only for its own gross negligence, bad faith or willful misconduct.

(d) The Rights Agent shall not be liable for or by reason of any of the statements of fact or recitals contained in this Agreement or in the Rights Certificates or be required to verify

the same (except as to its countersignature on such Rights Certificates), but all such statements and recitals are and shall be deemed to have been made by the Company only.

(e) The Rights Agent shall not be under any responsibility in respect of the validity of this Agreement or the execution and delivery hereof (except the due execution hereof by the Rights Agent) or in respect of the validity or execution of any Rights Certificate (except its countersignature thereof); nor shall it be responsible for any breach by the Company of any covenant or condition contained in this Agreement or in any Rights Certificate; nor shall it be responsible for any adjustment required under the provisions of Section 11 or Section 13 hereof or responsible for the manner, method or amount of any such adjustment or the ascertaining of the existence of facts that would require any such adjustment (except with respect to the exercise of Rights evidenced by Rights Certificates after receipt of the certificate described in Section 12 hereof setting forth any such adjustment); nor shall it by any act hereunder be deemed to make any representation or warranty as to the authorization or reservation of any shares of Common Stock or Preferred Stock to be issued pursuant to this Agreement or any Rights Certificate or as to whether any shares of Common Stock or Preferred Stock will, when so issued, be validly authorized and issued, fully paid and nonassessable.

(f) The Company agrees that it will perform, execute, acknowledge and deliver or cause to be performed, executed, acknowledged and delivered all such further and other acts, instruments and assurances as may reasonably be required by the Rights Agent for the carrying out or performing by the Rights Agent of the provisions of this Agreement.

(g) The Rights Agent is hereby authorized and directed to accept instructions with respect to the performance of its duties hereunder from the President, any Vice President, the Secretary, any Assistant Secretary, the Treasurer or any Assistant Treasurer of the Company, and to apply to such officers for advice or instructions in connection with its duties, and it shall not be liable for any action taken or suffered to be taken by it in good faith in accordance with the instructions of any such officer or for any delay in acting while awaiting instructions.

(h) Any application by the Rights Agent for written instructions from the Company may, at the option of the Rights Agent, set forth in writing any action proposed to be taken or omitted by the Rights Agent under this Rights Agreement and the date on and/or after which such action shall be taken or such omission shall be effective. The Rights Agent shall not be liable for any action taken by, or omission of, the Rights Agent in accordance with a proposal included in any such application on or after the date specified in such application (which date shall not be less than five Business Days after the date the President, any Vice President, the Secretary, any Assistant Secretary, the Treasurer or any Assistant Treasurer of the Company actually receives such application, unless any such officer shall have consented in writing to an earlier date) unless, prior to taking any such action (or the effective date in the case of an omission), the Rights Agent shall have received written instructions in response to such application specifying the action to be taken or omitted.

(i) The Rights Agent and any shareholder, director, officer or employee of the Rights Agent may buy, sell or deal in any of the Rights or other securities of the Company or become pecuniarily interested in any transaction in which the Company may be interested, or contract with or lend money to the Company or otherwise act as fully and freely as though it were not Rights Agent under this Agreement. Nothing herein shall preclude the Rights Agent from acting in any other capacity for the Company or for any other legal entity.

(j) The Rights Agent may execute and exercise any of the rights or powers hereby vested in it or perform any duty hereunder either itself or by or through its attorneys or agents, and the Rights Agent shall not be answerable or accountable for any act, default, neglect or misconduct of any such attorneys or agents or for any loss to the Company resulting from any such act, default, neglect or misconduct; provided, however, the Rights Agent was not grossly negligent in the selection or continued employment thereof.

(k) No provision of this Agreement shall require the Rights Agent to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder or in the exercise of its rights if there shall be reasonable grounds for believing that repayment of such funds or adequate indemnification against such risk or liability is not reasonably assured to it.

(l) If, with respect to any Rights Certificate surrendered to the Rights Agent for exercise or transfer, the certificate attached to the form of assignment or form of election to purchase, as the case may be, has either not been completed or indicates an affirmative response to clause 1 and/or 2 thereof, the Rights Agent shall not take any further action with respect to such requested exercise or transfer without first consulting with the Company.

(m) The Rights Agent undertakes only the express duties and obligations imposed on it by this Agreement and no implied duties or obligations shall be read into this Agreement against the Rights Agent.

(n) Anything in this Agreement to the contrary notwithstanding, in no event shall the Rights Agent be liable for special, indirect or consequential loss or damage of any kind whatsoever (including but not limited to lost profits).

21. Change of Rights Agent. The Rights Agent or any successor Rights Agent may resign and thereby be discharged from its duties under this Agreement upon thirty (30) days' notice in writing mailed to the Company, and to each transfer agent of the Common Stock and Preferred Stock, by registered or certified mail, and to the holders of the Rights Certificates by first-class mail. The Company may remove the Rights Agent or any successor Rights Agent upon thirty (30) days' notice in writing, mailed to the Rights Agent or successor Rights Agent, as the case may be, and to each transfer agent of the Common Stock and Preferred Stock, by registered or certified mail, and to the holders of the Rights Certificates by first-class mail. If the Rights Agent shall resign or be removed or shall otherwise become incapable of acting, the Company shall appoint a successor to

the Rights Agent. If the Company shall fail to make such appointment within a period of thirty (30) days after giving notice of such removal or after it has been notified in writing of such resignation or incapacity by the resigning or incapacitated Rights Agent or by the holder of a Rights Certificate (who shall, with such notice, submit his Rights Certificate for inspection by the Company), then any registered holder of any Rights Certificate may apply to any court of competent jurisdiction for the appointment of a new Rights Agent. Any successor Rights Agent, whether appointed by the Company or by such a court, shall be (a) a corporation or financial institution organized and doing business under the laws of the United States or of the States of New York or North Carolina (or of any other state of the United States so long as such corporation is authorized to do business as a banking institution in the States of New York or North Carolina), in good standing, and having a principal office in the States of New York or North Carolina, which is authorized under such laws to exercise corporate trust powers and is subject to supervision or examination by federal or state authority and which has at the time of its appointment as Rights Agent a combined capital and surplus of at least \$10,000,000 or (b) an affiliate of a corporation or financial institution described in clause (a) of this sentence. After appointment, the successor Rights Agent shall be vested with the same powers, rights, duties and responsibilities as if it had been originally named as Rights Agent without further act or deed; but the predecessor Rights Agent shall deliver, and transfer to the successor Rights Agent any property at the time held by it hereunder, and execute and deliver any further assurance, conveyance, act or deed necessary for the purpose. Not later than the effective date of any such appointment, the Company shall file notice thereof in writing with the predecessor Rights Agent and each transfer agent of the Common Stock and the Preferred Stock, and mail a notice thereof in writing to the registered holders of the Rights Certificates. Failure to give any notice provided for in this Section 21, however, or any defect therein, shall not affect the legality or validity of the resignation or removal of the Rights Agent or the appointment of the successor Rights Agent, as the case may be.

22. Issuance of New Rights Certificates. Notwithstanding any of the provisions of this Agreement or of the Rights to the contrary, the Company may, at its option, issue new Rights Certificates evidencing Rights in such form as may be approved by its Board of Directors to reflect any adjustment or change in the Purchase Price and the number or kind or class of shares or other securities or property purchasable under the Rights Certificates made in accordance with the provisions of this Agreement. In addition, in connection with the issuance or sale of shares of Common Stock following the Distribution Date and prior to the redemption or expiration of the Rights, the Company (a) shall, with respect to shares of Common Stock so issued or sold pursuant to the exercise of stock options or under any employee plan or arrangement, or upon the exercise, conversion or exchange of securities hereinafter issued by the Company, and (b) may, in any other case, if deemed necessary or appropriate by the Board of Directors of the Company, issue Rights Certificates representing the appropriate number of Rights in connection with such issuance or sale; provided, however, that (i) no such Rights Certificate shall be issued if, and to the extent that, the Company shall be advised by counsel that such issuance would create a significant risk of material adverse tax consequences to the Company or the Person to whom such Rights Certificate would be issued, and (ii) no such Rights Certificate shall be issued if, and to the extent that, appropriate adjustment shall otherwise have been made in lieu of the issuance thereof.

