



# **Q1 2010 Financial Results**

## **Conference Call Slides**

May 6, 2010

# Safe harbor summary

These slides and accompanying oral presentation contain forward-looking statements including our guidance for the second quarter of 2010 and the full year 2010, the expected release dates of Rosetta Stone Version 4 TOTALe and Rosetta Stone iPhone/iPod Touch, the costs of our launch of Rosetta Stone Version 4 TOTALe and our litigation with Google. These statements relate to future events or to future financial performance and involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by these forward-looking statements. In some cases, you can identify forward-looking statements by the use of words such as “may,” “could,” “expect,” “intend,” “plan,” “seek,” “anticipate,” “believe,” “estimate,” “predict,” “potential,” or “continue” or the negative of these terms or other comparable terminology. You should not place undue reliance on forward-looking statements because they involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond our control and that could materially affect actual results, levels of activity, performance, or achievements.

Factors that could materially affect actual results, levels of activity, performance or achievements include those listed under the caption “Risk Factors” of Rosetta Stone’s Form 10-K dated March 10, 2010.

If any of these risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary significantly from what we projected. Any forward-looking statement you see or hear during this presentation reflects our current views with respect to future events and is subject to these and other risks, uncertainties, and assumptions relating to our operations, results of operations, growth strategy, and liquidity. We assume no obligation to publicly update or revise these forward-looking statements for any reason, whether as a result of new information, future events, or otherwise.

# Use of non-GAAP measures

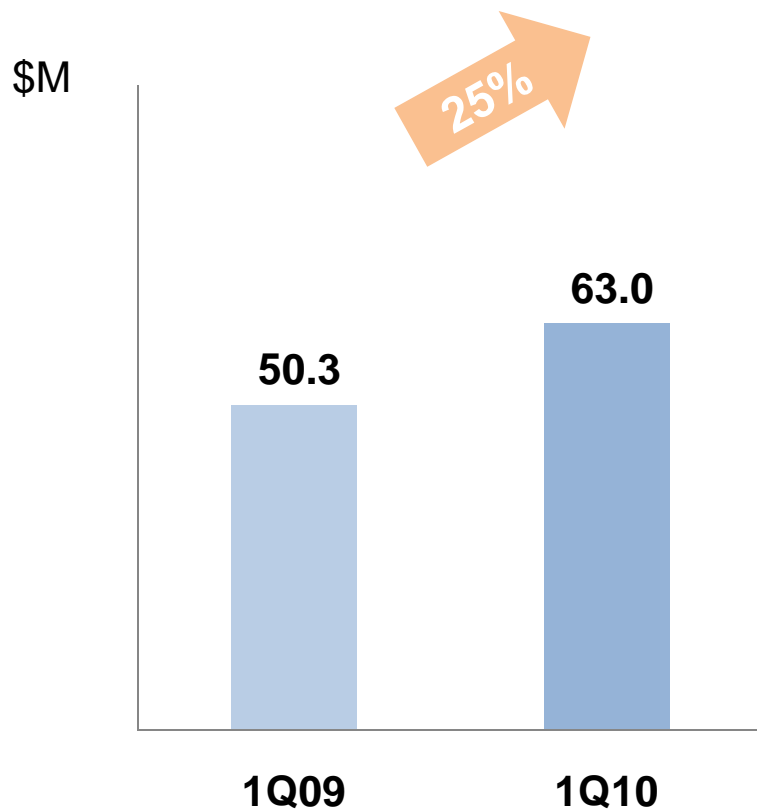
This presentation contains five non-GAAP financial measures: non-GAAP net income, non-GAAP net income per share, Adjusted EBITDA, Operating EBITDA and non-GAAP operating income. These measures differ from GAAP in that they exclude amortization primarily related to acquired intangibles, stock-based compensation expenses, IPO-related compensation expenses, and fees associated with the company's canceled secondary stock offering in August 2009. Adjusted EBITDA is GAAP net income or loss plus interest expense, income tax expense, depreciation, amortization and stock-based compensation expenses. Operating EBITDA is Adjusted EBITDA plus the change in deferred revenue. An additional non-GAAP financial measure in this press release is total sales bookings, which represents executed sales contracts received by the company that are either recorded immediately as revenue or as deferred revenue.

