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

FORM 10-Q

(Mark One)

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2013

OR

o Transition report pursuant to Section 13 of 15(d) of the Securities Exchange Act of 1934

For the transition period from ______ to ______

Commission File Number: 000-23329

Charles & Colvard, Ltd.
(Exact name of registrant as specified in its charter)

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☐ (Do not check if a smaller reporting company)	Smaller reporting company	x

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

As of October 28, 2013, there were 20,116,189 shares of the registrant's common stock, no par value per share, outstanding.

CHARLES & COLVARD, LTD.

FORM 10-Q
For the Quarterly Period Ended September 30, 2013

TABLE OF CONTENTS

		Page Number
	PART I – FINANCIAL INFORMATION	
Item 1.	Financial Statements	
	Condensed Consolidated Balance Sheets (unaudited) as of September 30, 2013 and December 31, 2012	3
	Condensed Consolidated Statements of Operations (unaudited) for the three and nine months ended September 30, 2013 and 2012	4
	Condensed Consolidated Statements of Cash Flows (unaudited) for the nine months ended September 30, 2013 and 2012	5
	Notes to Condensed Consolidated Financial Statements (unaudited)	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	31
Item 4.	Controls and Procedures	31
	PART II – OTHER INFORMATION	
Item 1.	Legal Proceedings	32
Item 1A.	Risk Factors	32
Item 5	Other Information	33
Item 6.	Exhibits	33
	Signatures	34

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

CHARLES & COLVARD, LTD.
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2013 (unaudited)	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,199,803	$ 11,860,842
Accounts receivable, net	9,038,174	8,138,358
Interest receivable	4,601	694
Held-to-maturity investments	500,999	505,068
Inventory, net	11,469,778	8,442,430
Prepaid expenses and other assets	1,018,921	737,406
Deferred income taxes	1,211,772	1,211,772
Total current assets	29,444,048	30,896,570
Long-term assets:		
Inventory, net	28,946,967	24,353,580
Property and equipment, net	1,835,446	1,746,792
Intangible assets, net	361,538	346,732
Deferred income taxes	2,586,910	2,520,818
Other assets	13,266	12,199
Total long-term assets	33,744,127	28,980,121
TOTAL ASSETS	$ 63,188,175	$ 59,876,691
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,078,859	$ 2,112,585
Accrued cooperative advertising	493,000	200,000
Accrued expenses and other liabilities	579,887	574,522
Total current liabilities	6,151,746	2,887,107
Long-term liabilities:		
Accrued income taxes	392,501	383,730
Total liabilities	6,544,247	3,270,837
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value	53,644,382	53,318,044
Additional paid-in capital – stock-based compensation	9,566,770	8,459,020
Accumulated deficit	(6,567,224)	(5,171,210)
Total shareholders' equity	56,643,928	56,605,854
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 63,188,175	$ 59,876,691

See Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Net sales	$ 6,858,252	$ 5,076,364	$ 19,875,826	$ 14,312,976
Costs and expenses:				
Cost of goods sold	3,805,227	2,092,734	10,076,520	5,763,179
Sales and marketing	2,449,679	1,678,779	7,228,883	4,764,595
General and administrative	1,723,676	1,192,278	3,917,461	3,834,744
Research and development	6,755	1,490	21,779	18,279
Loss on abandonment of assets	-	-	95,052	-
Total costs and expenses	7,985,337	4,965,281	21,339,695	14,380,797
(Loss) income from operations	(1,127,085)	111,083	(1,463,869)	(67,821)
Other income (expense):				
Interest income	5,135	16,002	19,609	57,690
Interest expense	(202)	(335)	(1,176)	(939)
Total other income, net	4,933	15,667	18,433	56,751
(Loss) income before income taxes	(1,122,152)	126,750	(1,445,436)	(11,070)
Income tax net (expense) benefit	(88,550)	(3,125)	49,422	307,421
Net (loss) income	$ (1,210,702)	$ 123,625	$ (1,396,014)	$ 296,351
Net (loss) income per common share:				
Basic	$ (0.06)	$ 0.01	$ (0.07)	$ 0.02
Fully diluted	$ (0.06)	$ 0.01	$ (0.07)	$ 0.01
Weighted average number of shares used in computing net (loss) income per common share:				
Basic	20,001,543	19,638,610	19,825,532	19,558,152
Fully diluted	20,001,543	20,017,147	19,825,532	19,942,891

See Notes to Condensed Consolidated Financial Statements.

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

	Nine Months Ended September 30,	
	2013	**2012**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$ (1,396,014)	$ 296,351
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	584,734	423,419
Amortization of bond premium	4,069	3,988
Stock-based compensation	1,192,823	801,119
Provision for uncollectible accounts	17,195	373,396
Provision for sales returns	(101,000)	237,000
Provision for inventory reserves	197,000	5,000
Benefit for deferred income taxes	(66,092)	-
Loss on abandonment of assets	95,052	-
Changes in assets and liabilities:		
Accounts receivable	(816,011)	(502,437)
Interest receivable	(3,907)	3,352
Inventory	(7,817,735)	1,314,577
Prepaid expenses and other assets, net	(282,582)	(282,285)
Accounts payable	2,966,274	(127,850)
Accrued cooperative advertising	293,000	225,000
Accrued income taxes	8,771	(355,768)
Other accrued liabilities	5,365	(309,646)
Net cash (used in) provided by operating activities	(5,119,058)	2,105,216
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(673,588)	(738,341)
Proceeds from call of long-term investments	-	2,500,000
Patent, license rights, and trademark costs	(109,658)	(41,344)
Net cash (used in) provided by investing activities	(783,246)	1,720,315
CASH FLOWS FROM FINANCING ACTIVITIES:		
Stock option exercises	241,265	156,093
Net cash provided by financing activities	241,265	156,093
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(5,661,039)	3,981,624
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	11,860,842	6,701,701
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 6,199,803	$ 10,683,325
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	$ 1,176	$ 939
Cash paid during the period for income taxes	$ 7,899	$ 12,221

See Notes to Condensed Consolidated Financial Statements.

CHARLES & COLVARD, LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. DESCRIPTION OF BUSINESS

Charles & Colvard, Ltd. (the "Company"), a North Carolina corporation founded in 1995, manufactures, markets, and distributes *Charles & Colvard Created Moissanite®* jewels (hereinafter referred to as moissanite or moissanite jewels), finished jewelry featuring moissanite, and fashion jewelry for sale in the worldwide jewelry market. Moissanite, also known by its chemical name of silicon carbide ("SiC"), is a rare mineral first discovered in a meteor crater. Because naturally occurring SiC crystals are too small for commercial use, larger crystals must be grown in a laboratory. Leveraging its advantage of being the sole source worldwide of created moissanite jewels, the Company's strategy is to establish itself with reputable, high-quality, and sophisticated brands and to position moissanite as an affordable, luxurious alternative to other gemstones, such as diamond. The Company believes this is possible due to moissanite's exceptional brilliance, fire, luster, durability, and rarity like no other jewel available on the market. The Company sells loose moissanite jewels and finished jewelry at wholesale to distributors, manufacturers, and retailers and at retail to end consumers through its wholly owned operating subsidiaries Moissanite.com, LLC and Charles & Colvard Direct, LLC.

2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation - The accompanying unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information. However, certain information or footnote disclosures normally included in complete financial statements prepared in accordance with U.S. GAAP have been condensed, or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). In the opinion of the Company's management, the unaudited statements in this Quarterly Report on Form 10-Q include all normal and recurring adjustments necessary for the fair statement of the results for the interim periods presented. The results for the three and nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2013.

The consolidated financial statements as of and for the three and nine months ended September 30, 2013 and 2012 included in this Quarterly Report on Form 10-Q are unaudited. The balance sheet as of December 31, 2012 is derived from the audited financial statements as of that date. The accompanying statements should be read in conjunction with the audited financial statements and related notes, together with Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 filed with the SEC on March 29, 2013 (the "2012 Annual Report").

The accompanying consolidated financial statements as of and for the three and nine months ended September 30, 2013 and 2012 include the accounts of the Company and its wholly owned subsidiaries Moissanite.com, LLC, formed in 2011; Charles & Colvard Direct, LLC, formed in 2011; and Charles & Colvard (HK) Ltd., the Company's Hong Kong subsidiary that became a dormant entity in the second quarter of 2009 and the operations of which ceased in 2008. All intercompany accounts have been eliminated.

Significant Accounting Policies - In the opinion of the Company's management, the significant accounting policies used for the three and nine months ended September 30, 2013 are consistent with those used for the year ended December 31, 2012. Accordingly, please refer to the 2012 Annual Report for the Company's significant accounting policies.

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

Reclassifications - Certain amounts in the prior year's condensed consolidated financial statements have been reclassified to conform to the current year presentation.

Recently Adopted/Issued Accounting Pronouncements - All new and recently issued, but not yet effective, accounting pronouncements have been deemed to be not relevant to the Company and therefore are not expected to have any impact once adopted.

3. SEGMENT INFORMATION AND GEOGRAPHIC DATA

The Company reports segment information based on the "management" approach. The management approach designates the internal reporting used by management for making operating decisions and assessing performance as the source of the Company's operating and reportable segments.

The Company manages its business primarily by its two distribution channels that it uses to sell its loose jewel and finished jewelry product lines. Accordingly, the Company determined its two operating and reporting segments to be wholesale distribution transacted through the parent entity and direct-to-consumer distribution transacted through the Company's wholly owned operating subsidiaries, Moissanite.com, LLC and Charles & Colvard Direct, LLC. The accounting policies of these segments are the same as those described in Note 2, "Basis of Presentation and Significant Accounting Policies," of this Quarterly Report on Form 10-Q and in the Notes to Consolidated Financial Statements in the 2012 Annual Report.

The Company evaluates the financial performance of its segments based on net sales; product line gross profit, or the excess of product line sales over product line cost of goods sold; and operating income (loss). The Company's inventories are maintained in the parent entity's wholesale distribution segment and are transferred without intercompany markup to the operating subsidiaries as product line cost of goods sold when sold to the end consumer. Product line cost of goods sold is defined as product cost of goods sold in each of the Company's wholesale distribution and direct-to-consumer distribution operating segments excluding non-capitalized expenses from the Company's manufacturing and production control departments, comprising personnel costs, depreciation, rent, utilities, and corporate overhead allocations; freight out; inventory valuation allowance adjustments; and other inventory adjustments, comprising costs of quality issues, damaged goods, and inventory write-offs.

The Company allocates certain general and administrative and information technology-related expenses from its parent entity to its two direct-to-consumer operating subsidiaries primarily based on net sales and headcount, respectively. Unallocated expenses, which also include interest and taxes, remain in the parent entity's wholesale distribution segment.

Summary financial information by reporting segment is as follows:

	Three Months Ended September 30,					
	2013			2012		
	Wholesale	Direct-to-Consumer	Total	Wholesale	Direct-to-Consumer	Total
Net sales						
Loose jewels	$ 4,744,308	$ 77,011	$ 4,821,319	$ 3,718,706	$ 55,035	$ 3,773,741
Finished jewelry	1,610,485	426,448	2,036,933	978,606	324,017	1,302,623
Total	$ 6,354,793	$ 503,459	$ 6,858,252	$ 4,697,312	$ 379,052	$ 5,076,364
Product line cost of goods sold						
Loose jewels	$ 2,214,152	$ 16,878	$ 2,231,030	$ 1,337,451	$ -	$ 1,337,451
Finished jewelry	795,711	213,566	1,009,277	538,196	10,094	548,290
Total	$ 3,009,863	$ 230,444	$ 3,240,307	$ 1,875,647	$ 10,094	$ 1,885,741
Product line gross profit						
Loose jewels	$ 2,530,156	$ 60,133	$ 2,590,289	$ 2,381,255	$ 55,035	$ 2,436,290
Finished jewelry	814,774	212,882	1,027,656	440,410	313,923	754,333
Total	$ 3,344,930	$ 273,015	$ 3,617,945	$ 2,821,665	$ 368,958	$ 3,190,623
Operating income (loss)	$ 175,342	$ (1,302,427)	$ (1,127,085)	$ 762,973	$ (651,890)	$ 111,083
Depreciation and amortization	$ 108,763	$ 91,222	$ 199,985	$ 69,117	$ 36,244	$ 105,361
Capital expenditures	$ 452,288	$ 18,600	$ 470,888	$ 22,520	$ 229,943	$ 252,463

	Nine Months Ended September 30,					
	2013			2012		
	Wholesale	Direct-to-Consumer	Total	Wholesale	Direct-to-Consumer	Total
Net sales						
Loose jewels	$ 13,022,685	$ 221,957	$ 13,244,642	$ 10,164,361	$ 148,618	$ 10,312,979
Finished jewelry	5,244,474	1,386,710	6,631,184	3,285,547	714,450	3,999,997
Total	$ 18,267,159	$ 1,608,667	$ 19,875,826	$ 13,449,908	$ 863,068	$ 14,312,976
Product line cost of goods sold						
Loose jewels	$ 5,264,563	$ 35,420	$ 5,299,983	$ 3,253,724	$ 12,014	$ 3,265,738
Finished jewelry	2,726,789	687,034	3,413,823	1,274,617	147,775	1,422,392
Total	$ 7,991,352	$ 722,454	$ 8,713,806	$ 4,528,341	$ 159,789	$ 4,688,130
Product line gross profit						
Loose jewels	$ 7,758,122	$ 186,537	$ 7,944,659	$ 6,910,637	$ 136,604	$ 7,047,241
Finished jewelry	2,517,685	699,676	3,217,361	2,010,930	566,675	2,577,605
Total	$ 10,275,807	$ 886,213	$ 11,162,020	$ 8,921,567	$ 703,279	$ 9,624,846
Operating income (loss)	$ 2,443,939	$ (3,907,808)	$ (1,463,869)	$ 1,912,231	$ (1,980,052)	$ (67,821)
Depreciation and amortization	$ 301,618	$ 283,116	$ 584,734	$ 281,645	$ 141,774	$ 423,419
Capital expenditures	$ 641,694	$ 31,894	$ 673,588	$ 391,637	$ 346,704	$ 738,341

	September 30, 2013			December 31, 2012		
	Wholesale	Direct-to-Consumer	Total	Wholesale	Direct-to-Consumer	Total
Total assets	$ 54,493,320	$ 8,694,855	$ 63,188,175	$ 58,823,642	$ 1,053,049	$ 59,876,691

A reconciliation of the Company’s product line cost of goods sold to cost of goods sold as reported in the consolidated financial statements is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Product line cost of goods sold	$ 3,240,307	$ 1,885,741	$ 8,713,806	$ 4,688,130
Non-capitalized manufacturing and production control expenses	380,369	300,025	989,009	1,038,413
Freight out	39,850	25,450	127,812	66,946
Inventory valuation allowances	122,000	(21,000)	197,000	5,000
Other inventory adjustments	22,701	(97,482)	48,893	(35,310)
Cost of goods sold	$ 3,805,227	$ 2,092,734	$ 10,076,520	$ 5,763,179

The Company’s net inventories by product line maintained in the parent entity’s wholesale distribution segment are as follows:

	September 30, 2013	December 31, 2012
Loose jewels		
Raw materials	$ 4,006,655	$ 3,189,320
Work-in-process	9,048,269	3,650,322
Finished goods	18,224,036	19,074,526
Finished goods on consignment	77,725	75,131
Total	$ 31,356,685	$ 25,989,299
Finished jewelry		
Raw materials	$ 283,167	$ 259,366
Work-in-process	730,298	250,628
Finished goods	7,378,672	5,451,178
Finished goods on consignment	575,919	748,022
Total	$ 8,968,056	$ 6,709,194

Supplies inventories of approximately $92,000 and $98,000 at September 30, 2013 and December 31, 2012, respectively, included in finished goods inventories in the consolidated financial statements are omitted from inventories by product line because they are used in both product lines and are not maintained separately.

The Company recognizes sales by geographic area based on the country in which the customer is based. A portion of the Company's international wholesale distribution segment sales represents products sold internationally that may be re-imported to United States ("U.S.") retailers. Sales to international end consumers made by the Company's direct-to-consumer distribution segment are included in U.S. sales because products are shipped and invoiced to a U.S.-based intermediary party that assumes all international shipping and credit risks. The following presents certain data by geographic area:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net sales				
United States	$ 3,852,627	$ 4,057,050	$ 14,338,094	$ 11,476,209
International	3,005,625	1,019,314	5,537,732	2,836,767
Total	$ 6,858,252	$ 5,076,364	$ 19,875,826	$ 14,312,976

	September 30, 2013	December 31, 2012
Property and equipment, net		
United States	$ 1,835,446	$ 1,746,792
International	-	-
Total	$ 1,835,446	$ 1,746,792

	September 30, 2013	December 31, 2012
Intangible assets, net		
United States	$ 197,747	$ 152,038
International	163,791	194,694
Total	$ 361,538	$ 346,732

4. INVESTMENTS

Investments consist of long-term U.S. government agency securities carried at amortized cost using the effective interest method. The Company classifies its marketable securities as held-to-maturity based upon management's positive intention and ability to hold these securities until their maturity dates.

The following table summarizes information about held-to-maturity investments at September 30, 2013:

	Amortized Cost	Gross Unrealized Gains	Estimated Fair Value
U.S. government agency securities	$ 500,999	$ 2,046	$ 503,045

As of September 30, 2013, the estimated fair value of the investments was greater than the amortized cost. Because management intends to hold the investments until their maturity dates, this unrealized gain was not recorded in the consolidated financial statements.

The maturities of held-to-maturity investments at September 30, 2013 were as follows:

	Less than 1 Year	Total
U.S. government agency securities	$ 500,999	$ 500,999

5. FAIR VALUE MEASUREMENTS

Under U.S. GAAP, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. U.S. GAAP also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are obtained from independent sources and can be validated by a third party, whereas unobservable inputs reflect assumptions regarding what a third party would use in pricing an asset or liability. The fair value hierarchy consists of three levels based on the reliability of inputs, as follows:

- *Level 1* - quoted prices in active markets for identical assets and liabilities

- *Level 2* - inputs other than Level 1 quoted prices that are directly or indirectly observable

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

The Company evaluates assets and liabilities subject to fair value measurements on a recurring and non-recurring basis to determine the appropriate level to classify them for each reporting period. This determination requires significant judgments to be made by management of the Company. The instruments identified as subject to fair value measurements on a recurring basis are cash and cash equivalents, trade accounts receivable, held-to-maturity investments, trade accounts payable, and accrued expenses. All instruments other than held-to-maturity investments are reflected in the consolidated balance sheets at carrying value, which approximates fair value due to the short-term nature of these instruments. The estimated fair value of the Company's held-to-maturity investments as of September 30, 2013 utilized Level 2 inputs of similar investments traded on active securities exchanges.

Assets that are measured at fair value on a non-recurring basis include property and equipment and intangible assets, comprising patents, license rights, and trademarks. These items are recognized at fair value when they are considered to be impaired. Level 3 inputs are primarily based on the estimated future cash flows of the asset determined by market inquiries to establish fair market value of used machinery or future revenue expected to be generated with the assistance of patents, license rights, and trademarks.