23. Redemption and Termination.

(a) (i) The Board of Directors of the Company may, at its option, at any time prior to the earlier of (x) the Close of Business on the tenth Business Day following the Stock Acquisition Date (or, if the Stock Acquisition Date shall have occurred prior to the Record Date, the Close of Business on the tenth Business Day following the Record Date), or (y) the Final Expiration Date, redeem all but not less than all the then outstanding Rights at a redemption price of \$0.01 per Right, as such amount may be appropriately adjusted, as determined by the Board of Directors, to reflect any stock split, stock dividend or similar transaction occurring after the date hereof (such redemption price being hereinafter referred to as the "Redemption Price").

(ii) If, following the occurrence of a Stock Acquisition Date and the expiration of the right of redemption set forth in Section 23(a)(i) but prior to any Section 13 Event, (x) a Person who is an Acquiring Person shall have transferred or otherwise disposed of a number of shares of Common Stock in one transaction or series of transactions, not directly or indirectly involving the Company or any of its Subsidiaries, such that such Person is thereafter a Beneficial Owner of less than 10% of the outstanding shares of Common Stock, and (y) there are no other Persons, immediately following the occurrence of the event described in clause (x), who are Acquiring Persons, then the right of redemption shall be reinstated and thereafter be subject to the provisions of this Section 23.

(iii) Notwithstanding anything contained in this Agreement to the contrary, the Rights shall not be exercisable after the first occurrence of an event described in Section 11(a)(ii) until such time as the Company's right of redemption hereunder has expired.

(iv) The Company may, at its option, pay the Redemption Price in cash, shares of Common Stock (based on the "Current Market Price," as defined in Section 11(d)(i) hereof, of the Common Stock at the time of redemption) or any other form of consideration deemed appropriate by the Board of Directors.

(b) Immediately upon the action of the Board of Directors of the Company ordering the redemption of the Rights, evidence of which shall have been filed with the Rights Agent and without any further action and without any notice, the right to exercise the Rights will terminate and the only right thereafter of the holders of Rights shall be to receive the Redemption Price for each Right so held. Promptly after the action of the Board of Directors ordering the redemption of the Rights, the Company shall give notice of such redemption to the Rights Agent and the holders of the then outstanding Rights by mailing such notice to all such holders at each holder's last address as it appears upon the registry books of the Rights Agent or, prior to the Distribution Date, on the registry books of the Transfer Agent for the Common Stock. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of redemption will state the method by which the payment of the Redemption Price will be made.

24. Exchange.

(a) The Company may, at its option, by resolution of the Board of Directors, at any time after any Person becomes an Acquiring Person, exchange all or any part of the then outstanding and exercisable Rights (which shall not include Rights that have become void pursuant to Section 7(e) of this Agreement) for shares of Common Stock at an exchange ratio (the "Exchange Ratio") of one share of Common Stock per Right, appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring with respect to the Common Stock after the date of this Agreement.

(b) Immediately upon action of the Board of Directors of the Company ordering the exchange of any Rights pursuant to Section 24(a) of this Agreement and without any further action and without any notice, the right to exercise such Rights shall terminate and the only right thereafter of a holder of such Rights shall be to receive that number of shares of Common Stock equal to the number of such Rights held by such holder multiplied by the Exchange Ratio. The Company shall promptly give public notice of any such exchange, provided, however, that the failure to give, or any defect in, such notice shall not affect the validity of such exchange. The Company shall promptly mail a notice of any such exchange to all of the holders of such Rights at their last addresses as they appear upon the registry books of the Rights Agent or, if prior to the Distribution Date, on the registry books of the transfer agent for the Common Stock. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of exchange will state the method by which the exchange of the shares of Common Stock for Rights will be effected and, in the event of any partial exchange, the number of Rights which will be exchange. Any partial exchange shall be effected pro rata based on the number of Rights (other than Rights which have become void pursuant to the provision of Section 7(e) of this Agreement) held by each holder of Rights.

(c) In the event that there shall not be sufficient shares of Common Stock authorized but unissued to permit the exchange in full of such Rights in accordance with the provisions of this Section 24, the Company shall take all such action as may be necessary to authorize additional shares of Common Stock for issuance upon the exchange of the Rights. In the event that the Company shall, after a good faith effort, be unable to take all such action as may be necessary to authorize such additional shares of Common Stock, the Company shall substitute, for each share of Common Stock that would otherwise be issuable upon exchange of a Right, a number of shares of other equity securities or a fraction thereof such that the Current Market Price of one share of such other equity securities multiplied by such number or fraction is equal to the Current Market Price of one share of Common Stock as of the date of issuance of such shares of such other equity securities or fraction thereof.

(d) The Company shall not be required to issue fractions of shares of Common Stock or to distribute certificates that evidence fractional shares of Common Stock. In lieu of such fractional shares of Common Stock, there shall be paid to the registered holders of the Rights

Certificates with regard to which such fractional shares of Common Stock would otherwise be issuable, an amount in cash equal to the same fraction of the Current Market Price of a whole share of Common Stock.

25. Notice of Certain Events.

(a) In case the Company shall propose, at any time after the Distribution Date, (i) to pay any dividend payable in stock of any class to the holders of Preferred Stock or to make any other distribution to the holders of Preferred Stock (other than a regular quarterly cash dividend out of earnings or retained earnings of the Company), or (ii) to offer to the holders of Preferred Stock rights or warrants to subscribe for or to purchase any additional shares of Preferred Stock or shares of stock of any class or any other securities, rights or options, or (iii) to effect any reclassification of its Preferred Stock (other than a reclassification involving only the subdivision of outstanding shares of Preferred Stock), or (iv) to effect any consolidation, statutory share exchange or merger into or with any other Person (other than a Subsidiary of the Company in a transaction which complies with Section 11(n) hereof), or to effect any sale or other transfer (or to permit one or more of its Subsidiaries to effect any sale or other transfer), in one transaction or a series of related transactions, of more than 50% of the assets or earning power of the Company and its Subsidiaries (taken as a whole) to any other Person or Persons (other than the Company and/or any of its Subsidiaries in one or more transactions each of which complies with Section 11(n) hereof), or (v) to effect the liquidation, dissolution or winding up of the Company, then, in each such case, the Company shall give to each holder of a Rights Certificate, to the extent feasible and in accordance with Section 26 hereof, a notice of such proposed action, which shall specify the record date for the purposes of such stock dividend, distribution of rights or warrants, or the date on which such reclassification, consolidation, statutory share exchange, merger, sale, transfer, liquidation, dissolution, or winding up is to take place and the date of participation therein by the holders of the shares of Preferred Stock, if any such date is to be fixed, and such notice shall be so given in the case of any action covered by clause (i) or (ii) above at least twenty (20) days prior to the record date for determining holders of the shares of Preferred Stock for purposes of such action, and in the case of any such other action, at least twenty (20) days prior to the date of the taking of such proposed action or the date of participation therein by the holders of the shares of Preferred Stock, whichever shall be the earlier.

(b) Upon the occurrence of a Section 11(a)(ii) Event, (i) the Company shall, as soon as practicable thereafter, give to each holder of a Rights Certificate, to the extent feasible and in accordance with Section 26 hereof, a notice of the occurrence of such event, which shall specify the event and the consequences of the event to holders of Rights under Section 11(a)(ii) hereof, and (ii) all references in the preceding paragraph to Preferred Stock shall be deemed thereafter to refer to Common Stock and/or, if appropriate, other securities.

