FIRST QUARTER 2013 INVESTOR WEBCAST

May 8, 2013

Prepared Remarks

Steve Somers, Investor Relations: Good afternoon and let me welcome you to Rosetta Stone's first quarter 2013 earnings call. I am Steve Somers, Vice President of Corporate Development and Investor Relations and I am joined today by Steve Swad, Rosetta Stone's President and CEO, and Tom Pierno, our CFO, to discuss the operations and financial results for the first quarter and our outlook.

In addition to our commentary, we have made our 1Q13 Earnings Results press release, and a slide deck supporting this webcast available on our IR website at investors.rosettastone.com. Please review them to find important additional information.

[Safe Harbor]

There are or will be forward-looking statements in our press release, slides and conversation today. We offer these statements under the Safe Harbor provided by U.S. law. Of course, risks and uncertainties attach to any forward-looking statement. A detailed discussion of such risks and uncertainties is contained in our Form 10-K for the fiscal year ended December 31, 2012 filed with the SEC in March 2013, which is available in the Investor Relations section of our website. We ask that you review those risk factors before making any investment decision. Please note these forward-looking statements reflect our opinions only as of the date of this presentation and we undertake no obligation to provide or publicly release the results of any revision to the forward-looking statements in light of new information or future events.

We also use non-GAAP numbers in our presentation. The definitions of those numbers, and their reconciliation to GAAP numbers, are available in today's press release on our website and as filed with the SEC today on Form 8-K.

Now here's Steve.

Steve Swad, Chief Executive Officer:

Thanks Steve and welcome everyone.

[First Quarter Overview]

As we have previously laid out, our strategy is to Leverage the Rosetta Stone brand by bringing new products into the fold, to Innovate the Platform by bringing social and mobile to our product suite and to Expand Distribution. During Q1 we played more offense in regards to executing this strategy. In particular, we meaningfully invested in product and platform while still delivering growth in Adjusted EBITDA. We also continued our shift towards a more digital business model, we launched a couple of new mobile apps and we also pushed further into the cloud by acquiring Livemocha. Let me address each of these strategic initiatives.

With respect to product, we made very significant strides to broaden our experience and skill-base to accelerate new product development and future growth. We opened new offices in Austin and San Francisco to tap into the talent pool in those locations and at the same time reduced approximately 70 product positions in our Virginia locations. In a short period of time, we launched a handful of new products that are targeted at mobile customers. In April we launched a new Android app that offers a free taste of our product and drives customers to trial and then purchase. In less than 3 weeks, with no advertising or marketing, it has over 50k downloads and a five star rating. The app engages customers and is driving customers to the Rosetta Stone website where they subsequently are purchasing our core TOTALe product. Similarly, we recently soft-launched a suite of free travel apps, called Rosetta Stone Navigator series, in Apple's App store. These too are getting traction, further exposing our brand and products to potential customers. While these are not game changers, the products will tap into the power of the massive iOS and Android ecosystems and enable many more people to interact with our brand, which will generate leads and ultimately sales. Over time, we expect this type of activity will become a way of attracting customers for trial and conversion, lessening our need for traditional TV and print advertising.

We also made further progress in shifting the channel distribution in our Consumer business. Our focus on digital products and distribution over the past 18 months led to our decision to shutter our remaining U.S. kiosks early last month. With that initiative now complete, we are re-deploying resources to invest in more profitable channels such as our key North American DTC and retail channels, which together saw mid-single digit growth in the quarter. In addition, Online Learners and digital downloads now make up approximately 20% of Consumer Revenues versus only 5% a year ago.

Another key development since our last call was that we acquired Livemocha. This acquisition provides Rosetta Stone with a sophisticated, extensible and cloud-based technology platform, which will allow us to modernize our existing products and accelerate our digital transformation and migration to downloadable, mobile, and cloud based products. It also gives us a foundation from which we can rapidly develop all of our new products. Livemocha brings with it an international community of over 16MM members and provides us with much broader global reach and an engaged community of learners in Latin America, Asia and Eastern Europe. With this extended consumer base, we plan to offer a tiered series of learning products and services, from low-priced, more simplistic offerings up to higher-end, more sophisticated ones and therefore address more customer needs and price points along the demand curve.

