SECOND QUARTER 2014 INVESTOR WEBCAST

August 5, 2014

Prepared Remarks

Steve Somers, Investor Relations: Good afternoon and let me welcome you to Rosetta Stone's second quarter 2014 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 second quarter and our outlook.

In addition to our commentary, we have made our 2Q14 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, 2013 filed with the SEC in March 2014, which is available on 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.

[Second Quarter Overview]

Second quarter performance reflected the continuation of our transformation. Most importantly, the quarter highlighted solid progress on our strategic focus to grow our Enterprise & Education business, which we call "E&E". In addition, we made meaningful operational progress around initiatives that enable sales of more than one product to our customers. These initiatives will lead to the consumer business stabilizing in the coming quarters.

On the E&E side of the business, we continue to move towards higher-quality, SaaS-based, recurring revenue. That business grew 73% on a reported basis and 8% on a pro forma basis, which assumes we purchased Tell Me More and Lexia at the beginning of 2013. This was the biggest E&E bookings quarter in the Company's history. Importantly, both the literacy and language sides of the business produced positive pro forma growth year-over-year on a more efficient cost base. For the six month period, that business has generated almost $48MM of bookings – up about 70% over last year and represents 40% of the $115MM target we laid out at the beginning of this year. This is encouraging progress given that Q3 is E&E's seasonally biggest quarter. Also, this marks the first full quarter where we have both Tell Me More and Lexia as part of the Company – and I feel pretty good about where we stand with both of these businesses.

In the second quarter, we completed the refresh of the Tell Me More product including all of the mobile applications. We also re-branded all of our products, including Tell Me More, giving us a comprehensive set of language solutions that we offer consistently around the globe. The Tell Me More solution is now called 'Rosetta Stone Advantage' within the expanded suite of language learning products while TOTALe has been renamed as 'Rosetta Stone Foundations', in the E&E segment reflecting its suitability for beginning learners.

Even before the introduction of unified branding and product feel, we have seen the benefits of a more complete and robust portfolio. We were very pleased to win a 7-figure, multi-year deal in the US K-12 vertical that was originally sourced by Tell Me More and closed jointly with the now combined Rosetta Stone team. I am convinced that the expanded product set will enable us to participate in many more large, comprehensive deals, which were not available to us last year because our product portfolio was not as robust as it is now. Overall, in terms of integration and progress, we have met or exceeded our expectations for the Tell Me More transaction. This gives us confidence for continued acceleration of growth in the second half so that we exit the year at a double-digit rate in E&E Language.

Our E&E Literacy business, which is Lexia, again produced really impressive results. Growth was again near 35%, reflecting the growing recognition and acceptance of the Core 5 reading product in the K-12 market. We rolled out additional apps for Core5 in the quarter, making the product more accessible to teachers and students and began developing a reading assessment product in partnership with the Florida Center for Reading Research, the leading center of its kind in the country. We have now owned Lexia for one year and are very happy with the progress and contribution from this acquisition. The addition of Lexia has elevated Rosetta Stone's capabilities, which we are leveraging to deliver a Kids Reading offering at the end of 2014 to the Consumer market. In summary, the E&E business is performing well and gathering momentum for a strong second half of the year.

On the North American Consumer side, results were lower than expected, principally due to continued headwinds from lower retail and call center sales.

Our strategy on the Consumer side is to leverage the power and recognition of the Rosetta Stone brand. This means selling new products to our growing customer base. We are just beginning to build momentum in executing against this strategy with sales of our newly acquired Fit Brains product. In the fourth quarter we will introduce a new Reading product for kids. These new products along with our world class set of language products will enable us to sell more than one product to our customer base, thereby gaining efficiencies on our marketing spend as we generate additional sales to revitalize this business.

