

CHARLES & COLVARD LTD  
Form 10-Q  
May 14, 2012

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-23329

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

North Carolina  
(State or other jurisdiction of  
incorporation or organization)

56-1928817  
(I.R.S. Employer  
Identification No.)

300 Perimeter Park Drive, Suite A  
Morrisville, North Carolina  
(Address of principal executive offices)

27560  
(Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

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any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer (Do not check if a smaller reporting company)	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>

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

As of May 9, 2012, there were approximately 19,528,879 shares of the registrant's common stock, no par value per share, outstanding.

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CHARLES & COLVARD, LTD.

FORM 10-Q

For the Quarterly Period Ended March 31, 2012

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

CHARLES & COLVARD, LTD.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(unaudited)

	March 31, 2012	December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$6,836,283	\$6,701,701
Accounts receivable, net	5,942,003	6,064,764
Interest receivable	14,412	12,109
Inventory, net	7,202,319	6,849,592
Prepaid expenses and other assets	439,518	419,729
Total current assets	20,434,535	20,047,895
Long-term assets:		
Held-to-maturity investments	3,759,076	3,760,399
Inventory, net	27,360,983	28,157,497
Property and equipment, net	1,670,555	1,420,971
Intangible assets, net	238,098	248,812
Other assets	13,116	13,746
Total long-term assets	33,041,828	33,601,425
<b>TOTAL ASSETS</b>	<b>\$53,476,363</b>	<b>\$53,649,320</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$1,567,508	\$1,060,937
Accrued cooperative advertising	150,000	213,000
Accrued expenses and other liabilities	305,651	581,009
Total current liabilities	2,023,159	1,854,946
Long-term liabilities:		
Accrued income taxes	380,447	741,645
Total liabilities	2,403,606	2,596,591
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value	53,236,809	52,833,716
Additional paid-in capital – stock-based compensation	7,760,658	7,767,877
Accumulated deficit	(9,924,710)	(9,548,864)
Total shareholders' equity	51,072,757	51,052,729
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$53,476,363</b>	<b>\$53,649,320</b>

See Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2012	2011
Net sales	\$4,178,385	\$2,977,556
Costs and expenses:		
Cost of goods sold	2,027,686	1,328,521
Sales and marketing	1,501,921	681,285
General and administrative	1,357,172	1,184,972
Research and development	8,408	12,548
Total costs and expenses	4,895,187	3,207,326
Loss from operations	(716,802 )	(229,770 )
Other income (expense):		
Interest income	23,865	17,919
Interest expense	(477 )	(12 )
Loss on call of long-term investments	-	(2,913 )
Total other income	23,388	14,994
Loss before income taxes	(693,414 )	(214,776 )
Income tax net benefit (expense)	317,568	(21,612 )
Net loss	\$(375,846 )	\$(236,388 )
Net loss per common share:		
Basic	\$(0.02 )	\$(0.01 )
Fully diluted	\$(0.02 )	\$(0.01 )
Weighted average number of shares used in computing net loss per common share:		
Basic	19,470,511	19,297,861
Fully diluted	19,470,511	19,297,861

See Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$(375,846 )	\$(236,388 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	116,600	42,439
Amortization of bond premium	1,323	1,165
Stock-based compensation	289,409	219,343
Provision for uncollectible accounts	151,952	29,000
Provision for sales returns	(42,000 )	(76,000 )
Provision for inventory reserves	(46,000 )	21,000
Loss on call of long-term investments	-	2,913
Changes in assets and liabilities:		
Accounts receivable	12,809	(287,508 )
Interest receivable	(2,303 )	(5,626 )
Income tax receivable	-	113,030
Inventory	489,787	578,489
Prepaid expenses and other assets, net	(19,159 )	35,316
Accounts payable	506,571	145,821
Accrued cooperative advertising	(63,000 )	5,000
Accrued income taxes	(361,198 )	21,611
Other accrued liabilities	(275,358 )	(118,585 )
Net cash provided by operating activities	383,587	491,020
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(351,793 )	(271,035 )
Purchases of long-term investments	-	(495,625 )
Proceeds from call of long-term investments	-	500,000
Patent, license rights, and trademark costs	(3,677 )	(6,435 )
Net cash used in investing activities	(355,470 )	(273,095 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Stock option exercises	106,465	19,162
Net cash provided by financing activities	106,465	19,162
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>134,582</b>	<b>237,087</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>6,701,701</b>	<b>7,736,044</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$6,836,283</b>	<b>\$7,973,131</b>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$477	\$12
Cash paid during the year for income taxes	\$11,800	\$-

See Notes to Condensed Consolidated Financial Statements.