# Highlights

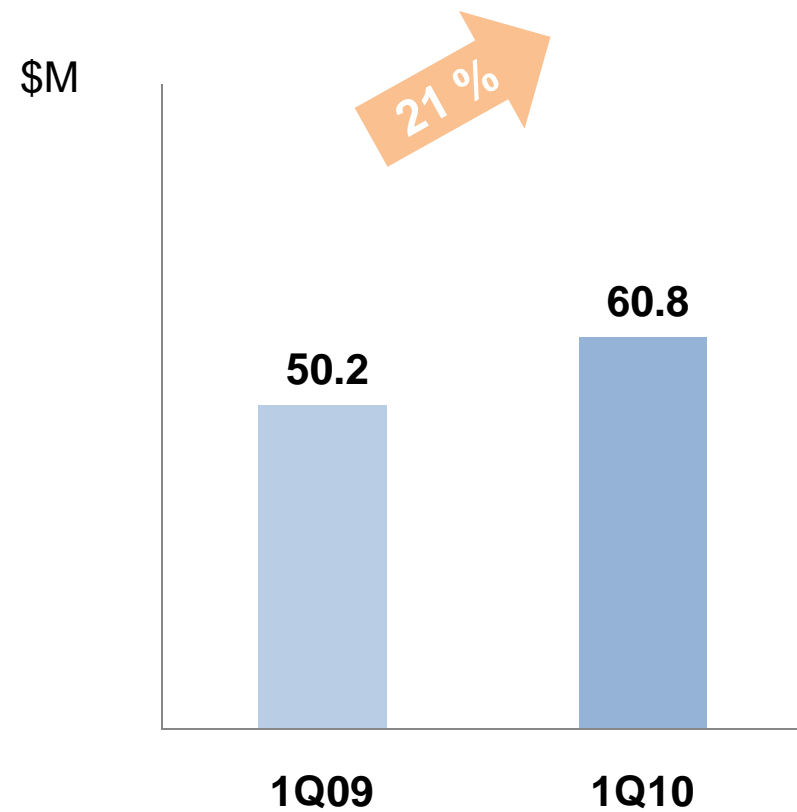
- **Strong revenue and earnings growth**
- **Strong demand drives performance in all business segments**
- **Record international growth in Q1**
- **Continued focus on two key areas:**
  - International expansion
  - Transformation of our product platform
- **Successful product and market testing for upcoming releases**