26. Notices. Notices or demands authorized by this Agreement to be given or made by the Rights Agent or by the holder of any Rights Certificate to or on the Company shall be sufficiently given or made if delivered by hand, sent by overnight courier or sent by first-class mail,

postage prepaid, addressed (until another address is filed in writing with the Rights Agent) as follows:

C3, Inc.
3800 Gateway Boulevard
Suite 310
Morrisville, NC 27560
Attention: Secretary

Subject to the provisions of Section 21, any notice or demand authorized by this Agreement to be given or made by the Company or by the holder of any Rights Certificate to or on the Rights Agent shall be sufficiently given or made if delivered by hand, sent by overnight courier or sent by first-class mail, postage prepaid, addressed (until another address is filed in writing with the Company) as follows:

First Union National Bank
1525 West W.T. Harris Boulevard, 3C3
Charlotte, North Carolina 28288-1153
Attention: Shareholder Services Group

Notices or demands authorized by this Agreement to be given or made by the Company or the Rights Agent to the holder of any Rights Certificate (or, if prior to the Distribution Date, to the holder of certificates representing shares of Common Stock) shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed to such holder at the address of such holder as shown on the registry books of the Company.

27. Supplements and Amendments. Prior to the Distribution Date, the Company and the Rights Agent shall, if the Company so directs, supplement or amend any provision of this Agreement without the approval of any holders of certificates representing shares of Common Stock. From and after the Distribution Date, the Company and the Rights Agent shall, if the Company so directs, supplement or amend this Agreement without the approval of any holders of Rights Certificates in order (i) to cure any ambiguity, (ii) to correct or supplement any provision contained herein which may be defective or inconsistent with any other provisions herein, (iii) to shorten or lengthen any time period hereunder, including the Final Expiration Date, (iv) to alter the Purchase Price if the Final Expiration Date is changed, or (v) to change or supplement the provisions hereunder in any manner which the Company may deem necessary or desirable and which shall not adversely affect the interests of the holders of Rights Certificates (other than an Acquiring Person or an Affiliate or Associate of any Acquiring Person); provided, however, this Agreement may not be supplemented or amended to lengthen, pursuant to clause (iii) of this sentence, (A) a time period relating to when the Rights may be redeemed at such time as the Rights are not then redeemable, or (B) any other time period unless such lengthening of such other time period is for the purpose of protecting, enhancing or clarifying the rights of, and/or the benefits to, the holders of Rights. Upon the delivery of a certificate from an appropriate officer of the Company which states that the proposed

supplement or amendment is in compliance with the terms of this Section 27, the Rights Agent shall execute such supplement or amendment. Prior to the Distribution Date, the interests of the holders of Rights shall be deemed coincident with the interests of the holders of Common Stock. Notwithstanding anything contained in this Agreement to the contrary, no supplement or amendment that changes the rights or duties of the Rights Agent under this Agreement shall be effective without the execution of such supplement or amendment by the Rights Agent.

28. Successors. All the covenants and provisions of this Agreement by or for the benefit of the Company or the Rights Agent shall bind and inure to the benefit of their respective successors and assigns hereunder.

29. Determinations and Actions by the Board of Directors, etc.

(a) For all purposes of this Agreement, any calculation of the number of shares of Common Stock outstanding at any particular time, including for purposes of determining the particular percentage of such outstanding shares of Common Stock of which any Person is the Beneficial Owner, shall be made in accordance with the last sentence of Rule 13d-3(d)(1)(i) of the General Rules and Regulations under the Exchange Act. The Board of Directors of the Company (or, as set forth herein, certain specified members thereof) shall have the exclusive power and authority to administer this Agreement and to exercise all rights and powers specifically granted to the Board of Directors of the Company or to the Company, or as may be necessary or advisable in the administration of this Agreement, including, without limitation, the right and power to (i) interpret the provisions of this Agreement, and (ii) make all determinations deemed necessary or advisable for the administration of this Agreement (including, but not limited to, a determination to redeem or not redeem the Rights or to amend this Agreement). All such actions, calculations, interpretations and determinations (including, for purposes of clause (y) below, all omissions with respect to the foregoing) which are done or made by the Board of Directors of the Company in good faith, shall (x) be final, conclusive and binding on the Company, the Rights Agent, the holders of the Rights and all other parties, and (y) not subject the Board to any liability to the holders of the Rights.

(b) For purposes of this Agreement, any determination to be made by the Board of Directors of the Company may be made by a duly constituted committee thereof if so authorized to act by the Board of Directors pursuant to the Company's Bylaws, and in such circumstances any reference to the Board of Directors herein shall be deemed to include a reference to such committee.

30. Benefits of This Agreement. Nothing in this Agreement shall be construed to give to any Person other than the Company, the Rights Agent and the registered holders of the Rights Certificates (and, prior to the Distribution Date, registered holders of the Common Stock) any legal or equitable right, remedy or claim under this Agreement; but this Agreement shall be for the sole and exclusive benefit of the Company, the Rights Agent and the registered holders of the Rights Certificates (and, prior to the Distribution Date, registered holders of the Common Stock).

31. Severability. If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated; provided, however, that notwithstanding anything in this Agreement to the contrary, if any such term, provision, covenant or restriction is held by such court or authority to be invalid, void or unenforceable and the Board of Directors of the Company determines in its good faith judgment that severing the invalid language from this Agreement would adversely affect the purpose or effect of this Agreement, the right of redemption set forth in Section 23 hereof shall be reinstated and shall not expire until the Close of Business on the tenth Business Day following the date of such determination by the Board of Directors of the Company.

32. Governing Law. This Agreement, each Right and each Rights Certificate issued hereunder shall be deemed to be a contract made under the laws of the State of North Carolina and for all purposes shall be governed by and construed in accordance with the laws of such State applicable to contracts made and to be performed entirely within such State.

33. Counterparts. This Agreement may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and all such counterparts shall together constitute but one and the same instrument.

34. Descriptive Headings. Descriptive headings of the several Sections of this Agreement are inserted for convenience only and shall not control or affect the meaning or construction of any of the provisions hereof.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed and their respective corporate seals to be hereunto affixed and attested, all as of the day and year first above written.

C3, INC.

By /s/ Robert S. Thomas

Name: Robert S. Thomas
Title: President

Attest:

By /s/ Mark W. Hahn

Name: Mark W. Hahn
Title: Secretary

[Corporate Seal]

FIRST UNION NATIONAL BANK

By /s/ Patrick J. Edwards

Name: Patrick J. Edwards
Title: Vice President

Attest:

By /s/ Kristin N. Knapp

Name: Kristin N. Knapp
Title: Asst. Vice President

[Corporate Seal]

EXHIBIT A

[Form of Rights Certificate]

Certificate No. R- _____ Rights _____

NOT EXERCISABLE AFTER FEBRUARY 22, 2009 OR EARLIER IF REDEEMED BY THE COMPANY. THE RIGHTS ARE SUBJECT TO REDEMPTION, AT THE OPTION OF THE COMPANY, AT \$0.01 PER RIGHT ON THE TERMS SET FORTH IN THE RIGHTS AGREEMENT. UNDER CERTAIN CIRCUMSTANCES, RIGHTS BENEFICIALLY OWNED BY AN ACQUIRING PERSON (AS SUCH TERM IS DEFINED IN THE RIGHTS AGREEMENT) AND ANY SUBSEQUENT HOLDER OF SUCH RIGHTS MAY BECOME NULL AND VOID. [THE RIGHTS REPRESENTED BY THIS RIGHTS CERTIFICATE ARE OR WERE BENEFICIALLY OWNED BY A PERSON WHO WAS OR BECAME AN ACQUIRING PERSON OR AN AFFILIATE OR ASSOCIATE OF AN ACQUIRING PERSON (AS SUCH TERM IS DEFINED IN THE RIGHTS AGREEMENT). ACCORDINGLY, THIS RIGHTS CERTIFICATE AND THE RIGHTS REPRESENTED HEREBY MAY BECOME NULL AND VOID IN THE CIRCUMSTANCES SPECIFIED IN SECTION 7(e) OF THE RIGHTS AGREEMENT.]¹

Rights Certificate

C3, Inc.