6. INVENTORIES

The Company's total inventories, net of reserves, consisted of the following as of September 30, 2013 and December 31, 2012:

	September 30, 2013	December 31, 2012
Raw materials	$ 4,289,822	$ 3,448,686
Work-in-process	9,778,567	3,900,950
Finished goods	26,211,712	24,978,221
Finished goods on consignment	708,644	843,153
Less inventory reserves	(572,000)	(375,000)
Total	$ 40,416,745	$ 32,796,010
Current portion	$ 11,469,778	$ 8,442,430
Long-term portion	28,946,967	24,353,580
Total	$ 40,416,745	$ 32,796,010

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

The Company's work-in-process inventories include raw SiC crystals on which processing costs, such as labor and sawing, have been incurred; and components, such as metal castings and finished good moissanite jewels, that have been issued to jobs in the manufacture of finished jewelry. The Company's moissanite jewel manufacturing process involves the production of intermediary shapes, called "preforms," that vary depending upon the size and shape of the finished jewel. To maximize manufacturing efficiencies, preforms may be made in advance of current finished inventory needs but remain in work-in-process inventories. As of September 30, 2013 and December 31, 2012, work-in-process inventories issued to active production jobs approximated $4.64 million and $1.12 million, respectively.

The Company's jewels do not degrade in quality over time and inventory generally consists of the shapes and sizes most commonly used in the jewelry industry. In addition, the majority of jewel inventory is not mounted in finished jewelry settings and is therefore not subject to fashion trends nor is obsolescence a significant factor. The Company has very small market penetration in the worldwide jewelry market, and the Company has the exclusive right in the U.S. through mid-2015 and in many other countries through mid-2016 to produce and sell created SiC for use in jewelry applications. In view of the foregoing factors, management has concluded that no excess or obsolete loose jewel inventory reserve requirements existed as of September 30, 2013.

In 2010, the Company began manufacturing finished jewelry featuring moissanite. Relative to loose moissanite jewels, finished jewelry is more fashion oriented and subject to styling trends that could render certain designs obsolete. The majority of the Company's finished jewelry featuring moissanite is held in inventory for resale and consists of such basic designs as stud earrings, solitaire and three-stone rings, pendants, and bracelets that tend not to be subject to significant obsolescence risk due to their classic styling. In addition, the Company manufactures small individual quantities of designer-inspired moissanite fashion jewelry as part of its sample line that are used in the selling process to its wholesale customers.

In 2011, the Company began purchasing fashion finished jewelry comprised of base metals and non-precious gemstones for sale through *Lulu Avenue*™, the direct-to-consumer home party division of its wholly owned operating subsidiary, Charles & Colvard Direct, LLC. This finished jewelry is fashion oriented and subject to styling trends that may change with each catalog season, of which there are several each year. Typically in the jewelry industry, slow-moving or discontinued lines are sold as closeouts or liquidated in alternative sales channels. The Company reviews the finished jewelry inventory on an ongoing basis for any lower of cost or market and obsolescence issues and has established an obsolescence reserve on its fashion finished jewelry at September 30, 2013 of $108,000. The Company concluded that no such finished jewelry inventory reserve requirements relating to the Company's fashion finished jewelry existed as of December 31, 2012 or relating to its new line of finished jewelry featuring moissanite existed as of September 30, 2013 or December 31, 2012.

Periodically, the Company ships finished goods inventory to wholesale customers on consignment terms. Under these terms, the customer assumes the risk of loss and has an absolute right of return for a specified period. Finished goods on consignment at September 30, 2013 and December 31, 2012 are net of shrinkage reserves of $55,000 and $20,000, respectively, to allow for certain loose jewels and finished jewelry on consignment with wholesale customers that may not be returned or may be returned in a condition that does not meet the Company’s current grading or quality standards.

Total net loose jewel inventories at September 30, 2013 and December 31, 2012, including inventory on consignment net of reserves, were $31.36 million and $25.99 million, respectively. The loose jewel inventories at September 30, 2013 and December 31, 2012 include shrinkage reserves of $50,000 and $36,000, respectively, including shrinkage reserves of $0 and $17,000 on inventory on consignment at September 30, 2013 and December 31, 2012, respectively. Loose jewel inventories at September 30, 2013 and December 31, 2012 also include recuts reserves of $167,000 and $109,000, respectively.

Total net jewelry inventories at September 30, 2013 and December 31, 2012, including inventory on consignment net of reserves, finished jewelry featuring moissanite manufactured by the Company since entering the finished jewelry business in 2010, and fashion finished jewelry purchased by the Company for sale through *Lulu Avenue*™, were $8.97 million and $6.71 million, respectively. Jewelry inventories consist primarily of finished goods, a portion of which the Company acquired as part of a January 2009 settlement agreement with a former manufacturer customer to reduce the outstanding receivable to the Company. Due to the lack of a plan to market this inventory at that time, a jewelry inventory reserve was established to reduce the majority of the acquired jewelry inventory value to scrap value, or the amount the Company would expect to obtain by melting the gold in the jewelry and returning to loose-jewel finished goods inventory those jewels that meet grading standards. The scrap reserve established for this acquired inventory at the time of the agreement is adjusted at each reporting period for the market price of gold and has generally declined as the associated jewelry is sold down. At September 30, 2013, the balance increased to $152,000 from $132,000 at December 31, 2012 as a result of a decrease in the market price of gold, offset in part by sell down of the inventory during the quarter. The reserve will increase when the market price of gold decreases so as to lower the net realizable value of the inventory due to the lower gold price. Because the finished jewelry the Company began manufacturing in 2010 after it entered that business was made pursuant to an operational plan to market and sell the inventory, it is not subject to this reserve. In addition, the finished jewelry inventories at September 30, 2013 and December 31, 2012 include shrinkage reserves of $95,000 and $98,000, respectively, including shrinkage reserves of $55,000 and $3,000 on inventory on consignment, respectively. The finished jewelry inventories at September 30, 2013 also include an inventory reserve for obsolescence of $108,000.

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

7. INCOME TAXES

The Company recognized an income tax expense of approximately $89,000 and an income tax net benefit of approximately $49,000 for the three and nine months ended September 30, 2013, respectively, compared to an income tax expense of approximately $3,000 and an income tax net benefit of approximately $307,000 for the three and nine months ended September 30, 2012, respectively.

During 2008, the Company recorded a full valuation allowance against certain deferred tax assets consisting primarily of net operating loss carryforwards. Due to continued uncertainty over sufficient future taxable income to fully utilize these deferred tax assets, the Company did not record an income tax expense for the pretax income earned during the three months ended September 30, 2012 or an income tax benefit for the pretax loss incurred during the nine months ended September 30, 2012.

As of each reporting date, the Company’s management considers new evidence, both positive and negative, that could impact its view with regard to future realization of deferred tax assets. For the year ended December 31, 2012, cumulative positive taxable income over the last three tax years had been generated, offsetting the negative evidence of cumulative losses in previous years. The Company also determined that its expectations of future taxable income in upcoming tax years would be sufficient to result in full utilization of these net operating loss carryforwards and deferred tax assets prior to any statutory expiration. As a result, the Company’s management determined that sufficient positive evidence existed as of December 31, 2012 to conclude that it is more likely than not that the majority of its deferred tax assets are realizable, and it reduced its valuation allowance accordingly. A valuation allowance remains against certain deferred tax assets relating to state net operating loss carryforwards from the Company’s e-commerce and home party operating subsidiaries due to the timing uncertainty of when the subsidiaries will generate cumulative positive taxable income to utilize the associated deferred tax assets. A valuation allowance also remains against certain deferred tax assets relating to investment loss carryforwards because the Company’s current investments are classified as held-to-maturity, indicating they will be redeemed at par value and will not generate gains sufficient or of the appropriate character to utilize the associated deferred tax assets.

For the three months ended September 30, 2013, the Company recognized $89,000 of current period income tax expense, offsetting an income tax benefit recorded in the first half of 2013 of approximately $138,000. The resulting income tax net benefit of $49,000 for the nine months ended September 30, 2013 represents an effective tax rate of 1.6% on the year-to-date pre-tax book loss. The effective tax rate for the nine months ended September 30, 2013 differs from the federal statutory rate of 34.0% primarily due to the impact of state income taxes, stock-based compensation expense that is not deductible for tax purposes, and other book-to-tax reconciling items. This effective tax rate has decreased from December 31, 2012 due to anticipation of lower taxable income in the current fiscal year, despite an additional $7,000 of income tax expense that was accrued and paid in the first quarter of 2013 related to the prior tax year, primarily for adjustment of the federal alternative minimum tax. Additionally, during the three months ended September 30, 2013 the Company paid $1,000 with a state tax filing for 2012 that was in excess of estimated payments. The Company recorded approximately $129,000 of income tax expense during the three months ended September 30, 2013 to reflect lower anticipated taxable income for the full year than had been previously estimated, which reduced the tax benefit for the nine months ended September 30, 2013 to $18,000. In addition, the Company recorded $44,000 and $48,000 of income tax benefit for discrete permanent tax deduction differences during the three and nine months ended September 30, 2013 and approximately $3,000 and $9,000 of income tax expense for estimated tax, penalties, and interest associated with uncertain tax positions during the three and nine months ended September 30, 2013, respectively.

During the three months ended September 30, 2012, the Company recognized approximately $4,000 of income tax expense for estimated tax, penalties, and interest associated with uncertain tax positions. During the nine months ended September 30, 2012, the Company entered into a voluntary disclosure agreement with a taxing authority for which the Company had previously recorded a liability for an uncertain tax position. As a result of the agreement, the Company reduced its total recorded liabilities relating to uncertain tax positions by approximately $320,000 and recognized a corresponding income tax benefit. This benefit was offset by approximately $9,000 of income tax expense for estimated tax, penalties, and interest for other uncertain tax positions.

8. COMMITMENTS AND CONTINGENCIES

Lease Commitments

In March 2004, the Company entered into a seven-year lease, beginning in August 2004, for approximately 16,500 square feet of mixed-use space from an unaffiliated third party at a base cost with escalations throughout the lease term plus additional common-area expenses based on the Company's proportionate share of the lessor's operating costs. The lease provided for two rent holidays, during which no rent was payable, and a moving allowance. In January 2011, the Company amended the lease effective January 1, 2011 to extend the term through January 2017 in exchange for a reduced rental rate and 50% rent abatement in the first 12 months of the extended term. The amended lease includes 3% annual rent escalations and a one-time option to terminate the lease effective as of July 31, 2014. The Company exercised this right to terminate the lease by giving notice to the lessor prior to October 31, 2013. The expected cost to terminate the lease effective July 31, 2014 is approximately $112,000, which the Company paid at the time notice was given to terminate the lease. See Note 13, "Subsequent Events" for further discussion. The Company recognizes rent expense on a straight-line basis, giving consideration to the rent holidays, the moving allowance paid to the Company, and the rent abatement.

As of September 30, 2013, the Company's future minimum payments under this operating lease were as follows:

2013	$	34,827
2014		143,486
2015		147,791
2016		152,224
2017		13,066
Total	$	491,394

Rent expense for the three months ended September 30, 2013 and 2012 was approximately $55,000 and $48,000, respectively. Rent expense for the nine months ended September 30, 2013 and 2012 was approximately $188,000 and $148,000, respectively.

Purchase Commitments

On June 6, 1997, the Company entered into an amended and restated exclusive supply agreement with Cree, Inc. ("Cree"). The exclusive supply agreement had an initial term of ten years that was extended in January 2005 to July 2015. In connection with the amended and restated exclusive supply agreement, the Company has committed to purchase from Cree a minimum of 50%, by dollar volume, of its raw material SiC crystal requirements. If the Company's orders require Cree to expand beyond specified production levels, the Company must commit to purchase certain minimum quantities. In February 2013, the Company entered into an amendment to a prior letter agreement with Cree, which provides a framework for the Company's purchases of SiC crystals under the amended and restated exclusive supply agreement. Pursuant to this amendment, the Company agreed to purchase at least $4.00 million of SiC crystals in an initial new order. After the initial new order, the Company has agreed to issue non-cancellable, quarterly orders that must equal or exceed a set minimum order quantity. The total purchase commitment under the amendment (as subsequently amended) until July 2015, including the initial new order, is dependent upon the grade of the material and ranges between approximately $7.64 million and approximately $18.56 million. During the nine months ended September 30, 2013, the Company purchased $9.54 million of raw material SiC crystals from Cree.

9. LINE OF CREDIT

On September 20, 2013, the Company obtained a $10,000,000 revolving line of credit (the "Line of Credit") from PNC Bank, National Association ("PNC Bank") for general corporate and working capital purposes. The Line of Credit is evidenced by a Committed Line of Credit Note, dated September 20, 2013 (the "Note"), which matures on June 15, 2015. Amounts outstanding under the Note accrue interest at the 1-month LIBOR rate (adjusted daily) plus 1.50%, calculated on an actual / 360 basis and payable monthly in arrears. Amounts outstanding during an event of default accrue interest at a rate 3.00% in excess of the standard rate, and late payments are subject to a 5.00% late charge. The Note may be repaid in whole or in part at any time, without penalty or premium.

The Line of Credit is also governed by a loan agreement, dated September 20, 2013 (the "Loan Agreement") and is guaranteed by Charles & Colvard Direct, LLC, and Moissanite.com, LLC. The Line of Credit is secured by a lien on substantially all assets of the Company and its subsidiaries. Under the Loan Agreement, the Company is required to comply with the following financial covenants, each tested on a quarterly basis: (1) interest coverage ratio, (2) funded debt to EBITDA ratio, and (3) ratio of current assets to funded debt. The Loan Agreement contains other customary covenants and representations, including a financial reporting covenant and limitations on dividends, debt, contingent obligations, liens, loans, investments, mergers, acquisitions, divestitures, subsidiaries, and change in control.

The events of default under the Line of Credit include, without limitation, (1) a material casualty or material adverse change in the collateral value or business and (2) an event of default under any other indebtedness. If an event of default occurs, PNC Bank is entitled to take various enforcement actions, including acceleration of amounts due under the Note. The Loan Agreement also contains other customary provisions, such as yield protection, expense reimbursement, and confidentiality. PNC Bank has indemnification rights and the right to assign the Line of Credit.

As of September 30, 2013, the Company has not taken any advances against the Line of Credit.

10. STOCK-BASED COMPENSATION

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Employee stock options	$ 246,771	$ 98,966	$ 547,268	$ 379,612
Restricted stock awards	202,419	132,923	645,555	421,507
Income tax expense/(benefit)	190,855	(48,193)	(10,329)	(152,822)
Totals	$ 640,045	$ 183,696	$ 1,182,494	$ 648,297

No stock-based compensation was capitalized as a cost of inventory during the three and nine months ended September 30, 2013 and 2012.

Stock Options - The following is a summary of the stock option activity for the nine months ended September 30, 2013:

	Shares	Weighted Average Exercise Price
Outstanding, December 31, 2012	1,147,847	$ 2.31
Granted	306,002	$ 4.71
Exercised	(113,736)	$ 2.12
Forfeited	(71,460)	$ 2.12
Expired	(70,786)	$ 2.21
Outstanding, September 30, 2013	1,197,867	$ 2.96

The weighted average grant-date fair value of stock options granted during the nine months ended September 30, 2013 was $3.27. The total fair value of stock options that vested during the nine months ended September 30, 2013 was approximately $491,000. The fair value of each stock option is estimated on the date of grant using the Black-Scholes-Merton option pricing model with the following weighted average assumptions for stock options granted during the nine months ended September 30, 2013:

Dividend yield	0.0%
Expected volatility	92.7%
Risk-free interest rate	1.01%
Expected lives (years)	4.9

Although the Company issued dividends in prior years, a dividend yield of zero was used due to the uncertainty of future dividend payments. Volatility is a measure of the amount by which a financial variable such as share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The Company estimates expected volatility giving primary consideration to the historical volatility of its common stock. The risk-free interest rate is based on the published yield available on U.S. Treasury issues with an equivalent term remaining equal to the expected life of the stock option. The expected lives of the stock options represent the estimated period of time until exercise or forfeiture and are based on historical experience of similar awards.

The following table summarizes information about stock options outstanding at September 30, 2013:

Options Outstanding			Options Exercisable			Options Vested or Expected to Vest		
Balance as of 9/30/2013	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of 9/30/2013	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Balance as of 9/30/2013	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
1,197,867	7.76	$ 2.96	752,592	7.13	$ 2.39	1,147,725	7.70	$ 2.90

As of September 30, 2013, the unrecognized stock-based compensation expense related to unvested stock options was approximately $981,000, which is expected to be recognized over a weighted average period of approximately 27 months.

The aggregate intrinsic value of stock options outstanding, exercisable, and vested or expected to vest at September 30, 2013 was approximately $4.89 million, $3.51 million, and $4.74 million, respectively. This amount is before applicable income taxes and represents the closing market price of the Company’s common stock at September 30, 2013 less the grant price, multiplied by the number of stock options that had a grant price that is less than the closing market price. This amount represents the amount that would have been received by the optionees had these stock options been exercised on that date. During the three and nine months ended September 30, 2013, the aggregate intrinsic value of stock options exercised was approximately $515,000 and $552,000, respectively.

Restricted Stock - The following is a summary of the restricted stock activity for the nine months ended September 30, 2013:

	Shares	Weighted Average Grant Date Fair Value
Unvested, December 31, 2012	191,843	$ 3.38
Granted	333,403	$ 4.45
Vested	(180,092)	$ 3.76
Canceled	-	$ -
Unvested, September 30, 2013	345,154	$ 4.22

As of September 30, 2013, the unrecognized stock-based compensation expense related to unvested restricted stock was approximately $1.23 million, which is expected to be recognized over a weighted average period of approximately 26 months.

Dividends - The Company has not paid any cash dividends in the current year through September 30, 2013.

11. NET (LOSS) INCOME PER COMMON SHARE

Basic net (loss) income per common share is computed by dividing net (loss) income by the weighted average number of common shares outstanding during the periods. Fully diluted net (loss) income per common share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the periods. Common equivalent shares consist of stock options that are computed using the treasury stock method. Antidilutive stock awards are comprised of stock options and unvested restricted shares which would have been antidilutive in the application of the treasury stock method in accordance with the "Earnings Per Share" topic of the Financial Accounting Standard Board Accounting Standards Codification.

The following table reconciles the differences between the basic and fully diluted earnings per share presentations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Numerator:				
Net (loss) income	$ (1,210,702)	$ 123,625	$ (1,396,014)	$ 296,351
Denominator:				
Weighted average common shares outstanding:				
Basic	20,001,543	19,638,610	19,825,532	19,558,152
Stock options	-	378,537	-	384,739
Fully diluted	20,001,543	20,017,147	19,825,532	19,942,891
Net (loss) income per common share:				
Basic	$ (0.06)	$ 0.01	$ (0.07)	$ 0.02
Fully diluted	$ (0.06)	$ 0.01	$ (0.07)	$ 0.01

For the three months ended September 30, 2013 and 2012, stock options to purchase approximately 176,000 and 383,000 shares, respectively, were excluded from the computation of fully diluted net (loss) income per common share because the exercise price of the stock options was greater than the average market price of the common shares or the effect of inclusion of such amounts would be anti-dilutive to net (loss) income per common share. For the nine months ended September 30, 2013 and 2012, stock options to purchase approximately 405,000 and 383,000 shares, respectively, were excluded from the computation of fully diluted net (loss) income per common share because the exercise price of the stock options was greater than the average market price of the common shares or the effect of inclusion of such amounts would be anti-dilutive to net (loss) income per common share.

