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THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

C3, Inc. (CTHR)



CEO INTERVIEW: JEFF N. HUNTER

JEFF N. HUNTER is Chairman and Chief Executive Officer of C3, Inc., a North Carolina based company that develops and markets lab-created moissanite gemstones. He was formerly Director of Business, Finance & Research Administration for the College of Engineering at North Carolina State University, where the technology was developed for making large single crystals of lab-grown moissanite. A frequent public speaker, Jeff has made presentations about lab-created moissanite gemstones to many jewelry industry groups including ISA, ASA, GIA Alumni Association Chapters, plus other interested audiences throughout the United States, Asia and Europe.

Company Description

(FAJ625)(12541)TWST: Give us a background summary on C3?

Mr. Hunter: C3 was founded over three years ago to commercialize a chemical compound used in the semiconductor industry called silicon carbide, as a new, unique gemstone in the jewelry industry. Silicon carbide, or the mineral name, moissanite, has characteristics and physical properties closer to diamonds than any other gemstone material. Dr. Henri Moissan, a French scientist, and a Nobel Prize winner found Moissanite in the 1890s in a meteorite. In nature, moissanite is so rare that only through advances in science over the past five years have we been able to produce it in a quality that would be used in jewelry.

Through an exclusive supply agreement, we buy our raw material—large single crystals of silicon carbide — from a semiconductor company in North Carolina, Cree Research (NASDAQ NM: CREE). They've been in business since 1987 and have patents on the process they use to grow these large crystals. Cree has about a 94 percent share of the worldwide market for large, single crystals of silicon carbide. The exclusivity for moissanite does not end there. C3 has two patents on silicon carbide gemstones: the first is a product patent and another is a process patent. These two patents give C3 broad, exclusive rights in the United States to use, manufacture, and sell moissanite gemstones. We have filed foreign patent applications as well.

Why is moissanite such an ideal gemstone material? Moissanite has brilliance and fire (fire is the spectrum or rainbow of colors that you see when looking at a prism) and it is a very hard gemstone material—that means it is resistant to scratching, second only to diamond, which is the hardest material in the world. And because it is exclusive, then consumers and jewelers see value in moissanite. Which leads me to the potential market for this product. The global jewelry industry is about \$90 billion a year. In the United States, just to give you an example, the value at retail of diamond jewelry sold last year is in the \$18-\$19 billion range. To put that in perspective, more than 30 million pieces of diamond jewelry were sold in the United States last year. I use diamonds for this example because, when consumers see moissanite gemstones in jewelry (moissanite has been on the market in selected areas of the southeast since June) they tend to think diamond because of the fire, brilliance and light reflecting from it. We consider the diamond industry as one of our primary competitors. In summary we have a superior product, in a huge existing market, with strong barriers to entry against competition.

Key Trends

TWST: Give us an idea of what the trends or issues are within the jewelry marketplace that would allow you to position a new corner?

Mr. Hunter: If you look at diamond prices over the past 20 years, the miner quality stones have increased in value nearly every year. These prices range from \$5,000 to \$10,000 for a good quality one-carat diamond sold at retail. Fine quality diamonds represent the high end of the gemstone marketplace and prices are expected to continue to rise. On the low end for mass merchandisers, cubic zirconia has been sold in large quantities as a diamond substitute in the \$25 to \$100 range for a one-carat stone at retail. Because there are no barriers to entry, cubic zirconia jewelry will likely stay at current levels and even lower.

We see an opportunity to position moissanite gemstones in the high end of what is called the bridge jewelry market. That's the bridge between costume jewelry, which is typically gold plated, and that jewelry used for fine gemstones like 14 to 18 karat gold and platinum. The typical range for the bridge jewelry market is \$400 to \$1000 at retail. This is the market segment that we believe is ideal for moissanite gemstones. This positioning has been confirmed by fairly extensive market research. Our target consumer is a sub-set of working women, ages 25-54, who based on a recent nationwide study, will pay more for moissanite jewelry if it is positioned as a unique gemstone and sold in mid to high-end jewelry stores as opposed to chains or mass merchandisers.

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Marketing

TWST: How do you propose to reach that marketplace? What are the marketing and distribution strategies? And what element of brand name do you feel you can achieve?

Mr. Hunter: First lets look at distribution channels. From early on, we recognized the opportunity for exclusivity and that the one group in the United States that could gain substantial value from such a product is independent jewelers (including single stores and small chains). The stores in these categories represented nearly 38 percent of the dollar volume, of jewelry products sold in the United States in 1997. We have found that stores owned by individuals who understand the value of geographic exclusivity with a product like moissanite that has superior characteristics then the level of enthusiasm, interest and support for positioning the product and selling it is much greater. We have found this distribution strategy to be on target for the U.S. In July, we released moissanite gemstones in Miami and Atlanta with fairly substantial marketing support. We identified the Southeast as our first major supported area. We are also testing different advertising and pricing

mixes outside of the Southeast, which includes California, Texas, the Northeast and several locations in the Midwest. To date we have more than 30 retail locations selling moissanite and we expect by the end of this year to be selling the product in approximately 100 stores. We are selling the loose moissanite gemstones directly to these independent jewelers. They, in turn, set the stones in jewelry. We are creating an opportunity for the independent jeweler to make a lot of money. Based on what we have seen to date, they are doing it.