This certifies that _____, or registered assigns, is the registered owner of the number of Rights set forth above, each of which entitles the owner thereof, subject to the terms, provisions and conditions of the Rights Agreement, dated as of February 22, 1999 (the "Rights Agreement"), between C3, Inc., a North Carolina corporation (the "Company"), and First Union National Bank (the "Rights Agent"), to purchase from the Company at any time prior to 5:00 P.M., Morrisville, North Carolina time, on February 22, 2009 at the office or offices of the Rights Agent designated for such purpose, or its successors as Rights Agent, one one-hundredths of a fully paid, nonassessable share of Series A Junior Participating Preferred Stock (the "Preferred Stock") of the Company, at a purchase price of \$125.00 per one one-hundredths of a share (the "Purchase Price"), upon presentation and surrender of this Rights Certificate with the Form of Election to Purchase and related Certificate duly executed. The Purchase Price may be paid in cash or by certified bank check or money order payable to the order of the Company. The number of Rights evidenced by this Rights Certificate (and the number of shares of Preferred Stock which may be purchased upon exercise hereof) set forth above, and the Purchase Price per share set forth above, are the number and Purchase Price as of February 22, 1999, based on the Preferred Stock as constituted at such date.

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¹The portion of the legend in brackets shall be inserted only if applicable and shall replace the immediately preceding sentence of the legend.

Upon the occurrence of a Section 11(a)(ii) Event (as such term is defined in the Rights Agreement), if the Rights evidenced by this Rights Certificate are beneficially owned by (i) an Acquiring Person or an Affiliate or Associate of any such Acquiring Person (as such terms are defined in the Rights Agreement), (ii) a transferee of any such Acquiring Person or an Associate or Affiliate of any such Acquiring Person, or (iii) under certain circumstances specified in the Rights Agreement, a transferee of a person who, after such transfer, became an Acquiring Person or an Affiliate or Associate of any such Acquiring Person, such Rights shall become null and void and no holder hereof shall have any right with respect to such Rights from and after the occurrence of such Section 11(a)(ii) Event.

As provided in the Rights Agreement, the Purchase Price and the number and kind of shares of Preferred Stock or other securities which may be purchased upon the exercise of the Rights evidenced by this Rights Certificate are subject to modification and adjustment upon the happening of certain events, including Triggering Events (as such term is defined in the Rights Agreement).

This Rights Certificate is subject to all of the terms, provisions, and conditions of the Rights Agreement, which terms, provisions and conditions are hereby incorporated herein by reference and made a part hereof and to which Rights Agreement reference is hereby made for a full description of the rights, limitations of rights, obligations, duties and immunities hereunder of the Rights Agent, the Company and the holders of the Rights Certificates, which limitations of rights include the temporary suspension of the exercisability of such Rights under the specific circumstances set forth in the Rights Agreement. Copies of the Rights Agreement are available upon written request to the Company.

This Rights Certificate, with or without other Rights Certificates, upon surrender at the principal office or offices of the Rights Agent designated for such purpose, may be exchanged for another Rights Certificate or Rights Certificates of like tenor and date evidencing Rights entitling the holder to purchase a like aggregate number of one one-hundredths of a share of Preferred Stock as the Rights evidenced by the Rights Certificate or Rights Certificates surrendered shall have entitled such holder to purchase. If this Rights Certificate shall be exercised in part, the holder shall be entitled to receive upon surrender hereof another Rights Certificate or Rights Certificates for the number of whole Rights not exercised.

Subject to the provisions of the Rights Agreement, the Rights evidenced by this Certificate may be redeemed by the Company at its option at a redemption price of \$0.01 per Right at any time prior to the earliest of the Close of Business on (i) the tenth Business Day following the Stock Acquisition Date (as such time period may be extended pursuant to the Rights Agreement) or (ii) the Final Expiration Date. After the expiration of the redemption period referenced in clause (i) above, the Company's right of redemption may be reinstated if an Acquiring Person reduces his beneficial ownership to less than 10% of the outstanding shares of Common Stock in a transaction or series of transactions not involving the Company and there are no other Acquiring Persons.

The Company may (but shall not be required to) issue fractional shares of Preferred Stock upon the exercise of any Right or Rights evidenced hereby (other than fractions which are integral multiples of one one-hundredth of a share of Preferred Stock, which may, at the election of the

Company, be evidenced by depositary receipts), and in lieu thereof a cash payment may be made, as provided in the Rights Agreement.

No holder of this Rights Certificate, as such, shall be entitled to vote or receive dividends or be deemed for any purpose the holder of shares of Preferred Stock or of any other securities of the Company which may at any time be issuable on the exercise hereof, nor shall anything contained in the Rights Agreement or herein be construed to confer upon the holder hereof, as such, any of the rights of a stockholder of the Company or any right to vote for the election of directors or upon any matter submitted to stockholders at any meeting thereof, or to give or withhold consent to any corporate action, or to receive notice of meetings or other actions affecting stockholders (except as provided in the Rights Agreement), or to receive dividends or subscription rights, or otherwise, until the Right or Rights evidenced by this Rights Certificate shall have been exercised as provided in the Rights Agreement.

This Rights Certificate shall not be valid or obligatory for any purpose until it shall have been countersigned by the Rights Agent.

WITNESS, the facsimile signature of the proper officers of the Company and its corporate seal.

Dated as of _____, _____

ATTEST:

[Corporate Seal]

C3, INC.

Name:
Title:

By _____
Name:
Title:

Countersigned:

FIRST UNION NATIONAL BANK

By _____
Authorized Signature

[Form of Reverse Side of Rights Certificate]

FORM OF ASSIGNMENT

[To be executed by the registered holder if such holder desires to transfer the Rights Certificate.]

FOR VALUE RECEIVED _____ hereby sells, assigns and transfers unto

(Please print name and address of transferee)

this Rights Certificate, together with all right, title and interest therein, and does hereby irrevocably constitute and appoint _____ Attorney, to transfer the within Rights Certificate on the books of the within-named Company, with full power of substitution.

Dated: _____, _____

Signature

Signature Guaranteed:

Certificate

The undersigned hereby certifies by checking the appropriate boxes that:

(1) this Rights Certificate [] is [] is not being sold, assigned and transferred by or on behalf of a Person who is or was an Acquiring Person or an Affiliate or Associate of any such Acquiring Person (as such term is defined in the Rights Agreement); and

(2) after due inquiry and to the best knowledge of the undersigned, it [] did [] did not acquire the Rights evidenced by this Rights Certificate from any Person who is, was or subsequently became an Acquiring Person or an Affiliate or Associate of any such Acquiring Person.

Dated: _____, _____

Signature

Signature Guaranteed:

NOTICE

The signature to the foregoing Assignment and Certificate must correspond to the name as written upon the face of this Rights Certificate in every particular, without alteration or enlargement or any change whatsoever.

FORM OF ELECTION TO PURCHASE

[To be executed by the registered holder if such holder desires to exercise Rights represented by the Rights Certificate.]

To: The Rights Agent

The undersigned hereby irrevocably elects to exercise _____ Rights represented by this Rights Certificate to purchase the shares of Preferred Stock issuable upon the exercise of the Rights (or such other securities of the Company or of any other Person which may be issuable upon the exercise of the Rights) and requests that certificates for such shares be issued in the name of and delivered to:

(Please print name and address)

Please insert social security or other identifying number: _____

If such number of Rights shall not be all the Rights evidenced by this Rights Certificate, a new Rights Certificate for the balance of such Rights shall be registered in the name of and delivered to:

(Please print name and address)

Please insert social security or other identifying number: _____

Dated: _____, _____

Signature

Signature Guaranteed:

Certificate

The undersigned hereby certifies by checking the appropriate boxes that:

(1) the Rights evidenced by this Rights Certificate [] are [] are not being exercised by or on behalf of a Person who is or was an Acquiring Person or an Affiliate or Associate of any such Acquiring Person (as such term is defined in the Rights Agreement);

(2) after due inquiry and to the best knowledge of the undersigned, it [] did [] did not acquire the Rights evidenced by this Rights Certificate from any Person who is, was or became an Acquiring Person or an Affiliate or Associate of any such Acquiring Person.