12. MAJOR CUSTOMERS AND CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, investments, and trade accounts receivable. The Company maintains cash, cash equivalents, and investments with high-quality financial institutions and invests in low-risk securities, primarily money market funds or long-term U.S. government agency obligations. At times, cash balances may exceed the Federal Deposit Insurance Corporation (“FDIC”) insurable limits of $250,000 per depositor at each financial institution. Amounts on deposit in excess of FDIC insurable limits at September 30, 2013 approximated $2.28 million.

Trade receivables potentially subject the Company to credit risk. The Company’s standard wholesale customer payment terms on trade receivables are generally between 30 and 90 days, though it may offer extended terms from time to time. The Company believes its competitors and other vendors in the wholesale jewelry industry have also expanded their use of extended payment terms and, in aggregate, the Company believes that by expanding its use of extended payment terms, it has provided a competitive response in its market and that its net sales have been favorably impacted. The Company is unable to estimate the impact of this program on its net sales, but if it ceased providing extended payment terms in select instances, the Company believes it would not be competitive for some wholesale customers in the marketplace and that its net sales and profits would likely decrease. The Company extends credit to its customers based upon a number of factors, including an evaluation of the customer’s financial condition and credit history, the customer’s payment history with the Company, the customer’s reputation in the trade, and/or an evaluation of the Company’s opportunity to introduce its moissanite jewels or finished jewelry featuring moissanite to new or expanded markets. Collateral is not generally required from customers. The need for an allowance for doubtful accounts is determined based upon factors surrounding the credit risk of specific customers, historical trends, and other information. The Company has not experienced any significant accounts receivable write-offs related to revenue arrangements with extended payment terms.

As of September 30, 2013, five customers accounted for 16%, 14%, 13%, 13%, and 12% of trade accounts receivable, respectively. As of December 31, 2012, one customer accounted for 30% of trade accounts receivable.

A significant portion of sales is derived from certain customer relationships. The following is a summary of customers that represent greater than or equal to 10% of total gross sales:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Customer A	19%	0%	7%	0%
Customer B	17%	16%	16%	25%
Customer C	17%	2%	8%	2%
Customer D	7%	9%	8%	11%

13. SUBSEQUENT EVENTS

Termination of Lease

On October 31, 2013, the Company exercised its right under the Lease Agreement, dated March 26, 2004, by and between Duke Realty Limited Partnership and the Company, as amended on September 22, 2004, July 30, 2010, and January 1, 2011 (collectively, the “Lease Agreement”), to terminate the Lease Agreement effective July 31, 2013. As provided by the Lease Agreement, the delivery of the termination notice was accompanied by the Company’s payment of approximately $112,000 to Raleigh Flex Owner I, LLC, the current landlord under the Lease Agreement. This amount reflects all unamortized lease transaction costs, including, without limitation, all rent abated since January 1, 2011, plus two months’ rent at the current rental rate.

On October 11, 2013 the Company entered into a non-binding letter of intent to lease approximately 36,000 square feet of mixed-use space from an unaffiliated third party, which the Company intends to use for its headquarters upon termination of the Lease Agreement. The Company expects to execute a definitive lease agreement related to this property during the fourth quarter of 2013.

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

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

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

- *Our future financial performance depends upon increased consumer acceptance, growth of sales of our products, and operational execution of our strategic initiatives.*
- *We are currently substantially dependent on a limited number of distributors, jewelry manufacturers, and retailers for the sale of our products.*
- *Our business and our results of operations could be materially adversely affected as a result of our inability to fulfill orders on a timely basis.*
- *The financial difficulties or insolvency of one or more of our major customers could adversely affect results.*
- *We expect to remain dependent upon Cree, Inc., or Cree, for the sole supply of our silicon carbide, or SiC, crystals for the foreseeable future.*
- *Our current wholesale customers may potentially perceive us as a competitor in the finished jewelry business.*
- *We face intense competition in the worldwide jewelry industry.*
- *Our business and our results of operations could be materially adversely affected as a result of general economic and market conditions, including the current economic environment.*
- *We are subject to certain risks due to our international distribution channels and vendors.*
- *Sales of moissanite jewelry could be dependent upon the pricing of precious metals, which is beyond our control.*
- *Seasonality of our business may adversely affect our net sales and operating income.*
- *We may not be able to adequately protect our intellectual property, which could harm the value of our products and brands and adversely affect our business.*
- *A failure of our information technology infrastructure or a failure to protect confidential information of our customers and our network against security breaches could adversely impact our business and operations.*
- *Governmental regulation and oversight might adversely impact our operations.*
- *Some anti-takeover provisions of our charter documents and agreements may delay or prevent a takeover of our company.*
- ***If we fail to evaluate, implement, and integrate strategic acquisition or disposition opportunities successfully, our business may suffer.***
- ***Although we have entered into a non-binding letter of intent to lease a new location to house our headquarters, our business may suffer if we fail to execute a definitive lease agreement on favorable terms or at all or if moving our headquarters significantly distracts management from operating our business.***

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

The following discussion is designed to provide a better understanding of our unaudited consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance, and a summary of our operating results. This information should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q and the consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2012. Historical results and percentage relationships among any amounts in the consolidated financial statements are not necessarily indicative of trends in operating results for future periods.

Overview

We manufacture, market, and distribute *Charles & Colvard Created Moissanite®* jewels (which we refer to as moissanite or moissanite jewels), finished jewelry featuring moissanite, and fashion jewelry for sale in the worldwide jewelry market. Moissanite, also known by its chemical name of silicon carbide, or SiC, is a rare mineral first discovered in a meteor crater. Because naturally occurring SiC crystals are too small for commercial use, larger crystals must be grown in a laboratory. Leveraging our advantage of being the sole source worldwide of created moissanite jewels, our strategy is to establish Charles & Colvard, Ltd. with reputable, high-quality, and sophisticated brands and to position moissanite as an affordable, luxurious alternative to other gemstones, such as diamond. We believe this is possible due to moissanite's exceptional brilliance, fire, luster, durability, and rarity like no other jewel available on the market.

We manage our business primarily by our two distribution channels that we use to sell our product lines, loose jewels and finished jewelry. Accordingly, we determined our two operating and reporting segments to be wholesale distribution transacted through our parent entity and direct-to-consumer distribution transacted through our wholly owned operating subsidiaries, Moissanite.com, LLC and Charles & Colvard Direct, LLC. We sell our loose moissanite jewels at wholesale to some of the largest distributors and manufacturers in the world, which mount them into fine jewelry to be sold at retail outlets and via the Internet. We also sell loose moissanite jewels and finished jewelry featuring moissanite at wholesale to retailers to be sold to end consumers and, in the third quarter of 2011, we established a direct-to-consumer e-commerce sales channel through our wholly owned operating subsidiary Moissanite.com, LLC that sells both loose moissanite jewels and finished jewelry featuring moissanite. Additionally, in April 2012 we launched a pilot test of a direct-to-consumer home party sales channel through our wholly owned operating subsidiary Charles & Colvard Direct, LLC, or Charles & Colvard Direct, that sells fashion and moissanite finished jewelry. We believe the expansion of our sales channels to the jewelry trade and the end consumer with branded finished moissanite jewelry creates a more compelling consumer value proposition to drive increased demand.

We are continuing to focus on our core business of manufacturing and distributing the loose moissanite jewel and finished jewelry featuring moissanite through wholesale sales channels, because this is currently the primary way we reach consumers. We believe there is opportunity to grow our wholesale business and to capture a larger share of the jewelry market as we execute our strategy to increase consumer awareness of moissanite.

The wholesale finished jewelry business that we launched in 2010 is currently expanding through select retailers and television shopping networks. We believe there is significant opportunity to further expand our wholesale finished jewelry business through e-commerce, television shopping, and other retailers. We also believe our finished jewelry business, including finished jewelry sold through our direct-to-consumer e-commerce and home party sales channels, allows us to have more control over the end product and enhance our relationships with consumers, as well as provide incremental sales and gross profit dollars due to the higher price points of finished jewelry containing moissanite relative to loose jewels. To that end, we are focusing on the following critical aspects of our strategic plan during 2013:

- *Developing brand strategies* - Our goal is to build multiple strong brands around the moissanite jewel and finished jewelry collections in attractive and desirable jewelry designs, especially those featuring larger center stones that leverage moissanite's point of differentiation and value proposition. We believe branding will allow us to increase consumer awareness, which we expect to help drive sales and develop consumer brand recognition and loyalty.

In June 2012, we launched a moissanite jewel with optical properties that are significantly whiter than our standard VG "classic moissanite" grade jewels. We are marketing these whiter jewels under the *Forever Brilliant*® trademark as a premier brand to differentiate from other grades of our moissanite as well as moissanite sold by potential competitors in the future.

We expect demand for our *Forever Brilliant*® loose jewel and finished jewelry featuring the *Forever Brilliant*® jewel to grow, both in our wholesale channel and on our *Moissanite.com* e-commerce website, and that *Forever Brilliant*® will become an increasingly important brand for Charles & Colvard, Ltd. as we execute future branding initiatives. We are also exploring additional product lines and branding strategies involving technologies for treating moissanite to produce such colors as pink, blue, and yellow, among others.

In October 2012, Charles & Colvard Direct entered into an exclusive services and licensing agreement with JudeFrances, a well-known designer jewelry brand. Under the agreement, JudeFrances custom designs and sources finished fashion and moissanite jewelry and provides branding direction for *Lulu Avenue*™, the home party direct sales brand of Charles & Colvard Direct. We believe this agreement serves as the point of differentiation that positions *Lulu Avenue*™ ahead of other jewelry home party direct sales companies and will excite both consumers and women searching for unique business ownership opportunities. We continue to seek additional opportunities to partner with recognized finished jewelry designers for our wholesale and other retail sales channels to create exclusive, branded pieces.

In June 2013, we engaged Cindy Riccio Communications, Inc., or CRC, a New York-based public relations, marketing, and events agency, as our agency of record to generate optimal exposure with consumer media for both our *Lulu Avenue*™ and *Forever Brilliant*® brands, with the goal to increase consumer awareness of our brands specifically and moissanite generally. Several media events occurred during the third quarter and are planned in the last quarter of 2013 where magazine editors, fashion columnists, and bloggers are invited to experience first-hand our *Lulu Avenue*™ fashion and moissanite finished jewelry and our *Forever Brilliant*® loose jewels. We are also exploring through CRC exposure opportunities for our brands in leading fashion periodicals and blogging sites.

We believe our efforts to position *Forever Brilliant*® as the whitest and brightest moissanite jewel available anywhere in the world, the introduction of designer finished jewelry brands, and the engagement of a branding public relations agency will help us to build brand recognition and increase consumer awareness of our products. We also expect that this strategy of building brand recognition will help to support revenue streams as our intellectual property rights expire in the future.

- *Expanding our direct-to-consumer e-commerce business* - Our direct-to-consumer e-commerce website, *Moissanite.com*, features an intuitive site design with robust functionality to enhance the customer experience and convert more traffic into sales. We continue to expand the website's jewelry collections and its loose moissanite jewel assortment by featuring a variety of colors and shapes, and we are investing resources in targeted advertising and marketing campaigns. In 2013, we plan to continue fine-tuning such marketing efforts to maximize return on investment, increasing product assortment, and building new site functionality designed to increase sales conversion rates. We believe our direct-to-consumer e-commerce sales channel will not only add to our top-line revenues in a significant manner, but will also play a key role in our campaign to increase overall consumer awareness of moissanite. We also envision e-commerce as a part of a broader effort to establish online connections with consumers that build our brands and our business with retail partners.

- *Developing our direct-to-consumer home party business* - In October 2012, our direct-to-consumer home party business, *Lulu Avenue*™, began the integration of JudeFrances designs into the current jewelry line. The first phase of the integration was completed in March 2013. In addition, in April 2013, we hired a President of *Lulu Avenue*™ whose focus is on the scale-up of the sales force, and in March 2013, we hired a Director of Finance and Administration, who leads the back office technology and supply chain efforts of *Lulu Avenue*™. With these new key personnel and the marketing personnel added in the fourth quarter of 2012, we completed the final phase of the integration process in the third quarter of 2013. We believe our direct-to-consumer home party sales channel will provide future sales growth and play a role in our campaign to increase overall consumer awareness of moissanite.

As we execute our strategy to build and reinvest in our businesses, significant expenses and investment of cash will be required ahead of the revenue streams we expect in the future, and this may result in some unprofitable quarters as we experienced in the third quarter of 2013. Despite this, we have maintained as one of our primary goals to generate positive cash flow each quarter to protect our cash position. We were not successful in achieving this goal during the nine months ended September 30, 2013 primarily as a result of our significant inventory build of *Forever Brilliant*® loose jewels to meet demand, establish an in-stock position for future orders and collect on our trade receivables generated from these sales. We will continue to diligently focus on cost containment and monitor our cash burn rate as we grow the business.

Our total consolidated net sales for the nine months ended September 30, 2013 of $19.88 million were 39% greater than total consolidated net sales during the same period of 2012. Wholesale distribution segment net sales for the nine months ended September 30, 2013 of $18.27 million were 36% greater than wholesale distribution segment net sales during the same period of 2012. Direct-to-consumer distribution segment net sales for the nine months ended September 30, 2013 of $1.61 million were 86% greater than direct-to-consumer distribution segment net sales during the same period of 2012.

Loose jewel sales comprised 67% of our total consolidated net sales and increased 28% to $13.25 million, for the nine months ended September 30, 2013 compared with $10.31 million in the same period of 2012. Finished jewelry sales comprised 33% of our total consolidated net sales and increased 66% to $6.63 million, compared with $4.0 million in the same period of 2012. We expect these increases in sales by product mix to continue as we execute our strategy of developing new wholesale and direct-to-consumer sales channels and expanding our finished jewelry business.

Operating expenses increased by $2.65 million, or 31%, to $11.26 million for the nine months ended September 30, 2013, compared with $8.62 million in the same period of 2012. Of this increase, sales and marketing expenses increased $2.46 million, or 52%, to $7.23 million, primarily as a result of personnel additions and advertising and marketing initiatives incurred to position our company for future growth, especially with respect to the two wholly owned operating subsidiaries formed in 2011 for our e-commerce and home party direct-to-consumer sales businesses; and a reallocation beginning in 2013 of certain information technology shared resources based on headcount. As we grow our business, we intend to continue to closely manage our operating expenses by seeking the most cost effective and efficient solutions to our operating requirements. We recorded a net loss of $1.40 million, or $0.07 per share, for the nine months ended September 30, 2013, primarily due to an increase in operating expenses and a lower gross profit margin, offset in part by our higher sales and an income tax net benefit recognized during the period. Our lower overall gross profit margin resulted from a slightly lower product margin on loose jewels due to sales mix and discounts; lower product margins on finished jewelry driven primarily by higher production costs and increased overhead allocations to cover the expansion of operations to support a larger sales volume.

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

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which we prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses and related disclosures of contingent assets and liabilities. “Critical accounting policies and estimates” are defined as those most important to the financial statement presentation and that require the most difficult, subjective, or complex judgments. We base our estimates on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Under different assumptions and/or conditions, actual results of operations may materially differ. We have disclosed our critical accounting policies and estimates in our Annual Report on Form 10-K for the year ended December 31, 2012, and that disclosure should be read in conjunction with this Quarterly Report on Form 10-Q.

Results of Operations

The following table sets forth certain consolidated statements of operations data for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net sales	$ 6,858,252	$ 5,076,364	$ 19,875,826	$ 14,312,976
Costs and expenses:				
Cost of goods sold	3,805,227	2,092,734	10,076,520	5,763,179
Sales and marketing	2,449,679	1,678,779	7,228,883	4,764,595
General and administrative	1,723,676	1,192,278	3,917,461	3,834,744
Research and development	6,755	1,490	21,779	18,279
Loss on abandonment of assets	-	-	95,052	-
Total costs and expenses	7,985,337	4,965,281	21,339,695	14,380,797
(Loss) income from operations	(1,127,085)	111,083	(1,463,869)	(67,821)
Other income (expense):				
Interest income	5,135	16,002	19,609	57,690
Interest expense	(202)	(335)	(1,176)	(939)
Total other income, net	4,933	15,667	18,433	56,751
(Loss) income before income taxes	(1,122,152)	126,750	(1,445,436)	(11,070)
Income tax net (expense) benefit	(88,550)	(3,125)	49,422	307,421
Net (loss) income	$ (1,210,702)	$ 123,625	$ (1,396,014)	$ 296,351

Consolidated Net Sales

Consolidated net sales for the three and nine months ended September 30, 2013 and 2012 comprise the following:

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	2012	Dollars	Percent	2013	2012	Dollars	Percent
Loose jewels	$ 4,821,319	$ 3,773,741	$ 1,047,578	28%	$13,244,642	$10,312,979	$ 2,931,663	28%
Finished jewelry	2,036,933	1,302,623	734,310	56%	6,631,184	3,999,997	2,631,187	66%
Total consolidated net sales	$ 6,858,252	$ 5,076,364	$ 1,781,888	35%	$19,875,826	$14,312,976	$ 5,562,850	39%

Consolidated net sales were $6.86 million for the three months ended September 30, 2013 compared to $5.08 million for the three months ended September 30, 2012, an increase of $1.78 million, or 35%. Consolidated net sales were $19.88 million for the nine months ended September 30, 2013 compared to $14.31 million for the nine months ended September 30, 2012, an increase of $5.56 million, or 39%.The improvement in consolidated net sales for the three and nine months ended September 30, 2013 was due primarily to an increase in loose jewel sales to our existing wholesale customer base resulting from our new whiter *Forever Brilliant*® moissanite jewel and the growth of our wholesale customers' moissanite finished jewelry lines with styles that include both *Forever Brilliant*® and our loose jewel standard grades. The improvement in consolidated net sales was also attributable to the growth of our direct-to-consumer businesses, *Moissanite.com* and *Lulu Avenue*™, which collectively increased 33% to $504,000 and 86% to $1.61 million during the three and nine months ended September 30, 2013, respectively. We anticipate orders and related sales of loose moissanite jewels and finished jewelry featuring moissanite in both our wholesale distribution segment and direct-to-consumer distribution segment will continue to improve as we execute our growth strategies.

Sales of loose jewels represented 70% and 67% of total consolidated net sales for the three and nine months ended September 30, 2013, respectively, compared to 74% and 72% of total consolidated net sales for the corresponding periods of the prior year. For the three months ended September 30, 2013, loose jewel sales were $4.82 million compared to $3.77 million for the corresponding period of the prior year, an increase of $1.05 million, or 28%. For the nine months ended September 30, 2013, loose jewel sales were $13.25 million compared to $10.31 million for the corresponding period of the prior year, an increase of $2.93 million, or 28%. The increase for the three and nine months ended September 30, 2013 was primarily due to robust sales we are experiencing from our existing wholesale customer base, particularly through continued expansion in the China market, and of our new whiter *Forever Brilliant*® moissanite jewel.