During the quarter, we made strides towards expanding the consumer ecosystem which now has a user base of 9.5 million and we increased our presence in the app store with over 4MM Fit Brains downloads this year and a sharp pick-up in downloads of the Rosetta Stone course app, which were over 1.2MM in the first half of the year. This is important because it gives us low cost touches with customers and a solid base to offer our full suite of products. With Fit Brains, we introduced a high-end, browser-based product to go along with our suite of mobile apps. This has the effect of significantly increasing Fit Brains ARPU and going head-to-head against market leader Lumosity. In addition, we also launched a new version of our website that enables the sales and marketing of multiple products, which now represents a store front for our company and a place where millions of people come each year. Improving the conversion of this traffic is key to the strategy.

With the significant pull-back from Asia, the Rest of World Consumer business is performing pretty much as expected with more streamlined operations.

From a financial results perspective, we again generated results that were within our guidance for both bookings and Adjusted EBITDA. Even with the softer than expected results in N.A. Consumer, growth on the E&E side balanced that out, enabling us to meet our guidance.

As I look at the remainder of the year, I have the following two priorities:

First, continue growing the E&E business – keeping the trends you are seeing this quarter moving forward – with growth in language accelerating as we continue to digest the Tell Me More business and at least high teen growth from Lexia.

Second, stabilize the Consumer business with a refresh of our media messaging and improved segmentation to strengthen our language business, while also introducing sales of Fit Brains and Kids Reading into the mix.

Before I turn the call over to Tom, let me just provide a high-level view of what we've accomplished since 2012. Because we have made a lot of changes to the business, the strides we've made sometimes get lost in all the activity and I think a brief summary would be helpful. This isn't meant to be an exhaustive list, but a representative list of a few key items:

- We've put greater emphasis on our E&E segment, which has more predictable recurring revenue. This has included changing the go-to-market model to a hunter-farmer approach, investing in sales force talent and deploying systems to manage the pipeline, renewals and commissions in a more disciplined way.
- We increased E&E through the acquisitions of Lexia and Tell Me More, almost doubling the size of the segment to $115MM.
- We revamped our product organization to make sure we've got the right type of product development talent and skill sets. This has helped move us to be a more agile and flexible. This remaking also involved the acquisition of Livemocha and its platform capabilities to power the next generation of products.
- We streamlined our international operations in Asia, better aligning our costs with our areas of focus and opportunities.
- We have expanded our Consumer product delivery options to be focused more online and digital, including shifting distribution by shuttering the kiosk channel and developing new partner relationships and
- We have expanded beyond language into literacy and brain fitness with the aim of leveraging the power and equity of the Rosetta Stone brand.

In summary, there have been a lot of positive actions taken in the business to reposition the company. Not all of the benefits of these actions have yet evidenced themselves in the financial results as we are still in early stages in many cases, but we are on a path to move this business forward, helping us achieve our financial and strategic goals for this year and beyond.

Now here is Tom.

Tom Pierno, Chief Financial Officer:

[Review of results]

Thanks Steve and good afternoon everyone. Financial results in the second quarter were in line with our guidance for the quarter, with bookings of $69MM vs. guidance of $68MM to $72MM and breakeven Adjusted EBITDA compared with guidance of negative $2MM to positive $2MM. In terms of guidance for the segments, we achieved 73% E&E bookings growth versus guidance of 55% to 75%, while pro forma bookings growth for Lexia was 38% versus mid-teens guidance and pro forma E&E language growth of 2% met our guidance of flat to positive growth. Where we were off was in N.A. Consumer, which was down 10% vs. guidance of flat to down single digit percent. ROW Consumer was in line with guidance. Overall, compared with guidance we were comfortably within our ranges and have been generally tracking towards our full year guidance. Because this is the last quarter in which we are comping the closure of the kiosk channel in North America, there is still about $0.6MM of kiosk bookings in 2Q13 results. Total consolidated bookings in the second quarter of $69MM were up 9% versus the prior year primarily reflecting the acquisitions of Lexia and Tell Me More in the E&E segment, offset in part by decreases in Consumer.