Dated: _____, _____

Signature

Signature Guaranteed:

NOTICE

The signature to the foregoing Election to Purchase and Certificate must correspond to the name as written upon the face of this Rights Certificate in every particular, without alteration or enlargement or any change whatsoever.

EXHIBIT B

SUMMARY OF RIGHTS TO PURCHASE PREFERRED STOCK

On February 21, 1999, the Board of Directors of C3, Inc., a North Carolina corporation (the "Company"), declared a dividend distribution of one Right for each outstanding share of the Company's common stock, no par value per share (the "Common Stock"), to stockholders of record at the close of business on March 8, 1999. One Right will also be distributed for each share of Common Stock issued after March 8, 1999, until the Distribution Date (which is described in the next paragraph). Each Right entitles the registered holder to purchase from the Company a unit consisting of one one-hundredths of a share (a "Unit") of Series A Junior Participating Preferred Stock, no par value per share (the "Preferred Stock"), at a Purchase Price of \$125.00 per Unit, subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement dated as of February 22, 1999 (the "Rights Agreement") between the Company and First Union National Bank, as Rights Agent.

Initially, the Rights will be attached to all Common Stock certificates representing shares then outstanding, and no separate Rights Certificates will be distributed. The Rights will separate from the Common Stock and a Distribution Date will occur upon the earliest of (i) 10 business days following a public announcement that a person or group of affiliated or associated persons (an "Acquiring Person") has acquired, or obtained the right to acquire, beneficial ownership of 20% or more of the outstanding shares of Common Stock (the "Stock Acquisition Date"), or (ii) 10 business days following the public announcement of a tender offer or exchange offer that would, if consummated, result in a person or group beneficially owning 20% or more of such outstanding shares of Common Stock, subject to certain limitations.

Until the Distribution Date (or earlier redemption or expiration of the Rights) (i) the Rights will be evidenced by the Common Stock certificates and will be transferred with and only with such Common Stock certificates, (ii) new Common Stock certificates issued after March 8, 1999 will contain a notation incorporating the Rights Agreement by reference and (iii) the surrender for transfer of any certificates for Common Stock outstanding, even without such notation, will also constitute the transfer of the Rights associated with the Common Stock represented by such certificate. As soon as practicable after the Distribution Date, Rights Certificates will be mailed to holders of record of the Common Stock as of the close of business on the Distribution Date and, thereafter, the separate Rights Certificates alone will represent the Rights. The Rights are not exercisable until the Distribution Date and will expire at the close of business on February 22, 2009, subject to extension by the Board of Directors, unless earlier redeemed by the Company as described below.

In the event that any person becomes an Acquiring Person, each holder of a Right will thereafter have the right (the "Flip-In Right") to receive, at the time specified in the Rights Agreement, (x) upon exercise and payment of the Purchase Price, Common Stock (or, in certain circumstances, cash, property or other securities of the Company) having a value equal to two times the Purchase Price of the Right or (y) at the discretion of the Board of Directors, upon exercise and without payment of the Purchase Price, Common Stock (or, in certain circumstances, cash, property

or other securities of the Company) having a value equal to the difference between the Purchase Price of the Right and the value of the consideration which would be payable under clause (x). Notwithstanding any of the foregoing, following the occurrence of any of the events set forth in this paragraph, all Rights that are, or (under certain circumstances specified in the Rights Agreement) were, beneficially owned by any Acquiring Person will be null and void. Rights are not exercisable following the occurrence of the event set forth above until such time as the Rights are no longer redeemable by the Company as set forth below.

For example, at a Purchase Price of \$125.00 per Right, each Right not owned by an Acquiring Person (or by certain related parties) following an event set forth in the preceding paragraph would entitle its holder to purchase \$250.00 worth of Common Stock (or other consideration, as noted above) for \$125.00. Assuming that the Common Stock had a per share value of \$62.50 at such time, the holder of each valid Right would be entitled to purchase four shares of Common Stock for \$125.00. Alternatively, at the discretion of the Board of Directors, each Right following an event set forth in the preceding paragraph, without payment of the Purchase Price, would entitle its holder to Common Stock (or other consideration, as noted above) worth \$125.00.

In the event that, at any time following the Stock Acquisition Date, (i) the Company is acquired in a merger, statutory share exchange or other business combination in which the Company is not the surviving corporation, (ii) the Company is the surviving party in a merger, statutory share exchange or other business combination and all or part of the Company's Common Stock is exchanged for stock or other securities of another corporation, or (iii) 50% or more of the Company's assets or earning power is sold or transferred, each holder of a Right (except Rights which previously have been voided as set forth above) shall thereafter have the right (the "Flip-Over Right") to receive, upon exercise, common stock of the acquiring corporation having a value equal to two times the Purchase Price of the Right. The holders of a Right will continue to have the Flip-Over Right whether or not such holder exercises or surrenders the Flip-In Right. The events set forth in this paragraph and in the second preceding paragraph are referred to as the "Triggering Events."

The Purchase Price payable, and the number of Units of Preferred Stock or other securities or property issuable, upon exercise of the Rights are subject to adjustment from time to time to prevent dilution (i) in the event of a stock dividend on, or a subdivision, combination or reclassification of, the Preferred Stock, (ii) if holders of the Preferred Stock are granted certain rights or warrants to subscribe for Preferred Stock or convertible securities at less than the current market price of the Preferred Stock, or (iii) upon the distribution to holders of the Preferred Stock of evidences of indebtedness or assets (excluding regular quarterly cash dividends) or of subscription rights or warrants (other than those referred to above). The number of outstanding Rights and the number of one one-hundredths of a share of Preferred Stock issuable upon exercise of each Right are also subject to adjustment in the event of a stock split of the Common Stock or a stock dividend on the Common Stock payable in Common Stock or subdivisions, consolidations or combinations of the Common Stock occurring, in each such case, prior to the Distribution Date.

With certain exceptions, no adjustment in the Purchase Price will be required until cumulative adjustments amount to at least 1% of the Purchase Price. No fractional Units will be

issued and, in lieu thereof, an adjustment in cash will be made based on the market price of the Preferred Stock on the last trading date prior to the date of exercise.

At any time after any person becomes an Acquiring Person, the Company may exchange all or part of the Rights for shares of Common Stock at an exchange ratio of one share per Right, as appropriately adjusted to reflect any stock dividend, stock split or similar transaction.

In general, the Company may redeem the Rights in whole, but not in part, at a price of \$0.01 per Right, at any time until 10 business days following the Stock Acquisition Date. After the redemption period has expired, the Company's right of redemption may be reinstated if an Acquiring Person reduces his beneficial ownership to less than 10% of the outstanding shares of Common Stock in a transaction or series of transactions not involving the Company and there are no other Acquiring Persons. Immediately upon the action of the Board of Directors ordering redemption of the Rights, the Rights will terminate and the only right of the holders of Rights will be to receive the \$0.01 redemption price.

Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder of the Company, including, without limitation, the right to vote or to receive dividends. While the distribution of the Rights will not be taxable to stockholders or to the Company, stockholders may, depending upon the circumstances, recognize taxable income in the event that the Rights become exercisable for stock (or other consideration) of the Company or for common stock of the acquiring company as set forth above.

Prior to the Distribution Date, any of the provisions of the Rights Agreement may be amended by the Board of Directors of the Company. After the Distribution Date, the provisions of the Rights Agreement may be amended by the Board in order to cure any ambiguity, to make changes which do not adversely affect the interests of holders of Rights (excluding the interests of any Acquiring Person), or to shorten or lengthen any time period under the Rights Agreement; provided, however, that no amendment to adjust the time period governing redemption shall be made when the Rights are not redeemable.

A copy of the Rights Agreement has been filed with the Securities and Exchange Commission as an Exhibit to a Registration Statement on Form 8-A dated _____, 1999. A copy of the Rights Agreement is available free of charge from the Company. This summary description of the Rights does not purport to be complete and is qualified in its entirety by reference to the Rights Agreement, which is incorporated herein by reference.

EXHIBIT C

ARTICLES OF AMENDMENT
OF C3, INC.