TWST: Trying to establish a marketplace with branding and with the other abilities to leverage that branding provides in this retail marketplace today, how are you utilizing that within your strategy?

Mr. Hunter: Brand equity is very, very important to us. It's one of the reasons that we are partnering with DDB Needham in Dallas, a subsidiary of DDB Needham Worldwide. DDB has been charged with the responsibility to take us from a Southeastern U.S. known product to one recognized around the world.

We are trying to establish brand recognition by sending one message to jewelers and consumers—moissanite is a unique new gemstone that has beauty, brilliance, fire and exclusivity. Moissanite advertising is geared toward working women and C3 is providing authorized dealers (selected retail jewelers) a variety of support materials including in-store point-of-sale materials. We are in the process of creating videos to train the sales staff in the stores, so that the message is consistent from store to store. Our Web Site is consistent with our advertising and marketing themes to consumers. We want to convey one simple message regardless of the advertising vehicle used—radio, newsprint, magazines, etc.

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TWST: Over the next year or two, what are the specific accomplishments that you feel are necessary in order for that time frame to be deemed a success for your company? What are the goals that you have on your agenda?

Mr. Hunter: There are really four primary goals over the next year or so. The first one is to continue to invest in the infrastructure and I define infrastructure as the systems marketing and the people for a much larger company.

The second is to focus on increasing the supply of raw material from which we can create these gemstones and to drive that manufacturing cost much lower. So supply is the second issue. Building brand awareness and consumer appeal for moissanite.

Third, finally, and this is definitely the most important goal, is to

grow domestic and international sales. I didn't mention international distribution. Our channels there are somewhat different; we sell through wholesalers and distributors. They again have an exclusive territory in one country or a few countries, and our cost of sales is much lower because we're selling volume and we're providing limited marketing support.

By moving forward and meeting these goals we expect to be a successful business.

Management

TWST: Give us a brief summary and a frank assessment of top management? What are the skill sets? What are the strengths that you have on your management team, and what, if any, changes or additions would you anticipate over the next year or two?

Mr. Hunter: Let me start with the key players. As part of our infrastructure development, we brought on a couple of additions in the last four or five months. One person was President and Chief Operating Officer. His name is Robert Thomas. He has extensive experience — more than 15 years experience — in managing operating companies. He was formerly President of a public company, not in the jewelry industry but in the food products, specifically in peanuts, and he has the kind of experience that can help grow the company very rapidly. One of his areas of expertise is in sales.

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We also were fortunate to recruit Dr. Mark Kellum, who is our Director of Technology. He is a scientist specializing in optical properties of materials, very important to us when it comes to the supply of high quality material for producing these gemstones. He also has more than 10 years experience in semiconductor manufacturing. And a lot of what we do in the manufacturing process of creating these gemstones requires equipment and technology that's similar to what you might find in a semiconductor environment.

Our Director of Manufacturing is Earl Hines, who is an ex-IBMer; he was a manufacturing manager there and retired. He also has about 10 years of experience in the jewelry industry, ran his own company, and is perfectly suited to help us apply the manufacturing technology required for moissanite gemstones.

Rene McCullen is the Director of Sales. She's been in the domestic jewelry business for more than 13 years. We also have supporting her a number of people who have broad international sales experience; of course, we have people on staff that speak anywhere from five to six different foreign languages, which is a real asset.

On the marketing side, we're relying primarily on our relationship with DDB Needham, and also we have a few staff in-house that have a marketing background.

Our Chief Financial Officer, Mark Hahn, he came to us from Ernst & Young where he worked with companies over a 12-year period in emerging growth activities. He has already had experience taking a number of companies public and helping them grow; supporting them in their finance and accounting needs.

Finally, for myself, I've been with the company since day one. I came from North Carolina State University, the university locally here, where the technology was created many years ago from which first Cree Research and now C3 evolved.

My role is more external. I spend a great deal of time on the road. My strengths lie in building relationships with our customers, with others that are influential in our industry, and with people in the investment community.

The strengths that the management team has, in particular, Bob Thomas on the operating level, and in communications with investors and shareholders—in the last few months we've moved to being very frank and open in what we share with investors so that they understand both the tremendous potential as well as the challenges facing C3.