Sales of finished jewelry represented 30% and 33% of total consolidated net sales for the three and nine months ended September 30, 2013, respectively, compared to 26% and 28% of total consolidated net sales for the corresponding periods of the prior year. For the three months ended September 30, 2013, finished jewelry sales were $2.04 million compared to $1.30 million for the corresponding period of the prior year, an increase of $734,000, or 56%. For the nine months ended September 30, 2013, finished jewelry sales were $6.63 million compared to $4.0 million for the corresponding period of the prior year, an increase of $2.63 million, or 66%. These increases were primarily attributable in our wholesale distribution segment to our ongoing expansion into the finished jewelry business and the growth of our wholesale customers' moissanite finished jewelry businesses, and in our direct-to-consumer distribution segment to the growth of our e-commerce and home party businesses.

United States, or U.S., net sales accounted for approximately 56% and 72% of total consolidated net sales for the three and nine months ended September 30, 2013, respectively, compared to 80% and 80% of total consolidated net sales for the corresponding periods of the prior year. U.S. net sales decreased 5% and increased 25% during the three and nine months ended September 30, 2013, respectively, from the corresponding periods of the prior year. The decrease in U.S. net sales during the three months ended September 30, 2013 was primarily as a result of timing differences in restocking orders with our existing wholesale distributors. The increase in U.S. net sales for the nine months ended September 30, 2013 is primarily due to increased sales to our wholesale customer base resulting from the launch of our new whiter *Forever Brilliant*® moissanite jewel and the growth of our wholesale customers' moissanite finished jewelry lines. The increase in U.S. net sales was also attributable to the growth of our direct-to-consumer businesses, *Moissanite.com* and *Lulu Avenue*™.

Our largest U.S. customer during the three months ended September 30, 2013 accounted for 17% of total consolidated sales compared to 16% during the same period of 2012. Our largest U.S. customer during the nine months ended September 30, 2013 accounted for 16% of total consolidated sales compared to 25% during the same period of 2012. One U.S. customer accounted for 11% of total consolidated sales during the nine months ended September 30, 2012 but did not account for a significant percentage of total consolidated sales during the same period of 2013. We expect that we will remain dependent on our ability, and that of our largest customers, to maintain and enhance retail programs. A change in or loss of any of these customer or retailer relationships could have a material adverse effect on our results of operations.

International net sales accounted for approximately 44% and 28% of total consolidated net sales for the three and nine months ended September 30, 2013, respectively, compared to 20% and 20% of total consolidated net sales for the corresponding periods of the prior year. International sales increased 195% and 95% during the three and nine months ended September 30, 2013, respectively, from the corresponding periods of the prior year primarily as a result of an increase in loose jewel sales to our wholesale customer base, particularly in the China market, resulting from the growth of our wholesale customers' moissanite businesses. Our two largest international customers accounted for 19% and 17%, respectively, of total consolidated sales during the three months ended September 30, 2013 but did not account for a significant percentage of total consolidated sales during the same period of 2012. No international customer accounted for a significant percentage of total consolidated sales for the nine months ended September 30, 2013 or in the corresponding period of the prior year. A portion of our international consolidated sales represents jewels sold internationally that may be re-imported to U.S. retailers. Our top three international distributors by sales volume during the three months ended September 30, 2013 were located in Hong Kong, China, and the United Kingdom. Our top three international distributors by sales volume during the nine months ended September 30, 2013 were located in Hong Kong, China, and India.

Table of Contents

Costs and Expenses

Cost of Goods Sold

Cost of goods sold for the three and nine months ended September 30, 2013 and 2012 are as follows:

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	2012	Dollars	Percent	2013	2012	Dollars	Percent
Product line cost of goods sold								
Loose jewels	$ 2,231,030	$ 1,337,451	$ 893,579	67%	$ 5,299,983	$ 3,265,738	$ 2,034,245	62%
Finished jewelry	1,009,277	548,290	460,987	84%	3,413,823	1,422,392	1,991,431	140%
Total product line cost of goods sold	3,240,307	1,885,741	1,354,566	72%	8,713,806	4,688,130	4,025,676	86%
Non-product line cost of goods sold	564,920	206,993	357,927	173%	1,362,714	1,075,049	287,665	27%
Total cost of goods sold	$ 3,805,227	$ 2,092,734	$ 1,712,493	82%	$10,076,520	$ 5,763,179	$ 4,313,341	75%

Total cost of goods sold was $3.81 million for the three months ended September 30, 2013 compared to $2.09 million for the three months ended September 30, 2012, an increase of $1.71 million, or 82%. Total cost of goods sold was $10.08 million for the nine months ended September 30, 2013 compared to $5.76 million for the nine months ended September 30, 2012, an increase of $4.31 million, or 75%. Product line cost of goods sold is defined as product cost of goods sold in each of our wholesale distribution and direct-to-consumer distribution operating segments excluding non-capitalized expenses from our manufacturing and production control departments, comprising personnel costs, depreciation, rent, utilities, and corporate overhead allocations; freight out; inventory valuation allowance adjustments; and other inventory adjustments, comprising costs of quality issues, damaged goods, and inventory write-offs.

The increase in cost of goods sold for the three months ended September 30, 2013 compared to the same period in 2012 was primarily due to a $894,000 increase in loose jewel product line cost of goods sold resulting from the 28% increase in loose jewel sales, and a greater percentage of higher-cost *Forever Brilliant*® loose jewel sales during the quarter; a $461,000 increase in finished jewelry product line cost of goods sold resulting from the 56% increase in finished jewelry sales, lower product margins driven primarily by higher production costs and increased overhead allocations to cover the expansion of operations to support a larger sales volume, and a net increase in non-product line cost of goods sold of $358,000. The net increase in non-product line cost of goods sold comprises a $143,000 increase in inventory valuation allowances, including inventory shrinkage, recuts, repairs, and scrap reserves; a $120,000 increase in other inventory adjustments; an $80,000 increase in non-capitalized manufacturing and production control expenses; and a $15,000 increase in freight out. See Note 3, “Segment Information and Geographic Data,” in the Notes to Condensed Consolidated Financial Statements for further discussion of non-product line cost of goods sold.

The increase in cost of goods sold for the nine months ended September 30, 2013 compared to the same period in 2012 was primarily due to a $2.03 million increase in loose jewel product line cost of goods sold resulting from the 28% increase in loose jewel sales and a greater percentage of higher-cost *Forever Brilliant*® loose jewel sales during the current year; and a $1.99 million increase in finished jewelry product line cost of goods sold resulting from the 66% increase in finished jewelry sales, lower product margins driven primarily by higher production costs and increased overhead allocations to cover the expansion of operations to support a larger sales volume, and a net increase in non-product line cost of goods sold of $288,000. The net increase in non-product line cost of goods sold comprises a $192,000 increase in inventory valuation allowances, including inventory shrinkage, recuts, repairs, and scrap reserves; $84,000 in other inventory adjustments; a $61,000 increase in freight out; offset by a $49,000 decrease in non-capitalized manufacturing and production control expenses

Information technology-related costs were historically included in general and administrative expenses. Beginning in 2013, our management determined that certain information technology shared resources should be allocated based on headcount to more accurately assign operating costs between our wholesale and direct-to-consumer operating segments. The net result of this allocation for the three and nine months ended September 30, 2013 compared to the same periods in the prior year were a $339,000 and a $855,000 aggregate decrease, respectively, in general administrative expenses; a $198,000 and a $513,000 aggregate increase, respectively, in sales and marketing expenses; and a $141,000 and a $342,000 aggregate increase, respectively, in cost of goods sold. For the three and nine months ended September 30, 2013, the allocation to cost of goods sold, which is included as non-product line cost of goods sold, comprised $79,000 and $193,000, respectively, of compensation costs; $26,000 and $71,000, respectively, of depreciation and amortization expense; $26,000 and $50,000, respectively, of professional services; $9,000 and $25,000, respectively, of office-related expenses; and $1,000 and $3,000, respectively, of travel-related expenses.

Sales and Marketing

Sales and marketing expenses for the three and nine months ended September 30, 2013 and 2012 are as follows:

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	**2012**	**Dollars**	**Percent**	**2013**	**2012**	**Dollars**	**Percent**
Sales and marketing	$ 2,449,679	$ 1,678,779	$ 770,900	46%	$ 7,228,883	$ 4,764,595	$ 2,464,288	52%

Sales and marketing expenses were $2.45 million for the three months ended September 30, 2013 compared to $1.68 million for the three months ended September 30, 2012, an increase of $771,000, or 46%. Sales and marketing expenses were $7.23 million for the nine months ended September 30, 2013 compared to $4.77 million for the nine months ended September 30, 2012, an increase of $2.46 million, or 52%.

The increase in sales and marketing expenses for the three months ended September 30, 2013 compared to the same period in 2012 was primarily due to a $245,000 net increase in compensation costs; a $201,000 net increase in advertising expenses; a $138,000 net increase in professional services related to the addition of temporary personnel, consulting services, public relations services, and the maintenance of software platforms for our direct-to-consumer e-commerce and home party lines of business; an $80,000 increase in office-related expenses to support a larger sales and marketing organization; a $57,000 increase in travel-related expenses resulting from new sales and marketing personnel and expanding business opportunities; and a $50,000 increase in depreciation expense related to the *Moissanite.com* and *Lulu Avenue*™ e-commerce websites. Compensation costs increased primarily as a result of an increase in salaries and related employee benefits in the aggregate of $208,000, an increase in stock-based compensation expense of $69,000, and an increase in employee relocation costs of $1,000. These increases in compensation costs were offset in part by a decrease in commissions of $33,000 due to the timing of orders by specific customers under which commission plans of sales representatives are based. The increase in advertising expenses comprises a net increase in cooperative advertising expenses of $151,000; an increase in agency expenses of $86,000 primarily in support of our *Moissanite.com* and *Lulu Avenue*™ direct-to-consumer businesses; an increase in print advertising of $5,000; and an increase in production advertising of $4,000. The increase in cooperative advertising expenses resulted primarily from the increase in sales of loose jewels compared to the same period in the prior year and management’s estimate of future utilization based on our historical experience with each customer and the related contractual arrangements to provide certain levels of cooperative advertising for our customers. These increases in advertising expenses were offset in part by a reduction of targeted marketing and trade shows of $45,000 and a decrease in Internet marketing of $29,000 due primarily to greater efficiencies gained in paid search advertising in support of our *Moissanite.com* and *Lulu Avenue*™ e-commerce websites.

The increase in sales and marketing expenses for the nine months ended September 30, 2013 compared to the same period in 2012 was primarily due to a $775,000 net increase in compensation costs; a $557,000 net increase in professional services related to the addition of temporary personnel, consulting services, public relations services, and the maintenance of software platforms for our direct-to-consumer e-commerce and home party lines of business; a $464,000 net increase in advertising expenses; a $373,000 increase in office-related expenses to support a larger sales and marketing organization; a $179,000 increase in depreciation expense related to the *Moissanite.com* and *Lulu Avenue*™ e-commerce websites; and a $116,000 increase in travel-related expenses resulting from new sales and marketing personnel and expanding business opportunities. Compensation costs increased primarily as a result of an increase in salaries and related employee benefits in the aggregate of $505,000, an increase in stock-based compensation expense of $189,000, and an increase in bonus expense of $157,000. These increases in compensation costs were offset in part by a decrease in commissions of $38,000 due to the timing of orders by specific customers under which commission plans of sales representatives are based; a decrease in severance pay of $21,000; and a decrease in employee relocation costs of $17,000. The increase in advertising expenses comprises a net increase in cooperative advertising expenses of $212,000; an increase in agency expenses of $126,000 primarily in support of our *Moissanite.com* and *Lulu Avenue*™ direct-to-consumer businesses; an increase in Internet marketing of $121,000 due primarily to greater paid search advertising during the first quarter of 2013 in support of our *Moissanite.com* and *Lulu Avenue*™ e-commerce websites; and an increase in production advertising of $14,000. The increase in cooperative advertising expenses resulted primarily from the increase in sales of loose jewels compared to the same period in the prior year and management’s estimate of future utilization based on our historical experience with each customer and the related contractual arrangements to provide certain levels of cooperative advertising for our customers. These increases in advertising expenses were offset in part by a decrease in targeted marketing and trade shows of $9,000.

As previously discussed, beginning in 2013, certain information technology-related costs historically included in general and administrative expenses are now allocated to sales and marketing expenses and cost of goods sold. For the three and nine months ended September 30, 2013 compared to the same period in the prior year, $198,000 and $513,000 in aggregate, respectively, of information technology-related costs were allocated to sales and marketing expenses, comprising $110,000 and $288,000, respectively, of compensation costs; $36,000 and $107,000, respectively, of depreciation and amortization expense; $38,000 and $76,000, respectively, of professional services; $13,000 and $37,000, respectively, of office-related expenses; and $1,000 and $5,000, respectively, of travel-related expenses.

We expect our total sales and marketing expenses will continue to increase as sales increase, but the rate of growth should slow and become a lower percentage of sales as expenses more variable in nature, such as advertising and commissions, increase as part of our strategy to build sales; but fixed expenses, such as compensation costs, grow at a slower rate.

General and Administrative

General and administrative expenses for the three and nine months ended September 30, 2013 and 2012 are as follows:

	Three Months Ended September 30,		**Change**		**Nine Months Ended September 30,**		**Change**	
	2013	**2012**	**Dollars**	**Percent**	**2013**	**2012**	**Dollars**	**Percent**
General and administrative	$ 1,723,676	$ 1,192,278	$ 531,398	45%	$ 3,917,461	$ 3,834,744	$ 82,717	2%

General and administrative expenses were $1.72 million for the three months ended September 30, 2013 compared to $1.19 million for the three months ended September 30, 2012, an increase of $531,000, or 45%. General and administrative expenses were $3.92 million for the nine months ended September 30, 2013 compared to $3.84 million for the nine months ended September 30, 2012, an increase of $83,000, or 2%.

The increase in general and administrative expenses for the three months ended September 30, 2013 compared to the same period in 2012 was primarily due to a $436,000 net increase in compensation costs; a $101,000 increase in consulting and professional services primarily relating to investor and public relations; a $100,000 increase in legal professional services; and a $21,000 increase in travel-related expenses associated with investor, customer, and supplier meetings. These increases were offset in part by a $50,000 decrease in bad debt expense associated with our allowance for doubtful accounts reserve policy; a $35,000 decrease in depreciation and amortization expense; a $20,000 decrease in office-related expenses; a $10,000 decrease in Board-related expenses as a result of fewer meetings than in the previous year; a $10,000 decrease in tax professional services due to the timing of work performed; and a $2,000 decrease in personal property and franchise taxes. Compensation costs increased primarily as a result of a $230,000 increase for severance associated with the departure of an executive officer; an increase in stock-based compensation expense of $149,000 primarily associated with the addition of a new executive officer; and an increase in salaries and related employee benefits in the aggregate of $64,000, offset in part by a decrease in employee relocation costs of $7,000.

The increase in general and administrative expenses for the nine months ended September 30, 2013 compared to the same period in 2012 was primarily due to a $551,000 net increase in compensation costs; a $125,000 increase in consulting and professional services primarily relating to investor and public relations; a $70,000 increase in legal professional services; an $18,000 increase in travel-related expenses associated with investor, customer, and supplier meetings; and a $5,000 increase in commercial insurance expenses. These increases were offset in part by a $356,000 decrease in bad debt expense associated with our allowance for doubtful accounts reserve policy; a $99,000 decrease in consulting and other professional services primarily relating to the support of our enterprise resource planning system that was placed in service during the first quarter of 2012; a $96,000 decrease in depreciation and amortization expense; a $66,000 decrease in office-related expenses; a $26,000 decrease in software maintenance agreements; a $21,000 decrease in audit and tax professional services due to the timing of work performed; a $9,000 decrease in Board-related expenses as a result of fewer meetings than in the previous year; and a $13,000 decrease in personal property and franchise taxes. Compensation costs increased primarily as a result of an increase in severance expense of $230,000 associated with the departure of an executive officer; an increase in stock-based compensation expense of $215,000 primarily due to the addition of two new executive officers; an increase in bonus expense of $81,000; and an increase in salaries and related employee benefits in the aggregate of $41,000, offset in part by a decrease in employee relocation costs of $16,000.

As previously discussed, beginning in 2013, certain information technology-related costs historically included in general and administrative expenses are now allocated to sales and marketing expenses and cost of goods sold. For the three and nine months ended September 30, 2013 compared to the same period in the prior year, $338,000 and $855,000 in aggregate, respectively, of information technology-related costs were allocated from general and administrative expenses, comprising $189,000 and $481,000, respectively, of compensation costs; $62,000 and $177,000, respectively, of depreciation and amortization expense; $64,000 and $126,000, respectively, of professional services; $22,000 and $66,000, respectively, of office-related expenses; and $2,000 and $8,000, respectively, of travel-related expenses.

Research and Development

Research and development expenses for the three and nine months ended September 30, 2013 and 2012 are as follows:

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	**2012**	**Dollars**	**Percent**	**2013**	**2012**	**Dollars**	**Percent**
Research and development	$ 6,755	$ 1,490	$ 5,265	353%	$ 21,779	$ 18,279	$ 3,500	19%

Research and development expenses were $7,000 for the three months ended September 30, 2013 compared to $2,000 for the three months ended September 30, 2012, an increase of $5,000, or 353%. Research and development expenses were $22,000 for the nine months ended September 30, 2013 compared to $18,000 for the nine months ended September 30, 2012, an increase of $4,000, or 19%.

The increase in research and development expenses for the three months ended September 30, 2013 compared to the same period in 2012 was primarily due to a $4,000 increase in compensation costs for time allocated by operations personnel to research and development activities and a $2,000 increase in consulting professional services, offset in part by a $1,000 decrease in office-related expenses.

The increase in research and development expenses for the nine months ended September 30, 2013 compared to the same period in 2012 was primarily due to a $10,000 increase in compensation costs for time allocated by operations personnel to research and development activities, offset in part by a $4,000 decrease in consulting professional services and a $2,000 decrease in office-related expenses.

Loss on Abandonment of Assets

Loss on abandonment of assets for the three and nine months ended September 30, 2013 and 2012 are as follows:

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	**2012**	**Dollars**	**Percent**	**2013**	**2012**	**Dollars**	**Percent**
Loss on abandonment of assets	$ -	$ -	$ -	-	$ 95,052	$ -	$ 95,052	100%

During the second quarter of 2013, we transitioned our *Lulu Avenue*™ direct sales front-end and back-office system to a new platform and abandoned the prior capitalized software modifications of approximately $95,000 associated with the previous platform, resulting in a loss on abandonment of assets for the nine months ended September 30, 2013.

Interest Income

Interest income for the three and nine months ended September 30, 2013 and 2012 is as follows:

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	2012	Dollars	Percent	2013	2012	Dollars	Percent
Interest income	$ 5,135	$ 16,002	$ (10,867)	-68%	$ 19,609	$ 57,690	$ (38,081)	-66%

Interest income was $5,000 for the three months ended September 30, 2013 compared to $16,000 for the three months ended September 30, 2012, a decrease of $11,000, or 68%. Interest income was $20,000 for the nine months ended September 30, 2013 compared to $58,000 for the nine months ended September 30, 2012, a decrease of $38,000, or 66%.

The decrease in interest income for the three and nine months ended September 30, 2013 compared to the same periods in 2012 resulted primarily from lower cash and investment balances of $6.7 million held at September 30, 2013 as compared to the balances of $11.94 million held at September 30, 2012. Additionally, this cash was invested in lower yielding money market accounts during the three and nine months ended September 30, 2013 due to the $3.25 million in U.S. government agency securities called during the year ended December 31, 2012.