C3, Inc., a North Carolina corporation (the "Corporation"), hereby submits these Articles of Amendment for the purpose of amending its Amended and Restated Articles of Incorporation to determine the preferences, limitations, and relative rights of a new series of Preferred Stock, no par value per share:

(1) The name of the Corporation is C3, Inc.

(2) Pursuant to authority granted by Article II, Paragraph B of the Amended and Restated Articles of Incorporation of the Corporation and in accordance with the provisions of Section 55-6-02 of the North Carolina Business Corporation Act, the Board of Directors of the Corporation duly adopted on February 21, 1999, the following amendment to the Amended and Restated Articles of Incorporation of the Corporation:

Article II of the Corporation's Amended and Restated Articles of Incorporation are hereby amended by adding the following as Paragraph E:

E. Series A Junior Participating Preferred Stock. There is hereby created a new series of Preferred Stock designated "Series A Junior Participating Preferred Stock." The number of shares constituting such series initially shall be one million (1,000,000). Such number of shares may be increased or decreased by the Board of Directors; provided, however, that no decrease shall reduce the number of shares of Series A Junior Participating Preferred Stock to a number less than the number of shares then outstanding plus the number of shares reserved for issuance upon the exercise of outstanding options, rights or warrants or upon the conversion of any outstanding securities issued by the Corporation convertible into Series A Junior Participating Preferred Stock. The Series A Junior Participating Preferred Stock shall have the preferences, limitations and relative rights set forth below:

(a) Dividends and Distributions.

(i) Subject to the prior and superior rights of the holders of any shares of any series of Preferred Stock ranking prior and superior to the shares of Series A Junior Participating Preferred Stock with respect to dividends, the holders of shares of Series A Junior Participating Preferred Stock, in preference to the holders of Common Stock and of any other junior stock, shall be entitled to receive, when, as and if declared by the Board of Directors out of funds legally available therefor, quarterly dividends payable in cash on the first day of February, May, August and November in each year

(each such date being referred to herein as a "Quarterly Dividend Payment Date"), commencing on the first Quarterly Dividend Payment Date after the first issuance of a share or fraction of a share of Series A Junior Participating Preferred Stock, in an amount per share (rounded to the nearest cent) equal to the greater of (a) \$1.00 or (b) subject to the provision for adjustment hereinafter set forth, 100 times the aggregate per share amount of all cash dividends, and 100 times the aggregate per share amount (payable in kind) of all non-cash dividends or other distributions, other than a dividend payable in shares of Common Stock or a subdivision of the outstanding shares of Common Stock (by reclassification or otherwise), declared on the Common Stock since the immediately preceding Quarterly Dividend Payment Date, or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of any share or fraction of a share of Series A Junior Participating Preferred Stock. In the event the Corporation shall on or at any time after February 21, 1999 (the "Rights Declaration Date") (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding Common Stock, or (iii) combine or consolidate the outstanding shares of Common Stock into a smaller number of shares, then in each such case the amount to which holders of shares of Series A Junior Participating Preferred Stock were entitled immediately prior to such event under clause (b) of the preceding sentence shall be adjusted by multiplying such amount by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(ii) The Corporation shall declare a dividend or distribution on the Series A Junior Participating Preferred Stock as provided in paragraph (i) above immediately after it declares a dividend or distribution on the Common Stock (other than a dividend payable in shares of Common Stock); provided that, subject to the requirements of applicable law and the Amended and Restated Articles of Incorporation, in the event no dividend or distribution shall have been declared on the Common Stock during the period between any Quarterly Dividend Payment Date and the next subsequent Quarterly Dividend Payment Date, a dividend of \$1.00 per share on the Series A Junior Participating Preferred Stock shall nevertheless be payable on such subsequent Quarterly Dividend Payment Date.

(iii) Dividends shall begin to accrue and be cumulative on outstanding shares of Series A Junior Participating Preferred Stock from the Quarterly Dividend Payment Date next preceding the date of issue of such shares of Series A Junior Participating Preferred Stock, unless the date of

issue of such shares is prior to the record date for the first Quarterly Dividend Payment Date, in which case dividends on such shares shall begin to accrue from the date of issue of such shares, or unless the date of issue is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of shares of Series A Junior Participating Preferred Stock entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in either of which events such dividends shall begin to accrue and be cumulative from such Quarterly Dividend Payment Date. Accrued but unpaid dividends shall not bear interest. Dividends paid on the shares of Series A Junior Participating Preferred Stock in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding. The Board of Directors may fix a record date for the determination of holders of shares of Series A Junior Participating Preferred Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be no more than 60 days prior to the date fixed for the payment thereof.

(b) Voting Rights. The holders of shares of Series A Junior Participating Preferred Stock shall have the following voting rights:

(i) Subject to the provision for adjustment hereinafter set forth, each share of Series A Junior Participating Preferred Stock shall entitle the holder thereof to 100 votes on all matters submitted to a vote of the shareholders of the Corporation. In the event the Corporation shall at any time on or after the Rights Declaration Date (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding Common Stock, or (iii) combine or consolidate the outstanding Common Stock into a smaller number of shares, then in each such case the number of votes per share to which holders of shares of Series A Junior Participating Preferred Stock were entitled immediately prior to such event shall be adjusted by multiplying such number by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(ii) Except as otherwise provided herein, in any other amendment to the Amended and Restated Articles of Incorporation of the Corporation or bylaw, the holders of shares of Series A Junior Participating Preferred Stock and the holders of shares of Common Stock shall vote together as one group on all matters submitted to a vote of shareholders of the Corporation.

(iii) Except as set forth herein, holders of Series A Junior Participating Preferred Stock shall have no special voting rights and their consent shall not be required (except to the extent they are entitled to vote with holders of Common Stock as set forth herein) for taking any corporate action.

(c) Certain Restrictions.

(i) Whenever quarterly dividends or other dividends or distributions payable on the Series A Junior Participating Preferred Stock as provided in Paragraph (a) are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series A Junior Participating Preferred Stock outstanding shall have been paid in full, the Corporation shall not:

(A) declare or pay dividends on, redeem or purchase or otherwise acquire for consideration, or make any other distributions on any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Junior Participating Preferred Stock;

(B) declare or pay dividends on, redeem or purchase or otherwise acquire for consideration, or make any other distributions on any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Junior Participating Preferred Stock, provided that there may be declared and paid ratably dividends on the Series A Junior Participating Preferred Stock and all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled; and, provided further, that the Corporation may at any time redeem or purchase or otherwise acquire shares of any such parity stock in exchange for shares of any stock of the Corporation ranking junior (either as to dividends or upon dissolution, liquidation or winding up) to the Series A Junior Participating Preferred Stock; or

(C) purchase or otherwise acquire for consideration any shares of Series A Junior Participating Preferred Stock, or redeem or purchase or otherwise acquire any shares of stock ranking on a parity with the Series A Junior Participating Preferred Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board of Directors) to all holders of such shares

upon such terms as the Board of Directors, after consideration of the respective annual dividend rates and other relative rights and preferences of the respective series and classes, shall determine in good faith will result in fair and equitable treatment among the respective series or classes.

(ii) The Corporation shall not permit any subsidiary of the Corporation (for the account of such subsidiary) to purchase or otherwise acquire for consideration any shares of stock of the Corporation unless the Corporation could, under paragraph (i) of this Paragraph (c), purchase or otherwise acquire such shares at such time and in such manner.

(iii) No dividend shall be declared and paid, or set apart for payment on, any share of the Series A Junior Participating Preferred Stock or any share of any other series of Preferred Stock or any share of any class of stock, or series thereof, ranking on a parity with the Series A Junior Participating Preferred Stock as to dividends, for any dividend period unless at the same time a like proportionate dividend for the same dividend period, ratably in proportion to the respective dividends applicable thereto, shall be declared and paid, or set apart for payment on, all shares of the Series A Junior Participating Preferred Stock and all shares of all other series of Preferred Stock and all shares of any class, or series thereof, ranking on a parity with the Series A Junior Participating Preferred Stock as to dividends, then issued and outstanding and entitled to receive dividends.