From a bookings perspective, I'm seeing growth in 2 of our 3 segments after adjusting for comparability and actions related to the transformation of the business. Specifically, in North American Consumer, we saw mid-single-digit year-over-year growth excluding the low-margin kiosk channel, which we have wound down. In the Institutional segment, bookings grew at high single-digit rates in the quarter after excluding sales of one-time network product, which we have de-emphasized as we move that business to a cloud–based, recurring business. Growth in both North American Consumer and Institutional are consistent with what we've said previously and underscore our confidence that we are making progress and can deliver growth this year. Our Rest of World Consumer business, however, continues to show shrinkage, down more than 25% in the quarter, even after adjusting for the absence of box product sales in Germany a year ago, with most of that decline coming from Japan. During 1Q, to help stabilize our Japan business we hired a new country manager and engaged specialized market consultants. This has led to us recently adopting a new go-to-market strategy for Japan that alters our target consumer group and improves our value proposition by reducing our price, changing our message and shifting the focus of our communications. We are also tightening up our deployment of capital until this focused approach shows consistent signs of progress. Korea and Europe also were softer than expected in the quarter, but not to the degree seen in Japan. We have developed tactical initiatives to improve those markets through the rest of the year and we are beginning to see revenue from our new proctor channel in Korea take hold.

In terms of the net results, I was pleased by the growth in Adjusted EBITDA and improvements in Adjusted EBITDA margin. We accomplished this while also investing substantially in Product development, which will drive future growth.

In terms of our shift to digital, we continued to make progress on this front. As I mentioned, we are already selling 95% online in our Institutional business. On the Consumer side, we again grew Online Learners by nearly triple-digits to over 80,000. Digital downloads, which we just introduced late in the fourth quarter, represented almost 10% of product units in 1Q. Together Online Learners and digital downloads make up 20% of total Consumer Revenues versus 5% a year ago.

As far as where we are in terms of our plans to reach the 2013 and beyond objectives, I feel that the first quarter confirmed that we are making the right moves and we are on the right path. We will have to start to deliver more growth on the top line now that we have largely shifted away from the slower growth products and channels. That growth is going to come from new products, better distribution, and acceleration of the strategy through acquisition. In 2013, we are still expecting single-digit growth from our core North American Consumer segment and we still anticipate low double-digit Institutional bookings growth with all of this growth coming towards the second half of the year, when the comp hurdle from de-emphasized network sales dissipates. That being said, we are still expecting bookings and revenue to increase beginning in 2Q.

Now let me turn the call over to Tom.

Tom Pierno, CFO:

[Review of results]

Thanks Steve and good afternoon everyone. Financial performance in the first quarter continues to move in the direction that we have set out as we again delivered incremental improvements in our results, particularly in Adjusted EBITDA and margin.

Total company bookings in the quarter decreased 8% to $60.4MM. However, as Steve mentioned, several factors related to business model changes and shifts in our channel mix are affecting comparisons to last year. For example, within our North America Consumer segment, DTC and Retail were up over 5% year-over-year; however, total bookings were off 1% to $41.3MM. The decline in N.A. Consumer was due to decreases in the homeschool and kiosk channels which are being de-emphasized or phased out. We expect that these changes will continue to impact year-on-year comparisons for the remainder of 2013.

On the international side, our Rest of World (“ROW”) Consumer segment declined by $4.2 million or 34%. Bookings were down in all geographies, with Japan driving almost half of the decrease in the segment. Because we moved our business in Germany to online-only in 1Q12, the absence of hard-product sales in Germany had a $1.2MM impact on the year-over-year comparison. Beginning with the second quarter, our German business will no longer have this comp issue. In fact, since going to only online in Germany last year, we have grown our online and digital download business there almost back to pre-transition levels, reflecting consumer acceptance and acclimation to our new model. We continue to work on each of our three key international consumer regions (Korea, Japan, and Europe) with new management and tactics, but also with an eye on limiting the amount of capital being deployed in these areas.

Overall, Consumer product units sold declined 1% to 142k units in the first quarter, while average revenue per unit or ARPU decreased 15% to $312 from $367. This decrease reflects the impact of promotional pricing in the quarter, as well as channel mix shift with more sales coming from online offers through daily deal partners like Groupon and Amazon and fewer units from the higher ARPU, but lower margin, kiosk channel.