Provision for Income Taxes

We recognized an income tax expense of approximately $89,000 and an income tax net benefit of approximately $49,000 for the three and nine months ended September 30, 2013, respectively, compared to an income tax expense of approximately $3,000 and an income tax net benefit of approximately $307,000 for the three and nine months ended September 30, 2012, respectively.

During 2008, we recorded a full valuation allowance against certain deferred tax assets consisting primarily of net operating loss carryforwards. Due to continued uncertainty over sufficient future taxable income to fully utilize these deferred tax assets, we did not record an income tax expense for the pretax income earned during the three months ended September 30, 2012 or an income tax benefit for the pretax loss incurred during the nine months ended September 30, 2012.

As of each reporting date, management considers new evidence, both positive and negative, that could impact its view with regard to future realization of deferred tax assets. For the year ended December 31, 2012, cumulative positive taxable income over the last three tax years had been generated, offsetting the negative evidence of cumulative losses in previous years. We also determined that our expectations of future taxable income in upcoming tax years would be sufficient to result in full utilization of these net operating loss carryforwards and deferred tax assets prior to any statutory expiration. As a result, management determined that sufficient positive evidence existed as of December 31, 2012 to conclude that it is more likely than not that the majority of our deferred tax assets are realizable, and we reduced our valuation allowance accordingly. A valuation allowance remains against certain deferred tax assets relating to state net operating loss carryforwards from our e-commerce and home party operating subsidiaries due to the timing uncertainty of when the subsidiaries will generate cumulative positive taxable income to utilize the associated deferred tax assets. A valuation allowance also remains against certain deferred tax assets relating to investment loss carryforwards because our current investments are classified as held-to-maturity, indicating they will be redeemed at par value and will not generate gains sufficient or of the appropriate character to utilize the associated deferred tax assets.

For the three months ended September 30, 2013, we recognized $89,000 of current period income tax expense, offsetting an income tax benefit recorded in the first half of 2013 of approximately $138,000. The resulting income tax net benefit of $49,000 for the nine months ended September 30, 2013 represents an effective tax rate of 1.6% on the year-to-date pre-tax book loss. The effective tax rate for the nine months ended September 30, 2013 differs from the federal statutory rate of 34.0% primarily due to the impact of state income taxes, stock-based compensation expense that is not deductible for tax purposes, and other book-to-tax reconciling items. This effective tax rate has decreased from December 31, 2012 due to anticipation of lower taxable income in the current fiscal year, despite an additional $7,000 of income tax expense that was accrued and paid in the first quarter of 2013 related to the prior tax year, primarily for adjustment of the federal alternative minimum tax. Additionally, during the three months ended September 30, 2013 we paid $1,000 with a state tax filing for 2012 that was in excess of estimated payments. We recorded approximately $129,000 of income tax expense during the three months ended September 30, 2013 to reflect lower anticipated taxable income for the full year than had been previously estimated, to reduce the tax benefit for the nine months ended September 30, 2013 to $18,000. In addition, we recorded $44,000 and $48,000 of income tax benefit for discrete permanent tax deduction differences during the three and nine months ended September 30, 2013 and approximately $3,000 and $9,000 of income tax expense for estimated tax, penalties, and interest associated with uncertain tax positions during the three and nine months ended September 30, 2013, respectively.

During the three months ended September 30, 2012, we recognized approximately $4,000 of income tax expense for estimated tax, penalties, and interest associated with uncertain tax positions. During the nine months ended September 30, 2012, we entered into a voluntary disclosure agreement with a taxing authority for which we had previously recorded a liability for an uncertain tax position. As a result of the agreement, we reduced our total recorded liabilities relating to uncertain tax positions by approximately $320,000 and recognized a corresponding income tax benefit. This benefit was offset by approximately $9,000 of income tax expense for estimated tax, penalties, and interest for other uncertain tax positions.

Liquidity and Capital Resources

We require cash to fund our operating expenses and working capital requirements, including outlays for capital expenditures. As of September 30, 2013, our principal sources of liquidity were cash and cash equivalents totaling $6.2 million, trade accounts receivable of $9.04 million, and short-term inventory of $11.5 million, as compared to cash and cash equivalents totaling $11.86 million, trade accounts receivable of $8.14 million, and short-term inventory of $8.44 million as of December 31, 2012. We had $501,000 of highly liquid U.S. government agency securities at September 30, 2013 that we classified as held-to-maturity current assets on our consolidated balance sheets due to our positive intention and ability to hold these securities until their maturity dates in 2013. As described more fully below, we also have access to a $10 million revolving line of credit.

During the nine months ended September 30, 2013, our working capital decreased by approximately $4.72 million to $23.29 million from $28.01 million at December 31, 2012. As described more fully below, the decrease in working capital at September 30, 2013 is primarily attributable to a decrease in cash and cash equivalents, a decrease in held-to-maturity investments, an increase in trade accounts payable, a net increase in accrued expenses and other liabilities, and a decrease in interest receivable, offset in part by an increase in trade accounts receivable, a greater allocation of inventory to short-term, and an increase in prepaid expenses and other assets.

During the nine months ended September 30, 2013, $5.12 million of cash was used in operations. The primary drivers of negative cash flow were a net increase in inventory of $7.82 million, an increase in accounts receivable of $816,000, and an increase in prepaid expenses and other assets of $283,000. These factors more than offset our net loss of $1.4 million that included $1.92 million of net non-cash expenses, an increase in trade accounts payable of $2.97 million, and a net increase in accrued liabilities of $307,000. Inventories increased primarily as a result of new raw material SiC crystals purchased during the nine months ended September 30, 2013 pursuant to our Amended and Restated Exclusive Supply Agreement with Cree, or the Cree Exclusive Supply Agreement; purchases of jewelry castings, findings, and other jewelry components; and production of moissanite gemstones, offset in part by sales during the quarter. Prepaid expenses and other assets increased primarily as a result of deposits made during the quarter in advance of goods or services received. Accounts payable increased primarily as a result of the timing of costs incurred but not yet paid as of September 30, 2013 associated with inventory-related purchases and professional services incurred but not yet due under our vendors' payment terms. Accounts receivable increased primarily as a result of extended wholesale customer payment terms that we offer from time to time that may not immediately increase liquidity as a result of current-period sales, offset in part from collection efforts during the nine months ended September 30, 2013. We believe our competitors and other vendors in the wholesale jewelry industry have also expanded their use of extended payment terms and, in aggregate, we believe that by expanding our use of extended payment terms, we have provided a competitive response in our market and that our net sales have been favorably impacted. We are unable to estimate the impact of this program on our net sales, but if we ceased providing extended payment terms in select instances, we believe we would not be competitive for some wholesale customers in the marketplace and that our net sales and profits would likely decrease. We have not experienced any significant accounts receivable write-offs related to revenue arrangements with extended payment terms.

We manufactured approximately $8.81 million in loose jewels and $5.6 million in finished jewelry, which includes the cost of the loose jewels and the purchase of precious metals and labor in connection with jewelry production, during the nine months ended September 30, 2013. We expect our purchases of precious metals and labor to increase as we increase our finished jewelry business. In addition, from the beginning of 2006 through the third quarter of 2013, the price of gold has increased significantly (approximately 150%), resulting in higher retail price points for gold jewelry. Because the market price of gold and other precious metals is beyond our control, the recent upward price trends could continue and have a negative impact on our operating cash flow and margins as we manufacture finished jewelry.

Historically, our raw material inventories of SiC crystals had been purchased under exclusive supply agreements with a limited number of suppliers. Because the supply agreements restricted the sale of these crystals exclusively to us, the suppliers negotiated minimum purchase commitments with us that, when combined with our reduced sales during the periods when the purchase commitments were in effect, have resulted in levels of inventories that are higher than we might otherwise maintain. As of September 30, 2013, $28.95 million of our inventories were classified as long-term assets. Loose jewel sales and finished jewelry that we manufacture will utilize both the finished good loose jewels currently on hand and, as we deplete certain shapes and sizes, our on-hand raw material SiC crystals of $4.01 million and new raw material that we are purchasing from Cree.

In connection with the Cree Exclusive Supply Agreement, which expires in July 2015, we have committed to purchase from Cree a minimum of 50%, by dollar volume, of our raw material SiC crystal requirements. If our orders require Cree to expand beyond specified production levels, we must commit to purchase certain minimum quantities.

In February 2013, we entered into an amendment to a prior letter agreement with Cree, which provides a framework for our purchases of SiC crystals under the Cree Exclusive Supply Agreement. Pursuant to this amendment, we agreed to purchase at least $4.00 million of SiC crystals in an initial new order. After the initial new order, we have agreed to issue non-cancellable, quarterly orders that must equal or exceed a set minimum order quantity. Our total purchase commitment under the amendment (as subsequently amended) until July 2015, including the initial new order, is dependent upon the grade of the material and ranges between approximately $7.64 million and approximately $18.56 million. During the nine months ended September 30, 2013, we purchased $9.54 million of raw material SiC crystals from Cree. We expect to use existing cash and cash equivalents and other working capital, together with future cash expected to be provided by operating activities and, if necessary, the revolving line of credit,to finance this purchase commitment.

We made approximately $8,000 of income tax payments during the nine months ended September 30, 2013, consisting of an approximate $6,000 federal alternative minimum tax payment; and approximately $2,000 of tax payments to various state taxing authorities, the majority of which was to settle prior year tax liabilities. As of September 30, 2013, we had approximately $881,000 of remaining federal income tax credits, $533,000 of which expire between 2018 and 2021 and the balance without an expiration, which can be carried forward to offset future income taxes. As of September 30, 2013, we also had a federal tax net operating loss carryforward of approximately $5.73 million expiring between 2020 and 2030, which can be used to offset against future federal taxable income, a North Carolina tax net operating loss carryforward of approximately $8.40 million expiring between 2015 and 2025, and various other state tax net operating loss carryforwards expiring between 2016 and 2030, which can be used to offset against future state taxable income.

On August 6, 2013, the Board authorized the extension of the Company's share repurchase program for an additional 12 months. The program, which was originally authorized on November 13, 2009, authorizes the Company to repurchase up to 1,000,000 shares of the Company's common stock until August 12, 2014 in open market or in privately negotiated transactions. The Company expects to use available cash to finance these purchases and will determine the timing and amount of stock repurchases based on the Company's evaluation of market conditions, the market price of the Company's common stock, and management's assessment of the Company's liquidity and cash flow needs. The Company has no obligations to repurchase shares under the program and the program may be suspended or terminated at any time. As of October 28, 2013, 809,213 shares of the Company's common stock remain available for repurchase under the program. We have not repurchased any shares under this program during the three and nine months ended September 30, 2013.

On September 20, 2013, we obtained a $10,000,000 revolving line of credit, or the Line of Credit from PNC Bank, National Association, or PNC Bank, for general corporate and working capital purposes. The Line of Credit is evidenced by a Committed Line of Credit Note, dated September 20, 2013, or the Note, which matures on June 15, 2015. Amounts outstanding under the Note accrue interest at the 1-month LIBOR rate (adjusted daily) plus 1.50%, calculated on an actual / 360 basis and payable monthly in arrears. Amounts outstanding during an event of default accrue interest at a rate 3.00% in excess of the standard rate, and late payments are subject to a 5.00% late charge. The Note may be repaid in whole or in part at any time, without penalty or premium.

The Line of Credit is also governed by a loan agreement, dated September 20, 2013, or the Loan Agreement, and is guaranteed by Charles & Colvard Direct, LLC, and Moissanite.com, LLC, as our wholly-owned subsidiaries. The Line of Credit is secured by a lien on substantially all of our assets, including those of our subsidiaries. Under the Loan Agreement, we are required to comply with the following financial covenants, each tested on a quarterly basis: (1) interest coverage ratio, (2) funded debt to EBITDA ratio, and (3) ratio of current assets to funded debt. The Loan Agreement contains other customary covenants and representations, including a financial reporting covenant and limitations on dividends, debt, contingent obligations, liens, loans, investments, mergers, acquisitions, divestitures, subsidiaries, and change in control.

The events of default under the Line of Credit include, without limitation, (1) a material casualty or material adverse change in the collateral value or business and (2) an event of default under any other indebtedness. If an event of default occurs, PNC Bank is entitled to take various enforcement actions, including acceleration of amounts due under the Note. The Loan Agreement also contains other customary provisions, such as yield protection, expense reimbursement, and confidentiality. PNC Bank has indemnification rights and the right to assign the Line of Credit.

As of October 28, 2013, we have not taken any advances against the Line of Credit.

We believe that our existing cash and cash equivalents and other working capital, together with future cash expected to be provided by operating activities, will be sufficient to meet our working capital and capital expenditure needs over the next 12 months. Our future capital requirements and the adequacy of available funds will depend on many factors, including our rate of sales growth; the expansion of our sales and marketing activities, including the operating capital needs of our wholly owned subsidiaries; the timing and extent of raw materials and labor purchases in connection with loose jewel production to support our moissanite jewel business and precious metals and labor purchases in connection with jewelry production to support our finished jewelry business; the timing of capital expenditures; and risk factors described in more detail in “Risk Factors” in this report and in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012. We obtained the Line of Credit to mitigate these risks to our cash and liquidity position. Also, we may make investments in, or acquisitions of, complementary businesses, which could also require us to seek additional equity or debt financing.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control Over Financial Reporting

We routinely review our internal control over financial reporting and from time to time make changes intended to enhance the effectiveness of our internal control over financial reporting. We will continue to evaluate the effectiveness of our disclosure controls and procedures and internal control over financial reporting on an ongoing basis and will take action as appropriate. During the three months ended September 30, 2013, we made no changes to our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, that we believe materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

We discuss in our Annual Report on Form 10-K for the year ended December 31, 2012 various risks that may materially affect our business. Except as set forth below, there have been no material changes to such risks.

Our future financial performance depends upon increased consumer acceptance, growth of sales of our products, and operational execution of our strategic initiatives. We believe that most consumers are not generally aware of the existence and attributes of moissanite jewels and that the consumer market for moissanite jewels and finished jewelry featuring moissanite remains in the early stages of development. Total moissanite jewelry retail sales have historically been less than 1% of the total jewelry market. The degree of future market acceptance and demand is subject to a significant amount of uncertainty. Our future financial performance will depend, in part, upon greater consumer acceptance of moissanite jewels, including both our classic moissanite jewels and our whiter *Forever Brilliant*® jewels, as an affordable, luxurious alternative to other gemstones, such as diamond; and our ability to develop brands and execute strategic initiatives, in particular, our direct-to-consumer e-commerce and home party businesses, to grow our sales and operating income. As we execute our strategy to build and reinvest in our businesses, significant expenses and investment of cash will be required ahead of the revenue streams we expect in the future, and this may adversely affect our operating income. If we are unable to execute and achieve desired revenue levels, we may adjust our strategic initiatives in response to the results of our investments.

In addition, consumer acceptance may be affected by retail jewelers' and jewelry manufacturers' acceptance of moissanite jewels and finished jewelry featuring moissanite. The quality, design, and workmanship of the jewelry settings, whether manufactured by us or other manufacturers, could affect both consumers' perception and acceptance of our jewels and costs incurred by returns and markdowns.

Thus, our future financial performance may be affected by:

- our continued success in developing and promoting brands for our moissanite jewel and finished jewelry featuring moissanite, resulting in increased interest and demand for moissanite jewelry at the consumer level;
- the continued willingness and ability of our jewelry distributors and other jewelry suppliers, manufacturers, and designers to market and promote *Charles & Colvard Created Moissanite*®, including both our classic moissanite jewels and *Forever Brilliant*® jewels, to the retail jewelry trade;
- the continued willingness of distributors, retailers, and others in the channel of distribution to purchase loose *Charles & Colvard Created Moissanite*®, including both our classic moissanite jewels and *Forever Brilliant*® jewels, and the continued willingness of manufacturers, designers, and retail jewelers to undertake setting of the loose jewels;
- our continued ability and the ability of manufacturers, designers, and retail jewelers to select jewelry settings that encourage consumer acceptance of and demand for our moissanite jewels and finished jewelry;
- our continued ability and the ability of jewelry manufacturers and retail jewelers to set loose moissanite jewels in finished jewelry with high-quality workmanship;

- our continued ability and the ability of retail jewelers to effectively market and sell finished jewelry featuring moissanite, including finished jewelry featuring both our classic moissanite jewels and *Forever Brilliant*® jewels, to consumers; and
- our ability to operationally execute our direct-to-consumer e-commerce and home party businesses.

Although we have entered into a non-binding letter of intent to lease a new location to house our headquarters, our business may suffer if we fail to execute a definitive lease agreement on favorable terms or at all or if moving our headquarters significantly distracts management from operating our business. The impact of the termination of the Lease Agreement will depend, in part, on our ability to execute a new lease agreement and move our executive offices, sales offices, administrative personnel, and production facilities to a new location. Although we have entered into a non-binding letter of intent to lease approximately 36,000 square feet of mixed-use space from an unaffiliated third party, there can be no assurance that we will execute a definitive lease agreement with this party on favorable terms or at all. If we are unable to negotiate a definitive lease agreement with this party, we may be forced to negotiate a lease for a different location on less favorable terms and/or incur significant additional expenses that may result from any delay in such negotiations. In addition, moving our headquarters is a complex, time-consuming, and expensive process that, without proper planning and effective and timely implementation, could significantly distract management from operating our business. Our inability to adequately address challenges that may arise during this transition could have an adverse effect on our business and results of operations.

Item 5. Other Information

On October 31, 2013, we exercised our right under the Lease Agreement, dated March 26, 2004, by and between Duke Realty Limited Partnership and us, as amended on September 22, 2004, July 30, 2010, and January 1, 2011, or collectively, the Lease Agreement, to terminate the Lease Agreement effective July 31, 2013. As provided by the Lease Agreement, the delivery of the termination notice was accompanied by our payment of approximately $112,000 to Raleigh Flex Owner I, LLC, the current landlord. This amount reflects all unamortized lease transaction costs, including, without limitation, all rent abated since January 1, 2011, plus two months' rent at the current rental rate.

On October 11, 2013, we entered into a non-binding letter of intent to lease approximately 36,000 square feet of mixed-use space from an unaffiliated third party, which we intend to use for our headquarters upon termination of the Lease Agreement. We expect to execute a definitive lease agreement related to this property during the fourth quarter of 2013.

Item 6. Exhibits

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

Exhibit No.	Description
10.1	Employment Agreement, effective as of August 5, 2013, by and between Charles & Colvard, Ltd. and Kyle Macemore
10.2	Separation of Employment Agreement, dated August 7, 2013, between Charles & Colvard, Ltd. and Timothy L. Krist
10.3	Amended and Restated Corporate Incentive Plan, dated August 30, 2013
10.4	Second Amendment to Letter Agreement, dated September 5, 2013, between Charles & Colvard, Ltd. and Cree, Inc.*
10.5	Loan Agreement, dated September 20, 2013, between Charles & Colvard, Ltd. and PNC Bank, National Association (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K, as filed with the SEC on September 24, 2013)
10.6	Committed Line of Credit Note, dated September 20, 2013, by Charles & Colvard, Ltd. in favor of PNC Bank, National Association (incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K, as filed with the SEC on September 24, 2013)
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from Charles & Colvard, Ltd.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 formatted in XBRL (eXtensible Business Reporting Language) and furnished electronically herewith: (i) Condensed Consolidated Balance Sheets; (ii) Condensed Consolidated Statements of Operations; (iii) Condensed Consolidated Statements of Cash Flows; and (iv) Notes to Condensed Consolidated Financial Statements.