Our reported E&E segment bookings grew 73% versus a year ago due to the aforementioned acquisitions. Within E&E, Language grew 35% on a reported basis to \$22.9MM vs. \$16.9MM a year ago. On a pro forma basis, assuming we had owned Tell Me More a year ago, growth was positive 2% in the quarter. This result represented sequential improvement in growth rate and was consistent with guidance of flat to positive pro forma growth for the quarter. It is also consistent with our plan that growth would be lower in the first half due to integration disruption with Tell Me More, with accelerating growth through the second half of the year as that disruption wanes and the combined team becomes more effective. Steve made mention of a large multi-year deal that we closed in the second quarter, which we view as a strong sign of acceptance in the market for our portfolio of solutions and what we think is a positive indication of things to come. On the literacy side, Lexia delivered \$6.3MM of bookings and pro forma growth of 38%, well ahead of our mid-teens % guidance. This growth reflects the strong reception in the marketplace for the Core5 reading product and the rapid adoption of the subscription model.

In our N.A. Consumer segment, bookings were \$34.8MM, down \$4.5MM or 12% from a year ago or down 10% excluding kiosk. The business continues to be impacted by softness in retail, which was down \$3.2MM or 32% and lower call center volume reflecting changes in consumer purchase behavior and changes to our media mix away from this channel. Web channel growth was up slightly reflecting overall higher volume compared with a year ago, but was largely offset by lower pricing.

Partially offsetting the decrease in the N.A. Consumer language business was a $1.2MM contribution from Fit Brains, which reflected over 100% growth on a pro forma basis.

In the Rest of the World Consumer segment, bookings were down 27% to $5.0MM in the quarter versus $6.9MM a year ago and was consistent with our expectation for bookings to be down about 25%. This decrease was driven by our Asia markets, following our decision in the first quarter when we shut down our company-owned operations in Japan and moved to a third-party model and downsized Korea to focus more on our Proctor Assisted Learning channel. We anticipate that decreases will ease in the back half of the year to meet our guidance of flat to down 10% on a full year basis.

In looking at our Consumer product unit and Paid Online Learner metrics, total Product Units decreased 12% to 130k units compared with 149k units a year-ago. While still down in aggregate, on an adjusted basis taking into account the effect of the closure of kiosk and Japan on units, units were down 10%. The year-over-year decrease reflects decreases in the retail and call center channels in North America as well as lower ROW volume in the UK and Korea. Average revenue per product unit (ARPU) decreased 13% to $238 from $275 in last year's second quarter.

Paid online learners grew 27% to 108k at the end of the quarter, while monthly ARPU declined to $19 compared with $25 a year ago due to lower pricing and introduction of longer term plans at lower monthly rates. Revenue from Paid Online Learners was down 7% to $5.8MM from last year.

Consumer revenues from online learners and digital offerings moved up to 43% compared with 42% in 1Q14, and were up from 25% a year ago.

Adjusted EBITDA in the quarter was essentially break-even in the quarter, which was in the middle of our guidance and compares with $3.7MM a year ago. Compared with 2Q13, the decrease in Adjusted EBITDA primarily reflects the lower contribution from N.A. Consumer, partially offset by an increase in contribution from E&E. The lower contribution from N.A. Consumer is primarily due to the $4.5MM of lower bookings in the quarter, mostly from the retail channel, combined with higher sales & marketing costs of approximately $2.4MM. The net effect is a $6.5MM decrease in segment contribution from N.A. Consumer. This was partially offset by a $3.7MM increase in segment contribution from E&E. The improvement in E&E segment contribution is starting to reflect efficiencies in the business resulting from higher sales productivity from a smaller combined sales force. Contribution from our ROW Consumer segment was negative $0.8MM, flat with a year ago, as softness in Europe offset improvements from the rightsizing of our Asia operations. As we have completed many of the operational changes in the business, including workforce realignment, closing the kiosk channel, space consolidations, and winding down our integration activities over the past year, our one-time adjustments to EBITDA are now starting to get smaller and were $0.6MM compared with $2.5MM in 2Q13 and $8.0MM in 1Q14. While we still expect to incur some additional one-time charges for remaining integration activities, the bulk of these one-time items for this year are now behind us.