In terms of Online Learners, we once again grew at high rates, up 95% to over 80,000 Paid Online Learners at the end of the quarter. These Paid Online Learners had monthly ARPU of $26, down from $28 a year ago but up from the last two quarters. The decline in monthly ARPU is primarily a function of an increasing mix of 12-month access versus very high-priced, but low volume legacy subscriptions that we had been testing and offering and not as a result of price discounting. In general, the lifetime revenue of an Online Learner is roughly the same as that of a purchase of the box at about $300. Of the $50MM of Consumer revenue that we recorded, approximately 20% now comes from Paid Online Learners and digital downloads compared to just 5% a year ago

Turning to our Institutional segment, bookings were down 2% in the quarter to $10.8MM, but our subscription service grew at high single digit rates as last year's first quarter included over $1MM of installed network product sales, mostly into the K-12 vertical; we still have one more quarter where comps will be affected by network product sales in the year-ago period. Growth came primarily from our international markets with Korea and Japan, as well as Brazil, all showing healthy increases.

Looking at the Income Statement, there were a couple of key themes in the quarter that I want to discuss. The first is that the ongoing transition to more online and digital continues to deliver improved gross margins, which increased 330 basis points to approximately 84% from 80.6% a year ago and was the result of the shift to more, lower-cost online distribution, greater efficiencies in our coaching operations and lower box costs.

In addition, Adjusted EBITDA and Adjusted EBITDA margin continue to improve year-over-year. For the first quarter of this year, Adjusted EBITDA increased 39% to $2.4MM and Adjusted EBITDA margin improved approximately 130 basis points from a year ago. As we’ve been discussing since last year’s first quarter, we have been undertaking transformation activities that are not representative of ongoing operations in order to effect change. These actions, which this quarter included a re-alignment of R&D headcount, the decision to shutter remaining US kiosks, reduce headcount in other areas and adjust our international facilities requirements, resulted in $2.7MM of other EBITDA adjustments that we add-back to calculate Adjusted EBITDA. We anticipate that these actions will assist us in achieving our 2015 margin goals of 10% to 13%.

[Balance Sheet and Cash Flow Review]

Our balance sheet remained strong at the end of the first quarter with an aggregate of $139.4MM of cash or approximately $6.50 of cash per share compared with $148.3MM at 12/31. The decrease in cash from year end was primarily due to a

$7.0MM decrease in working capital combined with capital expenditures of $2.5MM. The decrease in working capital was related to reductions in accrued compensation for 2012 bonuses, other current liabilities – primarily payments of accrued marketing expenses, and the decreases in deferred revenue, partially offset by collections of accounts receivable. Free cash flow in the quarter was negative $8.2MM compared with positive $1.7MM a year ago. Deferred revenue was $59.9MM, an increase of $12.2MM compared with a year-ago and a decrease of $3.6MM from the end of last year, reflecting normal seasonality for us. As we closed the $8.5MM cash acquisition of Livemocha at the beginning of April, our quarter-end cash balance does not reflect this outflow.

[Guidance]

Our guidance for the year for revenues and Adjusted EBITDA are unchanged. We continue to expect revenues to be between $280MM to $290MM. Please note that we are maintaining this guidance even as we expect approximately $10MM to $11MM in lost sales from shutting down the remaining US kiosks. We will partially make up for this by investing in higher-yielding channels and through the addition of the Livemocha-related sales. For Adjusted EBITDA, we continue to expect $16MM to $18MM, even with the anticipated near-term impact from Livemocha. While we are leaving both revenue and adjusted EBITDA guidance unchanged, we expect that results will be weighted toward the second half of the year, when we expect to begin to realize the benefits of actions taken in the first half of the year. Our guidance for Adjusted Net Income remains in a range of negative $1.0MM to positive $1.0MM and Adjusted EPS to be in a range of negative $0.02 to positive $0.04. There is also no change to our capex guidance of $5MM to $8MM. For 2013 we are still expecting to generate positive free cash flow, with all of the increase expected to occur in the second half of the year

Although we aren’t providing specific guidance for the second quarter, we would like to point out that 2Q is typically our lowest Adjusted EBITDA quarter and this year it will also be negatively impacted by the addition of Livemocha, since we aren’t able to immediately realize the benefits of the acquisition in this quarter. Accordingly, we expect Adjusted EBITDA to be flat to slightly down vs. prior year.

Before we move to Q&A, let me note that today we also filed a universal shelf registration, including approximately 8.4MM shares held by our two largest insider shareholders, ABS and Norwest, whose positions have been unchanged since the Company went public in 2009. This shelf registration provides maximum flexibility when raising capital, allowing both the Company and registered shareholders to be opportunistic in raising capital in the future. It also creates the opportunity to satisfy market demand for securities through block trades and provides the company a convenient vehicle to access the capital markets for potential future M&A.

With that, operator, we are ready to take questions.