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TWST: As the top manager, what are the basic business principles you have developed? What do you rely on as you set goals and standards? What are the distilled ABCs of business according to Jeff Hunter?

Mr. Hunter: The number one focus is "How do we best serve the customer?" That's the bottom line. Because if the customer is served well, then we believe we have a viable business (this assumes, of course that moissanite is selling at price where we are able to create earnings over time). So, number one, serving the customer.

Number two is, really, communicating our vision, not only internally, but externally, for our product so that not only do our customers, but consumers, our employees, as well as Wall Street understands what moissanite gemstones are, how this product is selling, how we are trying to position it and what's our vision for the future.

Third, is controlling costs.

Valuation

TWST: At this point, what level of equity ownership is there within the management team and within the Board of Directors or other principal investors? Shareholders and investors always want to know how the rewards and incentives for that management team are related to shareholder value. What structures do you have in place and how are the equities shared at this point?

Mr. Hunter: The management team and directors own about 10 percent. There are several major shareholders — two in particular — that together would be approximately 25 percent. From day one we have focused incentives for long-term growth and success of the company to create the greatest value for the shareholders. That means we hoard cash and we pay on performance based through primarily stock options. All employees have stock options in C3.

"We have a superior gemstone product with substantial proprietary strengths in patent positions and the exclusive supply agreement with Cree Research."

TWST: For investors, as they review your financial statements and look at the other reports and statements from your company over the next year or two, what would you suggest they focus on as far as key items or key sets of information? What will you be looking at outside of the traditional revenue and earnings matrix?

Mr. Hunter: One of the keys, as I mentioned earlier, is supply, is the growth of product, and growth of our capabilities to produce more product and get it out in the marketplace. That's the supply side.

The second would be looking at expansion of our distribution. I think a key metric is, when do you begin national advertising? When will I see a retailer in my area selling this product? So the three things I've mentioned are growth in supply, broader distribution, and national advertising.

TWST: At this point, how could the investment community improve its perception or its understanding of the company? Do you feel there are difficulties in assembling a peer group? What are the insights that you would ask investors to focus on?

Mr. Hunter: One of the challenges is that this is a rather unique company and it's hard to pigeon hole us because of the kind of product we have. We're really not a jewelry company because of the ties to technology in the semiconductor industry. On the other hand, if you look at the fact that today our product is going to be sold primarily in the jewelry industry it creates further challenges. There are some difficulties of assembling a peer group as a result. Probably the best way for the investment community to better understand is to walk into one of the exclusive stores selling moissanite, look at the way moissanite is being merchandised and talk to the owner. And one of the challenges we faced is that there is, I guess, a higher percentage of men in the investment community — I don't know what the percentages are. Men do not seem to have a strong understanding of the jewelry industry in general. There's a tendency sometimes for men to think that diamonds are sold in engagement rings. And of that 30 million pieces of diamond jewelry that I mentioned that are sold very year the vast majority are not engagement

rings; they represent around I believe, 25 percent. So there are some assumptions out there, primarily I think because of a lot of advertising that men are hit with by DeBeers and through their own experiences.

And so, part of what we've tried to do, and we need to do a better job of it, is to try and demonstrate how large that industry is, what a small segment of the market we would need in order to be a fairly substantial business. And, I think, again, seeing the product being sold in these exclusive stores and seeing further distribution of the product throughout the United States will help. But that first hand experience, I think, is a real significant eye-opener.

TWST: Do you find that there is a difficulty in distinguishing the commodity analogy for this business with the retail part of the business that you are representing?

Mr. Hunter: There has been that challenge because there's a tendency for some people to position moissanite with cubic zirconia which is just a commodity product, and fashion jewelry is, in general, sometimes viewed as a commodity product. However, because there's limited supply of moissanite, and because we're hitting a price point that is very attractive, at least it has been to date since we've started selling in the last couple of months, the price point has been very attractive for consumers. There really hasn't been any question about spending \$500-\$600-\$700 per carat. And this is true from, again, Miami to California in our various locations.

TWST: What is the essential message, the summary statement, you would give to investors, both individual and institutional, as they look at C3 over the next two to three years? What are the highlights and strengths that will distinguish C3 as an investment today?

Mr. Hunter: The strengths are a unique and exclusive product that consumers are interested in purchasing in reasonably large volumes, and that there is a void in this marketplace that we're going after in that \$300-\$400 up to \$1,000-\$1,200 range, and we see we have the product to fill that avenue.

What investors are going to see over time is — in that two to three year period — growth in the volume of stones that are sold; tremendous focus on driving the cost of manufacturing down; an increase in gross margins, is obviously what we're after; and a substantial international presence. We have a superior gemstone product with substantial proprietary strengths in patent positions and the exclusive supply agreement with Cree Research.

What this means is, a company that has the potential for huge growth in the next two to three years. It's growth top and bottom line. □

TWST: Thank you.

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