* Portions of this exhibit have been omitted and filed separately with the SEC as part of an application for confidential treatment pursuant to the Exchange Act.

SIGNATURES

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

CHARLES & COLVARD, LTD.

October 31, 2013	By: /s/ Randy N. McCullough Randy N. McCullough President and Chief Executive Officer
October 31, 2013	By: /s/ Kyle Macemore Kyle Macemore Senior Vice President and Chief Financial Officer (Principal Financial Officer and Chief Accounting Officer)

EXHIBIT INDEX

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* Portions of this exhibit have been omitted and filed separately with the SEC as part of an application for confidential treatment pursuant to the Exchange Act.

Exhibit 10.1

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (the “Agreement”) is made and entered into this the 5th day of August, 2013 (the “Effective Date”) by and between Charles & Colvard, Ltd. (the “Company”) and Kyle Macemore (the “Employee”).

WITNESSETH

WHEREAS, Employee and the Company wish to enter into an employment relationship on the terms and conditions set forth in this Agreement; and

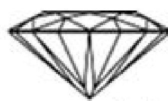
WHEREAS, the Board of Directors of the Company (the “Board”) has authorized the Company to enter into this Agreement.

NOW THEREFORE, in consideration of the foregoing and the mutual promises and covenants contained herein and for other good and valuable consideration, the sufficiency of which is hereby acknowledged, the parties hereto agree that:

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

2. Term of Employment. Unless earlier terminated as provided herein, the initial term of this Agreement shall commence on the Effective Date and shall continue until the one-year anniversary of the Effective Date (the “Initial Term”). After the Initial Term, this Agreement shall automatically renew for successive additional one-year terms on the same terms and conditions set forth herein, unless: (i) earlier terminated or amended as provided herein or (ii) either party gives written notice of non-renewal at least thirty (30) days prior to the end of the Initial Term or any renewal term of this Agreement. The Initial Term of this Agreement and all applicable renewals thereof are collectively referred to herein as the “Term.”

3. Position and Duties. Employee shall serve as Senior Vice President and Chief Financial Officer of the Company. Employee shall faithfully and to the best of his ability perform all duties of the Company related to his position with the Company, including, but not limited to, all duties set forth in this Agreement and/or in the Bylaws of the Company related to the position that he holds, as well as all duties that are reasonably assigned to him by the Board or its designees. Employee agrees to devote his entire working time, attention, energy, and skills to the Company in furtherance of the Company’s best interests, while so employed. Employee shall comply with all reasonable Company policies, standards, rules, and regulations (the “Company Policies”) and all applicable government laws, rules, and regulations that are now or hereafter in effect. Employee acknowledges receipt of copies of all written Company Policies that are in effect as of the date of this Agreement.



4. Compensation and Benefits. During the Term, Employee shall receive compensation and benefits for the services performed for the Company under this Agreement as follows (with no pro ration of any compensation and benefits set forth below to occur pursuant to Section III.B. of the Company's Corporate Incentive Plan):

(a) Base Salary. Employee shall receive a base salary of Two Hundred and Fifty Thousand and 00/100 Dollars ($250,000), payable in regular and equal installments in accordance with the Company's regular payroll schedule and practices ("Base Salary").

(b) Employee Benefits. Employee shall be entitled to receive those benefits that are made available to the other similarly-situated executive employees of the Company, including, but not limited to, life, medical, and disability insurance, as well as retirement benefits (collectively, the "Employee Benefits"), in accordance with the terms and conditions of the applicable plan documents, provided that Employee meets the eligibility requirements thereof. The Company reserves the right to reduce, eliminate, or change such Employee Benefits, in its sole discretion, subject to any applicable legal and regulatory requirements.

(c) Equity Compensation Awards. The Compensation Committee of the Board has approved an incentive stock option ("ISO") granting Employee the right to purchase up to 80,000 shares of the Company's common stock under the Charles & Colvard, Ltd. 2008 Stock Incentive Plan (the "2008 Plan") at an option exercise price equal to the closing price of the common stock on the Effective Date contingent upon Employee's execution of this Agreement and commencement of employment with the Company; provided that such option shall be granted as a non-ISO to the extent it does not qualify for ISO treatment on the Effective Date. This ISO award shall vest annually over a three-year period in accordance with the following vesting schedule: 25% of the ISO award (20,000 option shares) shall vest on the Effective Date and an additional 25% of the ISO award (20,000 option shares) shall vest on each of the following three anniversaries of the Effective Date provided Employee remains continuously employed with the Company (or other affiliated company) through each anniversary. The ISO award shall be contingent upon Employee's execution of a standard Employee Incentive Option Agreement in substantially the form attached as *Exhibit A* to this Agreement and the ISO award shall in all respects be subject to and governed by the provisions of the 2008 Plan and the Employee Incentive Option Agreement. In addition to the ISO award, the Compensation Committee of the Board has approved the grant of a Restricted Stock Award for 80,000 shares of the Company's common stock pursuant to the 2008 Plan on the Effective Date contingent upon Employee's execution of this Agreement and commencement of employment with the Company. The restricted stock award shall vest annually over a three-year period in accordance with the following vesting schedule: 25% of the shares (20,000 shares) shall vest on January 1, 2014 and an additional 25% of the shares (20,000 shares) will vest on each of the following three anniversaries of the Effective Date provided Employee remains continuously employed with the Company (or other affiliated company) through each anniversary. The restricted stock award shall be contingent upon Employee's execution of a standard Restricted Stock Award Agreement in substantially the form attached as *Exhibit B* to this Agreement and shall in all respects be subject to, and governed by, the provisions of the 2008 Plan and corresponding Restricted Stock Award Agreement.

(d) Reimbursement of Expenses. The Company shall reimburse Employee for all reasonable out-of-pocket expenses incurred by Employee that specifically and directly relate to the performance by Employee of the services under this Agreement, provided that Employee complies with the Company Policies for reimbursement that are now or hereafter in effect. Each such expense shall be submitted for reimbursement after they are incurred.

(e) Paid Time Off. During the first calendar year of his employment by the Company, Employee will: (i) earn, on a prorated basis from the Effective Date, the annualized equivalent of fifteen (15) days of paid time off ("PTO"), and (ii) receive 3 days of paid personal leave on the Effective Date. On a calendar year basis thereafter, Employee will: (i) earn PTO in accordance with the Company's PTO policy, and (ii) receive three (3) days of paid personal leave on January 1. In accordance with the Company Policies, all PTO that is earned by Employee shall be used or carried over to the extent permitted and all paid personal leave that is received by Employee shall be used or forfeited. Upon the termination of the Employee's employment by the Company, all earned and unused PTO shall be paid and all unused paid personal leave shall be forfeited in accordance with the terms of the Company Policies.

(f) Bonus. Employee shall be eligible for a bonus opportunity in 2013 under the terms and conditions of the Company's Corporate Incentive Plan of up to seventy-five percent (75%) of his base salary, payable in cash and/or equity in the discretion of the Company. This bonus must be approved by the Board and will be paid at the Company's discretion. For future years, Employee shall be eligible to participate in the Company's cash and equity incentive plans for executive officers upon terms substantially similar to other executive officers except for the Chief Executive Officer.

5. Withholding. The Company may withhold from any payments or benefits under this Agreement, including, but not limited to, any payments under Paragraphs 4(a), (c), (d), (e), and (f) of this Agreement, all federal, state, or local taxes or other amounts, as may be required pursuant to applicable law, government regulation, or ruling.

6. Termination. This Agreement and Employee's employment by the Company shall or may be terminated as follows:

(a) Expiration of the Term. This Agreement and Employee's employment by the Company shall terminate upon the expiration of the Term.

(b) Death of Employee. This Agreement and Employee's employment by the Company shall terminate upon the death of Employee ("Death").

(c) Discontinuance. The Company, immediately and without notice, may terminate this Agreement and Employee's employment by the Company upon the liquidation, dissolution, or discontinuance of business by the Company in any manner or the filing of any petition by or against the Company under any federal or state bankruptcy or insolvency laws, provided that such petition is not dismissed within sixty (60) days after filing ("Discontinuance").

(d) Termination by the Company for Just Cause. The Company may terminate this Agreement and Employee's employment by the Company at any time for Just Cause. Termination for "Just Cause" shall include termination for Employee's: dishonesty; gross incompetence; willful misconduct; breach of fiduciary duty owed to the Company, including any failure to disclose a material conflict of interest; failure to perform his duties as required by this Agreement or to achieve the reasonable objectives specified by the Board or their designees; material violation of any law (other than traffic violations or similar offenses); material failure to comply with Company Policies, including policies prohibiting harassment, discrimination, and retaliation, or any other reasonable directives of the Board or their designees; conviction of a felony of any nature or of a misdemeanor involving moral turpitude; use of illegal drugs or other illegal substance, or use of alcohol in a manner that materially interferes with the performance of Employee's duties under this Agreement; adverse action or omission that would be required to be disclosed pursuant to public securities laws, even though such laws may not then apply to the Company, that would limit the ability of the Company or any affiliated entity to sell securities under any federal or state law, or that would disqualify the Company or any affiliated entity from any exemption otherwise available to it; disability; or material breach of any provision of this Agreement, including provisions concerning confidentiality, proprietary information, and restrictive covenants. For purposes of this subsection, the term "disability" means the inability of Employee, because of the condition of his physical, mental, or emotional health, to satisfactorily perform the duties of his employment hereunder, with or without a reasonable accommodation, for a continuous three-month period.

(e) Termination by the Company Without Cause. The Company may terminate this Agreement and Employee's employment by the Company other than for "Just Cause," as described in Paragraph 6(d) above, and other than upon "Discontinuance," as described in Paragraph 6(c) above, at any time for any reason by providing written notice to Employee, which termination shall be effective immediately ("Without Cause"). For the avoidance of doubt, a notice by the Company that the Term of this Agreement shall not be automatically renewed as provided in Paragraph 2 of this Agreement shall constitute a termination by the Company Without Cause.

(f) <u>Termination by Employee for Good Reason.</u> Employee may terminate this Agreement and his employment by the Company for "Good Reason" (as defined herein), provided that: (i) Employee provides the Company with written notice of the Good Reason within ninety (90) days of the initial actions or inactions of the Company giving rise to Good Reason; (ii) the Company does not cure such conditions within sixty (60) days of such notice (the "Cure Period"); (iii) Employee terminates his employment under this Agreement within thirty (30) days of the expiration of the Cure Period; and (iv) the Company has not, prior to Employee giving notice of Good Reason, provided Employee with notice of termination or of non-renewal under this Agreement.

"Good Reason" shall mean the occurrence of any of the following events within six (6) months following a Change of Control (as defined herein) and without Employee's consent: (i) a substantial diminishment in Employee's responsibilities from those he had immediately prior to the Change of Control; (ii) a substantial reduction in Employee's base salary; (iii) Employee's place of employment is relocated more than fifty (50) miles from the location where Employee worked immediately prior to the Change of Control; or (iv) a material breach of this Agreement by the Company.

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 the Company, becomes, directly or indirectly, the "beneficial owner" (as defined in Rule 13d-3 promulgated under the Securities Exchange Act of 1934) of securities or ownership interests of the Company, representing 51% or more of the combined voting power of the Company's then outstanding securities or ownership interests; or (ii) during the then existing term of the Agreement, as a result of a tender offer or exchange offer for the purchase of securities or ownership interests of the Company (other than such an offer by the Company for its own securities), or as a result of a proxy contest, merger, consolidation or sale of assets, or as a result of any combination of the foregoing, individuals who at the beginning of any year period during such term constitute the Company Board, plus new directors whose election by the 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; or (iii) the shareholders of the Company approve a merger or consolidation of the Company with any other corporation or entity regardless of which entity is the survivor, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or being converted into voting securities of the surviving entity) at least 60% of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation which entity continues to be the sole or majority owner of the Company; or (iv) any event which the Company's Board of Directors determines should constitute a Change of Control. Notwithstanding anything in this Agreement to the contrary, in no event shall any of the following occurrences constitute a "Change of Control": (i) the Company's making any assignment for the benefit of its creditors or consenting to the appointment of a receiver or commencing any proceeding in bankruptcy or for dissolution, liquidation, winding-up, composition or other relief under state or federal bankruptcy laws or (ii) any proceeding in bankruptcy or for dissolution, liquidation, winding-up, composition or other relief under state or federal bankruptcy laws being commenced against the Company, or a receiver or trustee being appointed for the Company or a substantial part of its property.

(g) Termination by Employee Without Good Reason. Employee may terminate this Agreement and his employment by the Company for reasons other than Good Reason thirty (30) days after written notice of Employee's resignation is received by the Company ("Resignation").

(h) Obligations of the Company Upon Termination.

i. Upon the termination of this Agreement: (A) pursuant to the expiration of the Term, under Paragraph 6(a) of this Agreement, following Employee's notice of non-renewal pursuant to Paragraph 2 of this Agreement; (B) pursuant to Paragraph 6(b) of this Agreement ("Death"); (C) by the Company pursuant to Paragraph 6(c) of this Agreement ("Discontinuance") or Paragraph 6(d) of this Agreement ("Just Cause"); (D) by Employee pursuant to Paragraph 6(g) of this Agreement ("Resignation"); or (E) for any reason other than those set forth in Paragraph 6(h)(ii); the Company shall have no further obligation hereunder other than the payment of all compensation and other benefits payable to Employee through the date of such termination.

ii. Upon the termination of this Agreement (and subject to Employee's execution of a release under Paragraph 7 of this Agreement and compliance with his obligations under Paragraphs 8, 9, 10, and 11 of this Agreement): (A) by Employee pursuant to Paragraph 6(f) of this Agreement ("Good Reason"); (B) by the Company pursuant to Paragraph 6(e) of this Agreement ("Without Cause"); or (C) pursuant to the expiration of the Term, under Paragraph 6(a) of this Agreement, following the Company's notice of non-renewal pursuant to Paragraph 2 of this Agreement; the Company shall pay Employee an amount equal to twelve (12) months of his then current base salary (less all applicable deductions), payable in equal installment payments paid in accordance with the Company's regular payroll schedule, beginning on the first regular payroll date occurring on or after the date on which the release of claims required by Paragraph 7 of this Agreement becomes effective and non-revocable.

7. Release of Claims. Notwithstanding any provision of this Agreement to the contrary, the Company's obligation to provide any payment under Paragraph 6(h)(ii) of this Agreement is conditioned upon Employee's execution of an enforceable release of any and all claims arising before the date that he signs the release, in a form which is reasonable and which is satisfactory to the Company (satisfaction of the Company is not to be unreasonably withheld), and his compliance with the provisions of Paragraphs 8, 9, 10, and 11 of this Agreement. If Employee fails to execute such a release or fails to comply with such terms of this Agreement, then the Company's obligation to make any payments to him ceases on the effective termination date. The release of claims shall be provided to Employee within seven (7) days of the termination of his employment, and Employee must execute it within the time period specified in the release (which shall not be longer than forty-five (45) days from the date upon which he receives it). Such release shall not be effective until any applicable revocation period has expired. Notwithstanding any provision in this Agreement to the contrary, any payment conditioned upon this release shall be made, or commence, as applicable, within ninety (90) days of the termination of Employee's employment.

8. Definitions. For purposes of this Agreement, the following terms shall have the following meanings:

(a) "Confidential Information" shall mean: (i) any and all non-public or otherwise confidential proprietary knowledge, material, or information of the Company, including any and all knowledge, material, or information that is designated as Confidential Information by the Company and any and all confidential knowledge, material, or information that becomes generally known to the public as a result of a disclosure by Employee, or any other person or entity who is obligated to treat such knowledge, material, or information confidentially, and (ii) any and all non-public or otherwise confidential proprietary knowledge, material, or information of others who disclose that knowledge, material, or information to the Company, including any and all knowledge, material, or information designated as Confidential Information by the Company, or those others and any and all confidential knowledge, material, or information that becomes generally known to the public as a result of a disclosure by Employee, or any other person or entity who is obligation to treat such knowledge, material, or information confidentially. Confidential Information includes, but is not limited to, the following types of knowledge, material, or information (whether or not reduced to writing): trade secrets; concepts; designs; discoveries; ideas; know-how; processes; techniques; Inventions (as defined herein); drawings; specifications; models; data; software in various stages of development; source and object code; documentation; diagrams; flow charts; research; procedures; marketing and development techniques, materials, plans, and information; business methods, procedures, and policies; current and prospective customers names and lists and other information related to current and prospective customers; prices, including price lists, policies, and formulas; profit margins, data, and formulas; financial information; training manuals and methodologies; and employee files and information.

(b) "Inventions" shall means ideas, concepts, techniques, inventions, discoveries, and works of authorship, whether or not patentable or protectable by copyright or as a mask work and whether or not reduced to practice, including, but not limited, devices, processes, computer programs and related source code and object code, mask works, and methods, together with any improvements thereon or thereto, derivative works made therefrom, and know-how, descriptions, sketches, drawings, or other knowledge, information, or material related thereto.

(c) “Intellectual Property Rights” shall mean all patent, trademark, and copyright rights, moral rights, rights of attribution or integrity, trade secret rights, or other proprietary or intellectual property rights.

(d) “Competing Business” shall mean any corporation, partnership, person, or other entity that is researching, developing, manufacturing, marketing, distributing, or selling any product, service, or technology that is competitive with any part of the Company’s Business.

(e) “Company’s Business” shall mean the development, manufacture, marketing, distribution, or sale of, including research directed to, any product, service, or technology in the fashion jewelry or Moissanite jewelry industry. As of the date of this Agreement, Company’s Business includes, but is not limited to: (i) marketing and distributing fashion jewelry, Moissanite jewelry, and Moissanite gemstones, and (ii) fabricating (including wafering, pre-forming, and faceting), marketing, and distributing Moissanite gemstones or other diamond simulants to the gem and jewelry industry. Employee understands that during Employee’s employment with the Company, the Company’s Business may expand or change, and Employee agrees that any such expansions or changes shall expand or contract the definition of the Company’s Business and Employee’s obligations under this Agreement accordingly.

(f) “Territory” shall mean the following severable geographic areas: (i) throughout the world, (ii) within any country in which the Company, or a Competing Business is engaged in business; (iii) within any country in which the Company is engaged in business, (iv) within the United States, (v) within any state, including the District of Columbia, in which the Company or a Competing Business is engaged in business, (vi) within any state, including the District of Columbia, in which the Company is engaged in business, (vii) within a 100 mile radius of Employee’s principal place of employment or work for the Company, (viii) the state of North Carolina, and (ix) within a 100 mile radius of the Company’s corporate headquarters.