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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) and finished jewelry featuring moissanite 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 condensed consolidated financial statements included in this Quarterly Report on Form 10-Q have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information. However, certain information or footnote disclosures normally included in complete financial statements prepared in accordance with U.S. GAAP have been condensed, or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). In the opinion of the Company’s management, the unaudited statements in this Quarterly Report on Form 10-Q include all normal and recurring adjustments necessary for the fair statement of the results for the interim periods presented. The results for the three months ended March 31, 2012 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2012.

The condensed consolidated financial statements as of and for the three months ended March 31, 2012 and 2011 included in this Quarterly Report on Form 10-Q are unaudited. The balance sheet as of December 31, 2011 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, 2011 filed with the SEC on March 29, 2012 (the “2011 Annual Report”).

The accompanying condensed consolidated financial statements as of and for the three months ended March 31, 2012 and 2011 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 months ended March 31, 2012 are consistent with those used for the year ended December 31, 2011. Accordingly, please refer to the 2011 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.

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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 decisions and assessing performance as the source of the Company’s operating and reportable segments.

The Company manages its business primarily by its product lines. Accordingly, the Company determined its two operating and reporting segments to be loose jewels and finished jewelry. 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 2011 Annual Report.

The Company evaluates the performance of its segments based on net sales and segment gross profit, or the excess of product sales over segment cost of goods sold. Segment cost of goods sold is defined as product cost of goods sold excluding non-capitalized expenses from the Company’s manufacturing and production control departments, comprising personnel costs, depreciation, rent, utilities, and corporate overhead allocations; freight out; inventory valuation allowance adjustments; and other inventory adjustments, comprising costs of quality issues, damaged goods, and inventory writeoffs. Accordingly, also excluded from the Company’s segment performance measures are operating expenses, comprising sales and marketing, general and administrative, and research and development expenses; interest; and taxes.

Summary information by segment is as follows:

	Three Months Ended March 31,	
	2012	2011
<b>Loose jewels</b>		
Net sales	\$2,458,321	\$2,567,153
Segment cost of goods sold	811,613	854,311
Segment gross profit	\$1,646,708	\$1,712,842
<b>Finished jewelry</b>		
Net sales	\$1,720,064	\$410,403
Segment cost of goods sold	761,173	245,362
Segment gross profit	\$958,891	\$165,041

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

	Three Months Ended March 31,	
	2012	2011
Segment cost of goods sold	\$1,572,786	\$1,099,673
Non-capitalized manufacturing and production control expenses	406,129	155,929
Freight out	17,383	19,391
Inventory valuation allowances	(46,000 )	21,000

Other inventory adjustments	77,388	32,528
Cost of goods sold	\$2,027,686	\$1,328,521

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The Company's net inventories by segment are as follows:

	March 31, 2012	December 31, 2011
Loose jewels		
Raw materials	\$3,710,269	\$6,047,047
Work-in-process	4,341,866	2,505,219
Finished goods	21,534,978	21,722,869
Finished goods on consignment	560,955	505,753
Totals	\$30,148,068	\$30,780,888
Finished jewelry		
Raw materials	\$249,737	\$226,972
Work-in-process	203,710	85,786
Finished goods	3,601,370	3,292,810
Finished goods on consignment	249,941	499,577
Totals	\$4,304,758	\$4,105,145

Supplies inventories of approximately \$110,000 and \$121,000 at March 31, 2012 and December 31, 2011, respectively, included in finished goods inventories in the consolidated financial statements are omitted from inventories by segment 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 sales represents products sold internationally that may be re-imported to United States ("U.S.") retailers. The following presents certain data by geographic area:

Three Months Ended March 31,