[Balance Sheet and Cash Flow]

We ended the quarter with $46.8MM of cash on the balance sheet compared with $56.0MM at 3/31/14 and continued to have no debt. As a reminder, we have said that June and July are our seasonal low points for cash during the year, with all of our cash generation to come in the back half of the year as expected. Deferred revenue increased $11.7MM in the quarter to $93.2MM compared with $81.5MM at 3/31/14, reflecting the growth in E&E over the past year. Over 80% of this deferred revenue balance is expected to be recognized over the next 12 months.

Free cash flow in the second quarter was negative $7.7MM compared with positive $0.8MM a year ago, but was a sequential improvement of $7.3MM compared to 1Q14. Recall that we have talked about how our cash flow is highly seasonal, tied to our earnings and generated in the back half of the year. The year-over-year decline in free cash flow reflects the impact of lower Adjusted EBITDA, a $1.5MM increase in capex to $3.2MM, and an increase in working capital as we transition a larger portion of our business to E&E. Normalizing free cash flow for one-time cash items in each quarter would result in free cash flow of negative $6.8MM in 2Q14 vs. positive $1.6MM a year ago. We also paid out $1.7MM of cash related to the holdback for the Lexia acquisition, which didn't affect free cash flow, but did contribute to the lower cash balance.

[Guidance]

Based on the results from the first half of the year, we are again confirming our FY2014 guidance with bookings to continue to be in a range of $315MM to $325MM and Adjusted EBITDA to be in range of $18MM to $22MM. We still anticipate capex to be between $10MM and $14MM. Although results from N.A. Consumer have been softer than planned through the first half, continued strength from E&E and contribution from new consumer initiatives are expected to offset that weakness, allowing us to hold our guidance for the year.

Because our Adjusted EBITDA is all generated in the second half of the year, let me lay out the factors that provide confidence as to why we are comfortable with that outlook. The first factor is that our business is highly seasonal with an average 90% of our Adjusted EBITDA having been produced in the second half of the year in 2012 and 2013. The second factor is that the benefit from the acquisition of Tell Me More should accelerate in the back half of this year as we have now worked through most of the integration and are selling a suite of language learning solutions in E&E and should begin to realize some of the cost rationalization benefits. This is evidenced by the accelerating pace of bookings growth in E&E language, which was -4% in 1Q, +2% in 2Q and we expect to be 5-6% in 3Q so that we exit the year at a 10%+ rate. The third factor is the introduction of a Kids reading product in the fourth quarter, when we will start to realize bookings after having carried the development costs through the year without any top line. We are also in the process of launching a new marketing campaign aimed at Millenials and are refining our media spend mix, which we expect will help drive new interest and growth. The last major factor is that we anticipate benefit from Fit Brains as it builds greater scale in the back half of the year. In short, our Adjusted EBITDA results this year are even more skewed to the back half resulting from seasonality, the impact of acquisitions and the timing of new product launches, which all converge in the second half. For the third quarter, we expect total bookings to be between $80MM and $90MM. We start to lap the acquisition of Lexia in 3Q, so top line E&E bookings growth will be about 45-55%. This reflects high-teens percentage growth from Lexia and an acceleration of growth from E&E Language to mid to high single-digit percent on a pro forma basis. North America Consumer bookings are expected to be up mid-single digit percent, reflecting the impact of a lower pricing strategy, even as we expect volume to largely offset the price decline. ROW Consumer bookings should be down mid-teens percent reflecting the effect of the downsizing in Asia. Adjusted EBITDA will start to move into more meaningful positive territory and we expect it to come in between $4MM to $7MM for the quarter.

Thank you and we're happy to take your questions.