9. Covenant Not to Compete. As a result of Employee’s employment by the Company: (i) Employee will have access to trade secrets and Confidential Information of the Company, including, but not limited to, valuable information about its intellectual property, business operations and methods, and the persons with which it does business in various locations throughout the world, that is not generally known to or readily ascertainable by a Competing Business, (ii) Employee will develop relationships with the Company’s customers and others with which the Company does business, and these relationships are among the Company’s most important assets, (iii) Employee will receive specialized knowledge of and specialized training in the Company’s Business, and (iv) Employee will gain such knowledge of the Company’s Business that, during the course of Employee’s employment with the Company and for a period of one year following the termination thereof, Employee could not perform services for a Competing Business without inevitably disclosing the Company’s trade secrets and Confidential Information to that Competing Business. Accordingly, Employee agrees to the following:

(a) While employed by the Company, Employee will not, without the express written consent of an authorized representative of the Company: (i) perform services (as an employee, independent contractor, officer, director, or otherwise) within the Territory for any Competing Business, (ii) engage in any activities (or assist others to engage in any activities) within the Territory that compete with the Company's Business, (iii) own or beneficially own an equity interest in a Competing Business, (iv) request, induce, or solicit (or assist others to request, induce, or solicit) any customers, prospective customers, or suppliers of the Company to curtail or cancel their business with the Company, or to do business within the scope of the Company's Business with a Competing Business, (v) request, induce, or solicit (or assist others to request, induce, or solicit) for the benefit of any Competing Business any employee or independent contractor of the Company to terminate his or her employment or independent contractor relationship with the Company, or (vi) employ (or assist others to employ) for the benefit of any Competing Business any person who has been employed by the Company within the last year of Employee's employment with the Company.

(b) For a period of one year following the termination of Employee's employment with the Company, Employee will not, without the express written consent of an authorized representative of the Company: (i) perform services (as an employee, independent contractor, officer, director, or otherwise), within the Territory for any Competing Business, that are the same or similar to any services that Employee performed for the Company or that otherwise utilize skills, knowledge, and/or business contacts and relationships that Employee utilized while providing services to the Company, (ii) engage in any activities (or assist others to engage in any activities) within the Territory that compete with the Company's Business, (iii) own or beneficially own an equity interest in a Competing Business, (iv) request, induce, or solicit (or assist others to request, induce, or solicit) any customers, prospective customers, or suppliers of the Company, which were customers, prospective customers, or suppliers of the Company during the last year of Employee's employment with the Company, to curtail or cancel their business with the Company, or to do business within the scope of the Company's Business with a Competing Business, (v) request, induce, or solicit (or assist others to request, induce, or solicit) any customers, prospective customers, or suppliers of the Company with which Employee worked or had business contact during the last year of Employee's employment with the Company to curtail or cancel their business with the Company, or to do business within the scope of the Company's Business with a Competing Business, (vi) request, induce, or solicit (or assist others to request, induce, or solicit) any employee or independent contractor of the Company to terminate his or her employment or independent relationship with the Company, or (vii) request, induce, or solicit for employment (or assist others to request, induce or solicit) any person who has been employed by the Company within the last year of Employee's employment by the Company or thereafter to be employed with a Competing Business. These obligations will continue for the specified period regardless of whether the termination of Employee's employment was voluntary or involuntary or with or without cause, and the specified period shall be tolled and shall not run during any time in which Employee fails to abide by these obligations.

(c) As an exception to the above restrictions, Employee may own passive investments in Competing Businesses, (including, but not limited to, indirect investments through mutual funds), provided that the securities of the Competing Business are publicly traded and Employee does not own or control more than two percent of the outstanding voting rights or equity of the Competing Business.

10. Confidentiality.

(a) All documents or other records, paper or electronic, that, in any way, constitute, contain, incorporate, or reflect any Confidential Information and all proprietary rights therein, including Intellectual Property Rights, shall belong exclusively to the Company, and Employee agrees to promptly deliver to the Company, upon request or upon termination of Employee's employment with the Company, all copies of such materials and Confidential Information in Employee's possession, custody, or control, as well as all other property of the Company in Employee's possession, custody, or control. Likewise, Employee agrees to promptly deliver to the Company, upon request or upon termination of Employee's employment with the Company, all copies of all documents or other records that, in any way, constitute, contain, incorporate, or reflect any Confidential Information of others that was disclosed or provided to Employee during the Term that is in Employee's possession, custody, or control.

(b) Employee agrees, during the Term and thereafter: (i) to hold in confidence and treat with strict confidentiality all Confidential Information, (ii) not to directly or indirectly reveal, report, publish, disclose, or transfer any Confidential Information to any person or entity, and (iii) not to utilize any Confidential Information for any purpose, other than in the course and scope of Employees work for the Company. If Employee is required to disclose Confidential Information pursuant to a court order or subpoena or such disclosure is necessary to comply with applicable law, the undersigned shall: (i) promptly notify the Company before any such disclosure is made and provide the Company with reasonable and ample time within which to object to or oppose any such disclosure, (ii) at the Company's request and expense take all reasonably necessary steps to defend against such disclosure, including defending against the enforcement of the court order, subpoena, or other applicable law, and (iii) permit the Company to participate with counsel of its choice in any related proceedings.

11. Proprietary Information.

(a) Employee agrees that any Inventions created, conceived, developed, or reduced to practice, in whole or in part, by Employee, either solely or in conjunction with others, during or after the Term that arise in any way from the use of or reliance on any Confidential Information or any of the Company's equipment, facilities, supplies, trade secret information, or time, that relate to the Company's Business or the Company's demonstrably anticipated business, research, or development, or that result from any work performed by Employee for, on behalf of, or at the direction of the Company, shall belong exclusively to the Company and shall be deemed part of the Confidential Information for purposes of this Agreement, whether or not fixed in a tangible medium of expression. Employee agrees that all rights, title, and interest in and to all such Inventions, including, but not limited to, Intellectual Property Rights shall vest and reside in, and shall be the exclusive property of, the Company. Without limiting the foregoing, Employee agrees that any and all such Inventions shall be deemed to be "works made for hire" and that the Company shall be deemed the sole and exclusive owner thereof. In the event and to the extent that any such Inventions are determined not to constitute "works made for hire" or that, by operation of law or otherwise, any right, title, or interest in or to the Inventions, including, but not limited to, any Intellectual Property Rights, vests not in the Company, but, rather, in Employee, Employee hereby: (i) irrevocably and unconditionally assigns and transfers to the Company all rights, title, and interest in and to any such Inventions, including, but not limited to, all Intellectual Property Rights and (ii) forever waives and agrees never to assert all such rights, title, and interest.

(b) Employee agrees to promptly and fully disclose in writing to the Chief Executive Officer of the Company: (i) any Invention created, conceived, developed or reduced to practice by Employee, either solely or in conjunction with others, during the Term and (ii) any such Invention created, conceived, developed, or reduced to practice after the Term that belongs exclusively to the Company pursuant to the provisions of Paragraph 11(a) of this Agreement. For the avoidance of doubt, in no event shall any provision of this Agreement, including without limitation Paragraph 11(b), provide or be construed to provide Employee or any other party with any license or other right or authority to create, conceive, develop, or reduce to practice, after the Term, any Invention in which the Company has an ownership interest, without the prior written consent of the Company.

(c) Employee agrees to assist the Company, at the Company's expense, either during or subsequent to the Term, to obtain and enforce for the Company's own benefit, in any country, Intellectual Property Rights in connection with any and all Inventions created, conceived, developed, or reduced to practice by Employee (in whole or in part) that belong or have been assigned to the Company pursuant to the provisions of Paragraph 11(a) of this Agreement. Upon request, either during or subsequent to the Term, Employee will execute all applications, assignments, instruments, and papers and perform all acts that the Company or its counsel may reasonably deem necessary or desirable to obtain, maintain, or enforce any Intellectual Property Rights in connection with any such Inventions or to otherwise protect the interests of the Company in those Inventions.

12. Acknowledgements, Representations, and Warranties.

(a) Employee acknowledges that the Company has a strict policy against using proprietary information belonging to any other person or entity without the express permission of the owner of that information.

(b) Employee represents and warrants to the Company that Employee's performance under this Agreement and as an employee of the Company does not and will not breach any non-competition, non-solicitation, or confidentiality agreement to which Employee is a party. Employee represents and warrants to the Company that Employee has not entered into, and agrees not to enter into, any agreement that conflicts with or violates this Agreement.

(c) Employee represents and warrants to the Company that Employee has not brought and shall not bring to the Company, or use in the performance of Employee's responsibilities for the Company, any materials or documents of a former employer that are not generally available to the public or that did not belong to Employee prior to Employee's employment with the Company, unless Employee has obtained written authorization from the former employer or other owner for their possession and use and provided the Company with a copy thereof.

13. Indemnification. The Employee will be eligible for indemnification to the fullest extent authorized under the Company's Articles or Incorporation and By-Laws (as applicable) and will be eligible for coverage under the Company's Director's & Officer's liability insurance policy as approved by the Board, subject to the terms and conditions contained therein.

14. Entire Agreement. This Agreement constitutes the entire agreement of the parties with respect to the matters set forth herein and supersedes any prior agreements or understandings between them, whether written or oral.

15. 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.

16. Notices. Any notice to be given under this Agreement shall be deemed sufficient if addressed in writing and delivered personally, by telefax with receipt acknowledged, or by registered or certified U.S. mail to the following:

For the Company:
Chief Executive Officer
Charles & Colvard, Ltd.
300 Perimeter Park Drive, Suite A
Morrisville, North Carolina 27560
Fax: (919) 468-0486

For Employee:
Kyle Macemore
5105 Indigo Moon Way
Raleigh, NC 27613

17. Severability. In the event that any provision of any paragraph of this Agreement shall be deemed to be invalid or unenforceable for any reason whatsoever, it is agreed such invalidity or unenforceability shall not affect any other provision of such paragraph or of this Agreement, and the remaining terms, covenants, restrictions or provisions in such paragraph and in this Agreement shall remain in full force and effect and any court of competent jurisdiction may so modify the objectionable provision as to make it valid, reasonable, and enforceable. In the event that a court determines that the length of time, the geographic area, or the activities prohibited under this Agreement are too restrictive to be enforceable, the court may reduce the scope of the restriction to the extent necessary to make the restriction enforceable.

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

19. Restrictive Covenants Are Reasonable. The market for the Company's services and the Company's Business is highly specialized and highly competitive such that other companies and business entities compete with the Company in various locations throughout the world. The provisions set forth in this Agreement: (i) are reasonably necessary to protect the Company's legitimate business interests, (ii) are reasonable as to the time, territory, and scope of activities that are restricted, (iii) do not interfere with Employee's ability to earn a comparable living or secure employment in the field of Employee's choice, (iv) do not interfere and are not inconsistent with public policy or the public interest, and (v) are described with sufficient accuracy and definiteness to enable Employee to understand the scope of the restrictions on Employee.

20. Injunctive Relief. Because of the unique nature of the Confidential Information, Employee understands and agrees that the Company will suffer irreparable harm in the event that Employee fails to comply with any of Employee's obligations under Paragraphs 8, 9, 10, or 11 of this Agreement and that monetary damages will be inadequate to compensate the Company for such breach. Accordingly, Employee agrees that the Company will, in addition to any other remedies available to it at law or in equity, be entitled to injunctive relief to enforce the terms of Paragraphs 8, 9, 10, or 11 of this Agreement.

21. Publication. Employee hereby authorizes the Company to provide a copy of this Agreement to any and all of Employee's future employers and to notify any and all such future employers that the Company intends to exercise its legal rights arising out of or in connection with this Agreement and/or any breach or any inducement of a breach hereof.

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22. Survival. Employee agrees that: (i) Employee’s employment with the Company is contingent upon Employee’s execution of this Agreement, which is a material inducement to the Company to offer employment and the compensation and benefits hereunder to Employee and to provide Confidential Information to Employee, and (ii) Paragraphs 8, 9, 10, and 11 of this Agreement shall survive any termination for any reason whatsoever of Employee’s employment with the Company.

23. Governing Law. This Agreement shall be construed, interpreted, and governed in accordance with the laws of the state of North Carolina, without regard to the conflicts of laws principles thereof. The state and federal courts in North Carolina shall be the exclusive venues for the adjudication of all disputes arising out of this Agreement, and the parties consent to the exercise of personal jurisdiction over them in any such adjudication and hereby waive any and all objections and defenses to the exercise of such personal jurisdiction.

24. 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, her heirs, beneficiaries, and legal representatives. The Company may assign this Agreement or any rights hereunder, or delegate any obligations hereunder, without the consent of Employee. Employee shall not assign this Agreement or delegate Employee’s obligations hereunder without the prior written consent of the Company.

25. Compliance with Section 409A.

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

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

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

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

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

CHARLES & COLVARD, Ltd.

By:/s/ Randy N. McCullough
Randy N. McCullough
Chief Executive Officer

EMPLOYEE

/s/ Kyle Macemore
Kyle Macemore

Exhibit 10.2

SEPARATION OF EMPLOYMENT AGREEMENT

This **SEPARATION OF EMPLOYMENT AGREEMENT (**“Agreement”) is made and entered into by Timothy L. Krist (“Employee”) and Charles & Colvard, Ltd. (“the Company”).

Employee is currently employed by the Company as its Chief Financial Officer pursuant to an employment agreement between Employee and the Company dated June 23, 2009 (the “Employment Agreement”).

Employee and the Company have agreed that his employment with the Company shall terminate pursuant to his resignation which shall be effective as of August 5, 2013.

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

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

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

1. RESIGNATION/CONTINUING OBLIGATIONS UNDER EMPLOYMENT AGREEMENT. Employee’s employment with the Company will terminate pursuant to his resignation, effective August 5, 2013 (“Effective Termination Date”). By signing this Agreement, Employee represents that he has been properly paid for all time worked and received all salary, expense reimbursement, and all other amounts of any kind due to him from the Company with the sole exception of (a) his final paycheck for work during his final payroll period and for any accrued but unused vacation/paid time off which will be paid on the next regularly scheduled payroll date following the Effective Termination Date and (b) the benefits payable under this Agreement.

As of the Effective Termination Date, the Employment Agreement shall terminate and neither party shall have any further obligations thereunder except that Employee specifically acknowledges and agrees that his obligations under Sections 8 (Covenant Not to Compete), 9 (Confidentiality), and 10 (Proprietary Information) of the Employment Agreement shall continue after the termination of the Employment Agreement in accordance with their terms.

2. SEVERANCE BENEFITS.

A. Severance Pay. The Company will pay Employee severance pay in an amount equal to one year of his base annual salary as of the Effective Termination Date (less applicable taxes and withholdings), payable in consecutive substantially equal bi-weekly installments in accordance with the Company’s regular payroll schedule beginning with the first regularly scheduled bi-weekly payment date, which will occur on August 16, 2013.

B. COBRA Premium Assistance. If Employee timely and properly elects continuation coverage under the Company's group health plan pursuant to the Consolidated Omnibus Budget Reconciliation Act ("COBRA"), then the Company will pay the COBRA premiums for coverage for him and his eligible dependents during the 12-month period immediately following the Effective Termination Date.

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

Nothing in this Agreement shall constitute a guarantee of COBRA continuation coverage or benefits. Employee shall be solely responsible for all obligations in electing COBRA continuation coverage and taking all steps necessary to qualify for such coverage.

C. In response to reference requests from potential future employers, the Company will follow its neutral reference policy and shall provide only dates of employment, position held and compensation at time of resignation.

3. RELEASE.

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

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

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

(iii) related to his employment with the Company and separation therefrom under federal, state or local law of any nature whatsoever (including but not limited to constitutional, statutory, tort, express or implied contract or other common law); and

(iv) for attorneys' fees.

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

(vi) limit or release any indemnification rights of Employee as a former officer of the Company, whether provided in the Company's Articles of Incorporation, Bylaws, indemnification agreements, or any statute or rule of law providing for indemnification or advancement of expenses to officers, now or hereafter in effect;

(vii) limit or release any rights under any D&O insurance policies of the Company to the extent applicable to Employee;

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

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

(x) prohibit Employee from filing a charge with or participating in an investigation by the U.S. Equal Employment Opportunity Commission or other governmental agency with jurisdiction concerning the terms, conditions and privileges of employment or jurisdiction over the Company's business or assisting with an investigation conducted internally by the Company; provided, however, that by signing this Agreement, Employee waives the right to, and shall not seek or accept, any monetary or other relief of any nature whatsoever in connection with any such charges, investigations or proceedings.

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

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

4. COMPANY INFORMATION AND PROPERTY. Employee shall not at any time after his employment terminates disclose, use or aid third parties in obtaining or using any confidential or proprietary Company information nor access or attempt to access any Company computer systems, networks or any resources or data that resides thereon. Confidential or proprietary information is information relating to the Company or any aspect of its business which is not generally available to the public, the Company's competitors, or other third parties, or ascertainable through common sense or general business or technical knowledge. Nothing in this Agreement shall relieve him from any obligations under any previously executed confidentiality, proprietary information or secrecy agreements.

All records, files or other materials maintained by or under the control, custody or possession of the Company or its agents in their capacity as such shall be and remain the Company's property. By signing this Agreement, Employee represents that he: (i) has returned all the Company property (including, but not limited to, credit cards; keys; cellular telephone; air card; access cards; thumb drive(s), laptop(s), personal digital devices and all other computer hardware and software; records, files, documents, manuals, and other documents in whatever form they exist, whether electronic, hard copy or otherwise and all copies, notes or summaries thereof) and turned over all Company passwords or access codes which he created, received or otherwise obtained in connection with his employment; and (ii) has permanently deleted any Company information that may reside on his personal computer(s), other devices or accounts.

5. RIGHT TO REVIEW AND REVOKE. The Company delivered this Agreement to Employee on August 2, 2013 by hand-delivery and desires that he have adequate time and opportunity to review and understand the consequences of entering into it. Accordingly, the Company advises him to consult with his attorney prior to executing it and that he has 21 days within which to consider it. Additionally, he may not execute this Agreement prior to the Effective Termination Date. Employee may revoke this Agreement during the seven (7) day period immediately following his execution of it. The Agreement will not become effective or enforceable until the revocation period has expired. To revoke the Agreement, a written notice of revocation must be delivered to Randy N. McCullough at the above address. If Employee revokes this Agreement during the seven (7) day revocation period, Employee will forfeit any severance payments not already paid to Employee as of the date of such revocation.

6. COOPERATION. Employee agrees to provide reasonable cooperation with the transition to a new chief financial officer for 30 days following execution of this Agreement; provided that such cooperation is limited to no more than 10 hours of telephone conversations, scheduled upon reasonable advance notice.

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

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

This Agreement shall apply to, be binding upon and inure to the benefit of the parties' successors, assigns, heirs and other representatives and be governed by North Carolina law (with the sole exception of its conflicts of laws provisions) and the applicable provisions of federal law, including but not limited to ADEA.

The severance benefits afforded under this Agreement are in lieu of any other compensation or benefits, excluding accrued but unused vacation/paid time off (PTO) and vested retirement benetits, to which Employee otherwise might be entitled, and payment of the severance benefits is conditioned upon Employee's compliance with the terms of this Agreement.

8. SECTION 409A OF THE INTERNAL REVENUE CODE.

A. Parties' Intent. The parties intend that the provisions of this Agreement comply with the Internal Revenue Code of 1986, as amended (the "Code"), and the regulations and other interpretive authority thereunder (collectively, "Section 409A") and all provisions of this Agreement shall be construed and administered in a manner consistent with the requirements for avoiding taxes or penalties under Section 409A.