(d) Reacquired Shares. Any shares of Series A Junior Participating Preferred Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall be retired and canceled promptly after the acquisition thereof. All such shares shall upon their cancellation become authorized but unissued shares of Preferred Stock and may be reissued as part of a new series of Preferred Stock, subject to the conditions and restrictions on issuance set forth herein, in the Amended and Restated Articles of Incorporation of the Corporation (including Articles of Amendment duly adopted in accordance with the North Carolina Business Corporation Act) creating a series of Preferred Stock or any similar stock, or as otherwise required by law.

(e) Liquidation, Dissolution or Winding Up.

(i) Upon any liquidation (voluntary or otherwise), dissolution or winding up of the Corporation, no distribution shall be made to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Junior Participating Preferred

Stock unless, prior thereto, the holders of shares of Series A Junior Participating Preferred Stock shall have received \$100 per share, plus an amount equal to all accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment (the "Series A Liquidation Preference"). Following the payment of the full amount of the Series A Liquidation Preference, no additional distributions shall be made to the holders of shares of Series A Junior Participating Preferred Stock unless, prior thereto, the holders of shares of Common Stock shall have received an amount per share (the "Common Adjustment") equal to the quotient obtained by dividing (a) the Series A Liquidation Preference by (b) 100 (as appropriately adjusted as set forth in subparagraph (iii) below to reflect such events as stock splits, stock dividends and recapitalizations with respect to the Common Stock) (such number in clause (b), the "Adjustment Number"). Following the payment of the full amount of the Series A Liquidation Preference and the Common Adjustment in respect of all outstanding shares of Series A Junior Participating Preferred Stock and Common Stock, respectively, holders of Series A Junior Participating Preferred Stock and holders of shares of Common Stock shall receive their ratable and proportionate share of the remaining assets to be distributed in the ratio of the Adjustment Number to one (1) with respect to such Series A Junior Participating Preferred Stock and Common Stock, on a per share basis, respectively.

(ii) In the event, however, that there are not sufficient assets available to permit payment in full of the Series A Liquidation Preference and the liquidation preferences of all other series of Preferred Stock, if any, which rank on a parity with the Series A Junior Participating Preferred Stock, then such remaining assets shall be distributed ratably to the holders of the Series A Junior Participating Preferred Stock and such parity shares in proportion to their respective liquidation preferences. In the event that there are not sufficient assets available to permit payment in full of the Common Adjustment, then such remaining assets shall be distributed ratably to the holders of Common Stock.

(iii) In the event the Corporation shall at any time on or after the Rights Declaration Date (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding Common Stock, or (iii) combine the outstanding Common Stock into a smaller number of shares, then in each such case the Adjustment Number in effect immediately prior to such event shall be adjusted by multiplying such Adjustment Number by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of

which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(iv) Neither the sale, lease or conveyance of all or substantially all of the property or business of the Corporation, nor the merger, consolidation or statutory share exchange of the Corporation into or with any other corporation or the merger, consolidation or statutory share exchange of any other corporation into or with the Corporation, shall be deemed to be a liquidation, dissolution or winding-up, voluntary or involuntary, for the purposes of this Paragraph (e).

(f) Statutory Share Exchange, Merger Consolidation, etc. In case the Corporation shall enter into any statutory share exchange, merger, consolidation, combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case the shares of Series A Junior Participating Preferred Stock shall at the same time be similarly exchanged or changed in an amount per share (subject to the provision for adjustment hereinafter set forth) equal to 100 times the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is changed or exchanged. In the event the Corporation shall at any time on or after the Rights Declaration Date (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding Common Stock, or (iii) combine or consolidate the outstanding Common Stock into a smaller number of shares, then in each such case the amount set forth in the preceding sentence with respect to the exchange or change of shares of Series A Junior Participating Preferred Stock shall be adjusted by multiplying such amount by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(g) No Redemption. The shares of Series A Junior Participating Preferred Stock shall not be redeemable.

(h) Ranking. The Series A Junior Participating Preferred Stock shall rank junior to all other series of the Corporation's Preferred Stock as to the payment of dividends and the distribution of assets, unless the terms of any such series shall provide otherwise.

(i) Amendment. The Amended and Restated Articles of Incorporation of the Corporation shall not be further amended in any manner which would materially alter or change the powers, preferences or special rights of the Series A

Junior Participating Preferred Stock so as to affect them adversely, except in accordance with the provisions of Section 55-10-04 of the North Carolina Business Corporation Act, or as otherwise permitted by law.

(j) Fractional Shares. Series A Junior Participating Preferred Stock may be issued in fractions of a share (which shall be integral multiples of one one-hundredth of a share of Series A Junior Participating Preferred Stock), which shall entitle the holder, in proportion to such holder's fractional shares, to exercise voting rights, receive dividends, participate in distributions and to have the benefit of all other rights of holders of Series A Junior Participating Preferred Stock.

This 23rd day of February, 1999.

C3, INC.

By:

Name: Robert S. Thomas
Title: President

1998 DECLARATION OF AMENDMENT TO
1996 STOCK OPTION PLAN
OF C3, INC.

THIS DECLARATION OF AMENDMENT, made this 22nd day of November, 1998, by C3, INC., a North Carolina corporation (the "Corporation"), to the 1996 Stock Option Plan of C3, Inc. (as amended October 27, 1997) (the "Plan");

R E C I T A L S:

It is deemed advisable to amend the Plan to (i) clarify the intention of the Board of Directors (as reflected in minutes of the Board dated November 15, 1996) that all options shall become fully exercisable in the event of a "change of control" of the Corporation (subject to the discretion of the Board not to accelerate options in limited circumstances); (ii) alter the permissible methods of payment of the option price upon exercise by deleting the reference in Section 6(c)(ii) to payment by withholding of shares of the Corporation's common stock, except in the event of a change of control of the Corporation; and (iii) to clarify in Section 14(b) and (c) those circumstances in which (A) amendment or termination of the Plan may be subject to optionee consent and (B) amendment of an option may be subject to delivery of a legal opinion.

NOW, THEREFORE, IT IS DECLARED that the Plan shall be and hereby is amended, effective with respect to (i) all outstanding options, provided that the consent of the optionee is obtained in the event that such consent is required pursuant to the terms of the Plan, and (ii) all subsequent options which may be granted on or after the date hereof, as follows:

1. Section 6(b) of the Plan shall hereby be deleted and the following shall be inserted in lieu thereof:

"(b) An Option may be exercised by giving written notice of at least ten days to the Secretary of the Corporation at the Corporation's principal office. Such notice shall specify the number of shares to be purchased pursuant to an option and the aggregate purchase price to be paid therefor, and shall be accompanied by the payment of such purchase price. Such payment shall be in the form of (i) cash; (ii) certified check; (iii) shares of common stock owned by the optionee at the time of exercise; (iv) delivery of written notice of exercise to the Corporation and delivery to a broker of written notice of exercise and irrevocable instructions to promptly deliver to the Corporation the amount of sale or loan proceeds to pay the Option Price; or (v) a combination of the foregoing methods, as elected by the optionee. Notwithstanding the foregoing, in the event of a "change of control" of the Corporation (as such term is defined by Section 17(c) herein), then, in addition to the foregoing methods of exercise, payment may be made by the withholding of shares of Common Stock otherwise deliverable upon exercise. Shares tendered or withheld in payment upon the exercise of an option shall be valued at their fair market value on the date of exercise, as determined by the Board by applying the provisions of Paragraph 6(b)."

2. A new Section 17 shall hereby be added by inserting the following after Section 16:

"17. CHANGE OF CONTROL

(a) Notwithstanding any other provision of the Plan to the contrary, in the event of a Change of Control (as defined in Section 17(c) herein) all Options outstanding as of the date of such Change of Control shall become fully exercisable, whether or not then otherwise exercisable.