B. Separate Payments. Each installment payment required under this Agreement shall be considered a separate payment for purposes of Section 409A to the extent such treatment is consistent with Section 409A.

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

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

/s/ Timothy L. Krist — 8/7/2013
Timothy L. Krist — Date

Charles & Colvard, Ltd.

By: /s/ Randall N. McCullough — 8/7/2013
Name: Randall N. McCullough — Date
Title: President & Chief Executive Officer

Exhibit 10.3

CHARLES & COLVARD, LTD.
Amended and Restated CORPORATE INCENTIVE PLAN
Amended August 30, 2013

The purpose of the Corporate Incentive Plan (the "Plan") is to provide eligible employees of Charles & Colvard, Ltd. (the "Corporation") as selected by the Board of Directors of the Corporation (the "Board") upon recommendation of management to participate in the Plan with incentives for the successful execution of both short- and long-term plans that:

1. Provide significant revenue growth,

2. Maintain and increase the profitability of the Corporation,

3. Develop the human, fiscal, and physical capacity to enable the Corporation to accelerate and maintain growth into the indefinite future

This Plan supersedes and replaces all prior annual bonus plans, programs or similar incentive arrangements of the Corporation, with effect as of January 1, 2013, and is subject to the terms and conditions of the Charles & Colvard, Ltd. 2008 Stock Incentive Plan, or any subsequent incentive stock plan approved by the Corporation and its shareholders, as applicable (the "2008 Plan").

I. Short-Term Incentive Opportunity

The short-term incentive portion of the Plan provides each Eligible Employee (as defined under Section III.B. below) with the opportunity to earn a performance-based cash award up to a certain percentage of his/her total base salary (excluding bonuses, reimbursement for moving expenses, disability benefits, vacation cash-outs and similar payments). The short-term incentive award shall be calculated as a percentage of each Eligible Employee's annual base salary in effect as of the last day of the fiscal year for which the award is payable.

Eligible Employees are eligible for cash awards under the Plan based on the achievement of different levels of EBITDA, revenue, and personal objectives as set by the Committee (as defined in Section III.A. below), and the actual cash award amounts, if any, will therefore vary. A threshold level of EBITDA as determined by the Committee must be met before any cash awards are made under the Plan. Once the threshold level of EBITDA is met, the eligible bonus is based a percentage split among the achievement of levels of EBITDA , revenue, and personal objectives as set by the Board on an annual basis.

Under the Plan, the threshold cash award opportunity for the Corporation's executive officers will be based on a percentage of his/her annual base salary as defined by the Committee annually. As higher levels of EBITDA or revenue are achieved, the performance-based cash award will increase because the percentage of base salary for each Eligible Employee attributable to the award increases. For the Corporation's executive officers, the maximum cash award opportunity obtainable for achieving the maximum EBITDA and revenue performance level shall be at the percentage of his/her annual base salary as defined by the Committee annually.

Notwithstanding the foregoing, if the Committee determines that it is in the best interests of the Corporation for the short-term incentive awards made pursuant to this Section I to comply with the performance-based compensation exception to Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"), the Committee may, in its discretion, instead make such short-term incentive awards in the form of Performance Awards issued under and pursuant to the appropriate Performance Measures set forth in the 2008 Plan for purposes of complying with Code Section 162(m).

II. Long-Term Incentive Opportunity

The long-term incentive portion of the Plan provides each Eligible Employee with the opportunity to earn a performance-based equity award up to a certain percentage of his/her total base salary (excluding bonuses, reimbursement for moving expenses, disability benefits, vacation cash-outs and similar payments) divided by the closing price of the Corporation's common stock on the grant date (as adjusted for any stock splits or dividends prior to the issuance of the equity award), with any fractional shares included as part of the cash award defined in the Short-Term Incentive Opportunity above. The long-term equity award shall be calculated as a percentage of each Eligible Employee's annual base salary in effect as of the last day of the fiscal year for which the equity award is granted.

Eligible Employees shall be eligible for equity awards under the long-term incentive portion of the Plan based on the achievement of different levels of EBITDA, revenue, and personal objectives as set by the Committee in accordance with the Performance Measures and other performance conditions set forth in the 2008 Plan, and the actual equity award amounts, if any, will therefore vary. A threshold level of EBITDA as determined by the Committee must be met before any equity awards are made under the Plan. Once the threshold level of EBITDA is met, the eligible bonus is based a percentage split among the achievement of levels of EBITDA , revenue, and personal objectives as set by the Board on an annual basis.

To avoid administrative burden, any calculated equity award amount under this Long-Term Incentive shall instead be paid as a cash bonus as defined in the Short-Term Incentive Opportunity section above if such calculated amount has a value less than $2,000.

Under the Plan, the threshold equity award opportunity for the Corporation's executive officers will be calculated based upon a percentage of his/her annual base salary as defined by the Committee annually divided by the closing price of the Corporation's common stock as of the grant date (as adjusted for any stock splits or dividends prior to the issuance of the equity award) in accordance with Code Section 409A. As higher levels of EBITDA or revenue are achieved, the performance-based equity award will increase because the percentage of base salary for each Eligible Employee attributable to the award increases. For the Corporation's executive officers, the maximum equity award opportunity obtainable for achieving the maximum EBITDA and revenue performance level shall be calculated based upon the percentage of his/her annual base salary as defined by the Committee annually divided by the closing price of the Corporation's common stock as of the grant date (as adjusted for any stock splits or dividends prior to the issuance of the equity award) in accordance with Code Section 409A.

The equity award shall be made in the form of stock options or restrictive stock at the discretion of the Committee. Each award shall be subject to a vesting schedule of 25% upon grant date and 25% over each of the following three years. The Eligible Employee must remain in service to the Corporation as an employee, consultant or director on each of the vesting dates, and with such further terms and conditions as set forth in the documents that accompany the equity awards. Unless the Committee determines otherwise, upon termination of employment prior to the third anniversary of the equity award (subject to any applicable change in control provisions of such equity award), any remaining unvested portion of the equity award will be forfeited and the Eligible Employee shall have no right to the unvested shares subject to the equity award.

III. Terms and Conditions of the Plan

A. Administration of the Plan

The Plan shall be administered by the independent members of the Board or, upon the Board’s delegation, by the Compensation Committee of the Board (the “Committee”).

In addition to action by meeting in accordance with applicable law, any action of the Committee with respect to the Plan may be taken by a written instrument signed by all of the members of the Committee and any such action so taken by written consent shall be as fully effective as if it had been taken by a majority of the members at a meeting duly held and called.

Subject to the provisions of the Plan, the Committee shall have full and final authority in its discretion to take any action with respect to the Plan including, without limitation, the authority to:

(1) determine all matters relating to any awards under the Plan, including selection of individuals to be granted awards, the types of awards, the number of shares of common stock, if any, subject to an award, and all terms, conditions, restrictions and limitations of an award;

(2) prescribe the form or forms of any agreements, if any, evidencing any awards granted under the Plan;

(3) establish, amend and rescind rules and regulations for the administration of the Plan;

(4) construe and interpret the Plan and any agreements evidencing awards granted under the Plan, to establish and interpret rules and regulations for administering the Plan and to make all other determinations deemed necessary or advisable for administering the Plan; and

(5) in its sole discretion, adjust the EBITDA calculation for one-time events, including accounting charges not forecasted, as approved by the Committee.

In addition, except to the extent otherwise required under Code Section 409A, related regulations or other guidance, the Committee shall have authority, in its sole discretion, to accelerate the date that any award that was not otherwise exercisable or vested shall become exercisable or vested in whole or in part without any obligation to accelerate such date with respect to any other awards granted to any recipient. The Committee also shall have the authority and discretion to establish terms and conditions of awards (including but not limited to the establishment of subplans) as the Committee determines to be necessary or appropriate to conform to the applicable requirements or practices of jurisdictions outside of the United States.

B. Eligible Employees

No later than the first regularly scheduled meeting of the Committee in each fiscal year (the "Effective Date"), upon recommendation of the Chief Executive Officer of the Corporation, the Committee shall expressly designate the employees eligible to participate in the Plan (the "Eligible Employees") for such fiscal year. Participation in the Plan in any one year does not guarantee the right to participate in any other year.

The Committee shall have full authority and discretion to reduce or eliminate all awards made pursuant to the Plan at any time.

Eligible Employees must be employed on the date awards are made pursuant to Section III.D. of the Plan in order to receive a payout. Notwithstanding the foregoing, the Committee may, in its sole discretion, provide for awards to be paid to Eligible Employees (or their heirs, as applicable) whose employment with the Corporation has terminated due to death or disability or other exceptional reasons provided that such amounts are prorated based on the period of service rendered to the Corporation and paid at the time other awards under the Plan are regularly paid.

C. Commencement of Employment After the Effective Date

Non-Officer Employees

Any non-officer employee of the Corporation who commences employment with the Corporation after the Effective Date for a fiscal year may be designated an Eligible Employee for purposes of the Plan for such fiscal year at the discretion of the Chief Executive Officer and upon concurrence of the Chairperson of the Committee; provided that any non-officer employee who commences his/her employment during the fourth fiscal quarter of a year will not be eligible to participate in the Plan for such fiscal year unless the Committee expressly approves such participation.

Executive Officers

Any executive officer of the Corporation who commences employment with the Corporation after the Effective Date for a fiscal year may be designated an Eligible Employee for purposes of the Plan for such fiscal year at the discretion and upon approval of the Committee.

Pro-Ration of Awards

Any non-officer employee or executive officer who is designated an Eligible Employee pursuant to this Section III.C. of the Plan after the Effective Date of a fiscal year will have any award amounts for that fiscal year pro-rated in a manner as determined by the Committee.

D. Timing of Awards Under the Plan

As soon as practicable upon the completion of the annual audit by the Corporation's independent accountant and delivery of an audit opinion to the Corporation by such accountant for the applicable fiscal year, each of the Eligible Employees shall be eligible to receive cash awards and equity awards as described in this Plan.

E. Source of Equity Awards

Provided sufficient shares remain available for issuance, any Performance Awards or equity awards made under the Plan shall be issued under and pursuant to the 2008 Plan. With respect to any Performance Awards or equity awards made under the Plan, all terms, conditions, and requirements of such 2008 Plan are incorporated into the Plan by reference. For any Performance Awards or equity awards, to the extent that there is a contradiction between the Plan and the 2008 Plan or an ambiguity as to the provisions of the Plan, the terms of such 2008 Plan shall control. All shares issued under the Plan shall be drawn from the shares reserved under such 2008 Plan for issuance of awards.

F. Compliance with Code Section 409A

Notwithstanding any other provision in the Plan or an award to the contrary, if and to the extent that Section 409A of the Code is deemed to apply to the Plan or any award granted under the Plan, it is the general intention of the Corporation that the Plan and all such awards shall comply with Code Section 409A, related regulations or other guidance, and the Plan and any such award shall, to the extent practicable, be construed in accordance therewith. Deferrals of shares or cash distributable pursuant to the Plan in a manner that would cause Code Section 409A to apply shall not be permitted. Without in any way limiting the effect of the foregoing, in the event that Code Section 409A, related regulations or other guidance require that any special terms, provisions or conditions be included in the Plan or any award, then such terms, provisions and conditions shall, to the extent practicable, be deemed to be made a part of the Plan or award, as applicable. Further, in the event that the Plan or any award shall be deemed not to comply with Code Section 409A or any related regulations or other guidance, then neither the Corporation, the Board nor its or their designees or agents shall be liable to any participant or other person for actions, decisions or determinations made in good faith.

G. Applicable Law

The Plan shall be governed by and construed in accordance with the laws of the State of North Carolina, without regard to the conflicts of laws provisions of any state, and in accordance with applicable federal laws of the United States.

H. Amendment and Termination of the Plan

The Plan and any award may be amended or terminated at any time by the Board or the Committee. No action to amend or terminate the Plan or an award shall permit the acceleration of the time or schedule or any payment of amounts deemed to involve the deferral of compensation under Code Section 409A, except as may be otherwise permitted under Section 409A, related regulations or other guidance.

Without limiting the effect of this Section III.H., the Board shall have unilateral authority to amend the Plan and any award (without participant consent) to the extent necessary to comply with applicable laws, rules or regulations or changes to applicable laws, rules or regulations (including but not limited to Code Section 409A, federal securities laws or related regulations or other guidance).

I. No Right or Obligation of Continued Employment

Nothing contained in the Plan shall require the Corporation or a related corporation to continue the employment or service of an employee, nor shall any such individual be required to remain in the employment or service of the Corporation or a related corporation. Except as otherwise provided in the Plan (or 2008 Plan, if applicable), all rights of a participant with respect to any award shall terminate upon the participant's termination of employment or service with the Corporation.

J. Compliance with Laws

The Board may impose such restrictions on any shares or other payments or awards hereunder as it may deem advisable, including without limitation restrictions under the Securities Act of 1933, as amended (the "Securities Act"), under the requirements of any stock exchange or similar organization and under any blue sky, state or foreign securities laws applicable to such shares. Notwithstanding any other Plan provision to the contrary, the Corporation shall not be obligated to issue, deliver or transfer shares of common stock under the Plan, make any other distribution of benefits under the Plan or take any other action, unless such delivery, distribution or action is in compliance with all applicable laws, rules and regulations (including but not limited to the requirements of the Securities Act). The Corporation may cause a restrictive legend to be placed on any certificate issued hereunder in such form as may be prescribed from time to time by applicable laws and regulations or as may be advised by legal counsel.

K. Unfunded Plan; No Effect on Other Plans

The Plan shall be unfunded, and the Corporation shall not be required to create a trust or segregate any assets that may at any time be represented by awards under the Plan. The Plan shall not establish any fiduciary relationship between the Corporation and any employee or other person. Neither an employee nor any other person shall, by reason of the Plan, acquire any right in or title to any assets, funds or property of the Corporation or any related corporation, including, without limitation, any specific funds, assets or other property that the Corporation or any related corporation, in their discretion, may set aside in anticipation of a liability under the Plan. A participant shall have only a contractual right to the common stock or other amounts, if any, payable under the Plan, unsecured by any assets of the Corporation or any related corporation. Nothing contained in the Plan shall constitute a guarantee that the assets of such entities shall be sufficient to pay any benefits to any person.

The amount of any compensation deemed to be received by a participant pursuant to an award shall not constitute compensation with respect to which any other employee benefits of such participant are determined, including, without limitation, benefits under any bonus, pension, profit sharing, life insurance or salary continuation plan, except as otherwise specifically provided by the terms of such plan or as may be determined by the Board or Committee.

The adoption of the Plan shall not affect any other compensation plans in effect for the Corporation or any related corporation, nor shall the Plan preclude the Corporation from establishing any other forms of compensation for employees or service providers of the Corporation or any related corporation.

L. Withholding; Tax Matters

The Corporation shall withhold, or shall require the participant to pay the Corporation in cash, the amount of any local, state, federal, foreign or other tax or other amount required by any governmental authority to be withheld and paid over by the Corporation to such authority for the account of the participant.

The Corporation makes no warranties or representations with respect to the tax consequences (including but not limited to, income tax consequences) related to the transactions contemplated by this Plan. A participant should consult with his/her own attorney, accountant, and/or tax advisor regarding the decision to participate in the Plan and the consequences thereof. The Corporation has no responsibility to take or refrain from taking any actions in order to achieve a certain tax result for any participant.

Exhibit 10.4

[Cree, Inc. Letterhead]

September 5, 2013

Mr. Randy N. McCullough
Chief Executive Officer
Charles & Colvard, Ltd.
300 Perimeter Park, Suite A
Morrisville, North Carolina 27560

Dear Randy:

This document (the "Second Amendment") serves as an amendment to the letter agreement between Charles & Colvard, Ltd. ("C&C") and Cree, Inc. ("Cree") dated March 22, 2010 (the "2010 Agreement") and previously amended by the letter dated February 1, 2013 (the "First Amendment") (collectively, the "Letter Agreement"). Except as expressly set forth in the Letter Agreement, as modified herein, the supply and purchase of SiC Materials will be governed in all respects by the terms and conditions of the parties' Amended and Restated Exclusive Supply Agreement dated June 6, 1997 (the "Supply Agreement," as amended). Capitalized terms used herein which are not defined herein shall have the meanings specified in the Letter Agreement or the Supply Agreement, as the case may be.

1. Cree will supply SiC production crystals to C&C, and C&C will purchase SiC production crystals from Cree, according to the terms stated in the Letter Agreement, as modified herein.

2. Cree will provide 1.5" SiC production crystals for sale to C&C for $$[****]/gram for Grade 10 and $[****]/gram for Grade 20. Cree may fulfill C&C's outstanding purchase orders [****] as agreed. All delivered orders [****] will be applied toward C&C's outstanding purchase orders [****] and its New Order requirements in paragraph 2 of the First Amendment. The quantity of "usable material" in 1.5" crystals delivered to C&C pursuant to the Letter Agreement will be graded according to the specifications in Attachment A of the 2010 Agreement.

The contents of this Second Amendment will be considered "Confidential Information" of each parry subject to the provisions of Section 5 of the Supply Agreement. No amendment or modification of this Second Amendment or the Letter Agreement shall be effective unless reduced to writing and executed by an authorized representative of each party hereto. Except as modified by this Second Amendment, the Letter Agreement and the Supply Agreement shall remain in full force and effect in accordance with their terms and conditions.

If the foregoing terms and conditions meet with your approval, please execute this Second Amendment where indicated below and return a signed copy to my attention via fax at (919) [****] or via email at [****].

Regards,

/s/ David T. Emerson
David T. Emerson
Vice President – Chips and Materials

AGREED AND ACCEPTED BY:
CHARLES & COLVARD, LTD.

By: /s/ Randy N. McCullough
Randy N. McCullough, CEO

[****] Confidential treatment requested pursuant to a request for confidential treatment filed with the Securities and Exchange Commission. Omitted portions have been separately filed with the Commission.

Exhibit 31.1

**CERTIFICATION PURSUANT TO SECURITIES AND EXCHANGE ACT OF 1934
RULE 13a-14(a) AS ADOPTED PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, Randy N. McCullough, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2013 of Charles & Colvard, Ltd.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

	By:	/s/ Randy N. McCullough
October 31, 2013		Randy N. McCullough
		President and Chief Executive Officer

Exhibit 31.2

**CERTIFICATION PURSUANT TO SECURITIES AND EXCHANGE ACT OF 1934
RULE 13a-14(a) AS ADOPTED PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, Kyle Macemore, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2013 of Charles & Colvard, Ltd.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ Kyle Macemore

October 31, 2013

Kyle Macemore
Senior Vice President and Chief Financial Officer

Exhibit 32.1

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Charles & Colvard, Ltd. (the “Company”) on Form 10-Q for the quarterly period ended September 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Randy N. McCullough, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

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

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

/s/ Randy N. McCullough
Randy N. McCullough
President and Chief Executive Officer
October 31, 2013

This Certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and shall not be deemed “filed” by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and shall not be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Report, irrespective of any general incorporation language contained in such filing.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Charles & Colvard, Ltd. (the “Company”) on Form 10-Q for the quarterly period ended September 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Kyle Macemore, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

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

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

/s/ Kyle Macemore
Kyle Macemore
Senior Vice President and Chief Financial Officer
October 31, 2013

This Certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and shall not be deemed “filed” by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and shall not be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Report, irrespective of any general incorporation language contained in such filing.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.