(b) Notwithstanding the foregoing, in the event of a merger, share exchange, reorganization or other business combination affecting the Corporation or a related corporation, the Board may, in its sole and absolute discretion, determine that any or all Options granted pursuant to the Plan shall not become exercisable on an accelerated basis, if the board of directors of the surviving or acquiring corporation, as the case may be, shall have taken such action, including but not limited to the assumption of Options granted under the Plan or the grant of substitute awards (in either case, with substantially similar terms as Options granted under the Plan), as in the opinion of the Board of Directors of the Corporation is equitable or appropriate to protect the rights and interests of participants under the Plan. For the purposes herein, two-thirds of the members of the Board of Directors of the Corporation shall have been directors of the Corporation prior to the merger, share exchange, reorganization or other business combinations affecting the Corporation or a related corporation.

(c) For the purposes herein, a "Change of Control" shall be deemed to have occurred on the earliest of the following dates:

(i) The date any person or group of persons (as defined in Section 13(d) and 14(d) of the Exchange Act) together with its

affiliates, excluding employee benefit plans of Corporation, becomes, directly or indirectly, the "beneficial owner" (as defined in Rule 13d-3 promulgated under the Exchange Act) of securities of the Corporation representing 20% or more of the combined voting power of the Corporation's then outstanding securities;

(ii) The date upon which, as a result of a tender offer or exchange offer for the purchase of securities of Corporation (other than such an offer by the Corporation 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 Corporation's Board of Directors, plus new directors whose election by the Corporation's shareholders is approved by a vote of at least two-thirds of the outstanding voting shares of the Corporation, cease for any reason during such year period to constitute at least two-thirds of the members of such Board of Directors;

(iii) The date the shareholders of the Corporation approve a merger or consolidation of the Corporation 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 Corporation 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 Corporation or such surviving entity outstanding immediately after such merger or consolidation;

(iv) The date the shareholders of the Corporation approve a plan of complete liquidation or winding-up of the Corporation or an agreement for the sale or disposition by the Corporation of all or substantially all of the Corporation's assets; or

(v) The occurrence of any other event which the Corporation's Board of Directors determines should constitute a Change of Control."

3. Section 14(b) and (c) of the Plan shall be deleted in their entirety and the following shall be inserted in lieu thereof:

"(b) No outstanding option shall be adversely affected by a subsequent amendment or termination of the plan without the optionee's consent.

(c) If an option is an incentive option, the option may not be amended without the opinion of legal counsel to the Corporation that such amendment will not constitute a "modification" within the meaning of Section 424 of the Code, if the Board determines that such an opinion is necessary."

IN WITNESS WHEREOF, this Declaration of Amendment is executed on behalf of C3, Inc. as the day and year first above written.

C3, INC.

By: /s/ Robert S. Thomas

Robert S. Thomas
President

ATTEST:

/s/ Mark W. Hahn

Mark W. Hahn
Secretary

[Corporate Seal]

1998 DECLARATION OF AMENDMENT TO
1997 OMNIBUS STOCK PLAN
OF C3, INC.

THIS DECLARATION OF AMENDMENT, made this 22nd day of November, 1998, by C3, INC., a North Carolina corporation (the "Corporation"), to the 1997 Omnibus Stock Plan of C3, Inc. (the "Plan");

R E C I T A L S:

It is deemed advisable to amend the Plan to alter the permissible methods of payment of the option price upon exercise by deleting the reference in Section 6(c)(ii) to payment by withholding of shares of the Corporation's common stock, except in the event of a "change of control" (as defined in the Plan) of the Corporation.

NOW, THEREFORE, IT IS DECLARED that the Plan shall be and hereby is amended, effective with respect to all outstanding options, provided that the consent of the optionee is obtained, and all subsequent options which may be granted on or after the date hereof, by deleting Section 6(c)(ii) of the Plan and inserting therefor the following:

"(ii) An Option may be exercised by giving written notice to the Corporation at such place as the Corporation shall direct. Such notice shall specify the number of shares to be purchased pursuant to an Option and the aggregate purchase price to be paid therefor, and shall be accompanied by the payment of such purchase price. Such payment shall be in the form of (A) cash; (B) shares of Common Stock owned by the Participant at the time of exercise; (C) delivery of written notice of exercise to the Corporation and delivery to a broker of written notice of exercise and irrevocable instructions to promptly deliver to the Corporation the amount of sale or loan proceeds to pay the Option Price; or (D) a combination of the foregoing methods, as elected by the Participant. Notwithstanding the foregoing, in the event of a "change of control" of the Corporation (as such term is defined in Section 19(b) herein), then, in addition to the foregoing methods of exercise, payment may also be made by the withholding of shares of Common Stock otherwise deliverable upon exercise. Shares tendered or withheld in payment on the exercise of an Option shall be valued at their fair market value on the date of exercise, as determined by the Committee by applying the provisions of Section 6(b)(ii)."

IN WITNESS WHEREOF, this Declaration of Amendment is executed on behalf of C3, Inc. as the day and year first above written.

C3, INC.

By: /s/ Robert S. Thomas

Robert S. Thomas
President

ATTEST:

/s/ Mark W. Hahn

Mark W. Hahn
Secretary

[Corporate Seal]

EMPLOYMENT AGREEMENT

This Employment Agreement (the "Agreement"), dated as of March 1, 1999 is entered into by and between C3, Inc, a North Carolina corporation with its principal office at 3800 Gateway Boulevard, Suite 310, Morrisville, NC 27560 (the "Company") and Robert S. Thomas an individual currently residing at P.O. Box 146, Edenton, NC 27932 ("Employee").

Statement of Purpose

The Company wishes to obtain the services of the 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 February 28, 2000. 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 existing term, renew for successive one year terms.
3. Position and Duties. The Employee shall serve as President and COO of the Company. Employee will, under the direction of CEO of the Company, faithfully and to the best of his ability perform the duties as set out in the minutes of the June 10, 1998 Board of Directors meeting and such additional duties as may be reasonably assigned by the CEO 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 per year, payable in regular and equal semi-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.

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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 of the Employee of the services under the 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 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 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 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 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. 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 the 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 employee benefit plans or programs 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 offices of Company, then at the date of 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 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 the 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 the Employee was eligible in the preceding 12 months; or
- (iii) An involuntary relocation of the Employee more than fifty (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 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 proxy contest, merger, consolidation or sale of assets, or as a result of any combination for 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 which 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

the 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 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 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, 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 Company, its successors or assigns all of the 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. 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 of this Agreement, and the remaining terms, covenants, restrictions, or provisions in such paragraph and in the Agreement shall remain in full force and effect and any court of competent jurisdiction may so modify the objectionable provision to make it valid, reasonable and enforceable.
12. 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.
13. Notices. Any notice to be given under this Agreement shall be deemed sufficient if addressed in writing and delivered personally, be 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. Amendment. This Agreement may be amended only by an agreement in writing signed by each of the parties hereto.
15. Entire Agreement. This Agreement contains the entire agreement of the parties with respect to Employee's employment with the Company and supercedes any prior agreements between them, whether written or oral.
16. 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.
17. 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.
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, CEO

/s/ Robert S. Thomas

Robert S. Thomas

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement No. 333-43613 of C3, Inc. on Form S-8 of our report dated February 18, 1999, appearing in this Annual Report on Form 10-K of C3, Inc. for the year ended December 31, 1998.

/s/ DELOITTE & TOUCHE LLP
Raleigh, North Carolina
March 12, 1999

This Schedule Contains Summary Financial Information Extracted From The Balance Sheet As Of December 31, 1998 And The Statement Of Operations For The Year Ended December 31, 1998 And Is Qualified In Its Entirety By Reference To Such Financial Statements.

1

Year	DEC-31-1998	DEC-31-1998
		32,004,045
		0
	623,921	
	77,000	
	3,092,448	
	36,059,487	
		4,064,032
	232,013	
	40,168,323	
	2,171,991	
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	0	
		0
		48,149,406
		10,153,074
40,168,323		
		4,026,309
	4,026,309	
		2,913,208
	2,913,208	
		0
	77,607	
		0
	(6,733,488)	
		0
	(6,733,488)	
		0
		0
		0
	(6,733,488)	
	(.97)	
	(.97)	