# Strong revenue and bookings growth

## Revenue

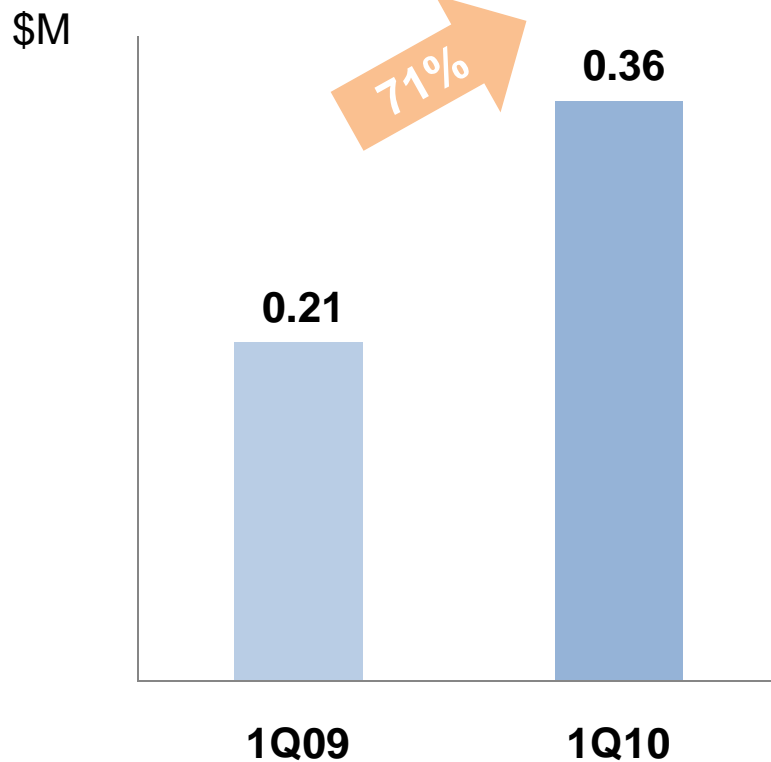


## Sales Bookings

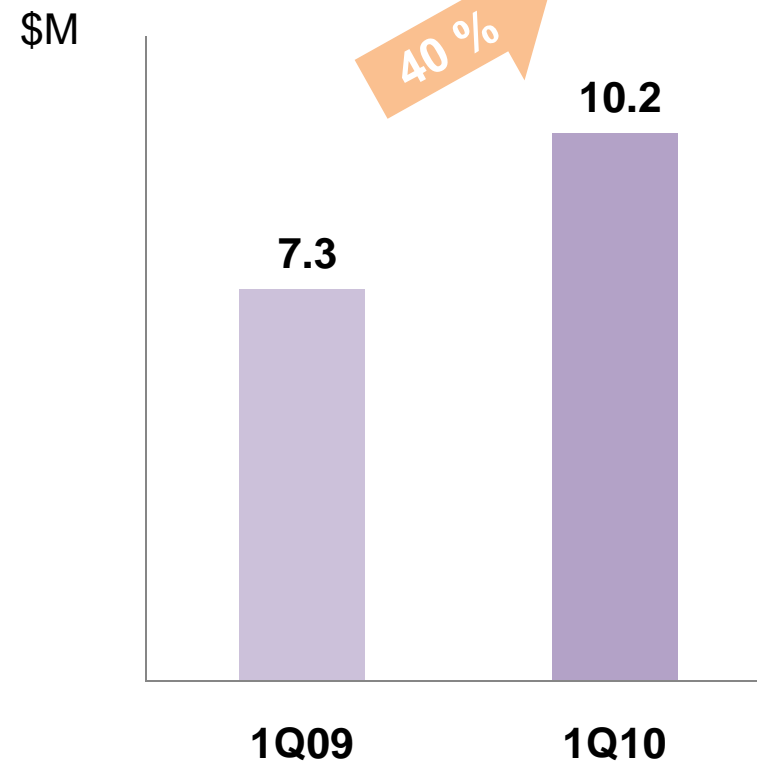


# Healthy earnings and adjusted operating EBITDA

## Proforma EPS<sup>(1)</sup>



## Operating EBITDA<sup>(2)(3)</sup>



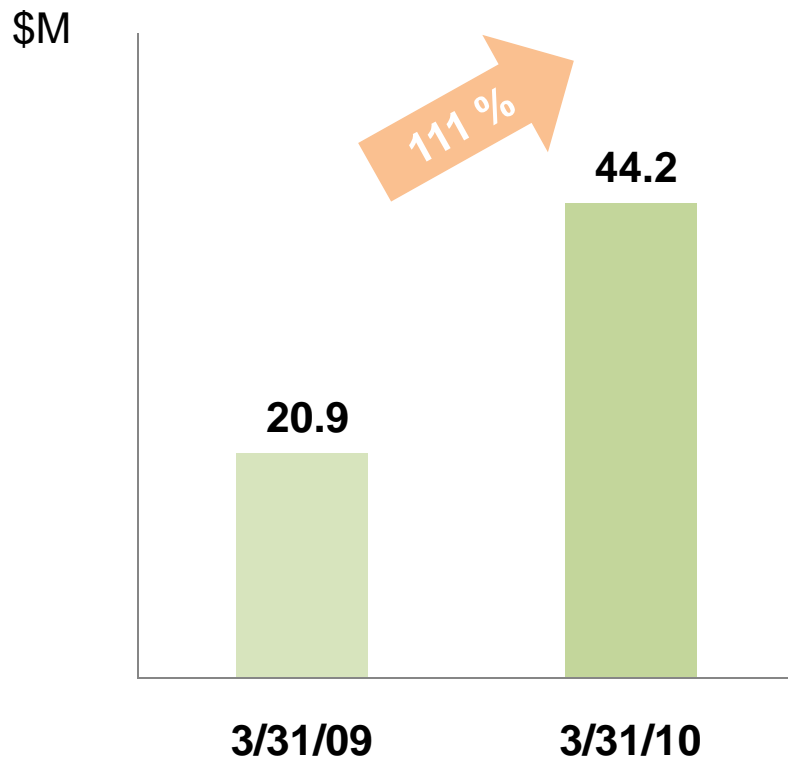
(1) Proforma EPS is defined as Non-GAAP earnings per share excluding the net tax impact of \$3.2 million (or \$0.10 per share) litigation expenses.

(2) Operating EBITDA is defined as Adjusted EBITDA plus change in deferred revenue

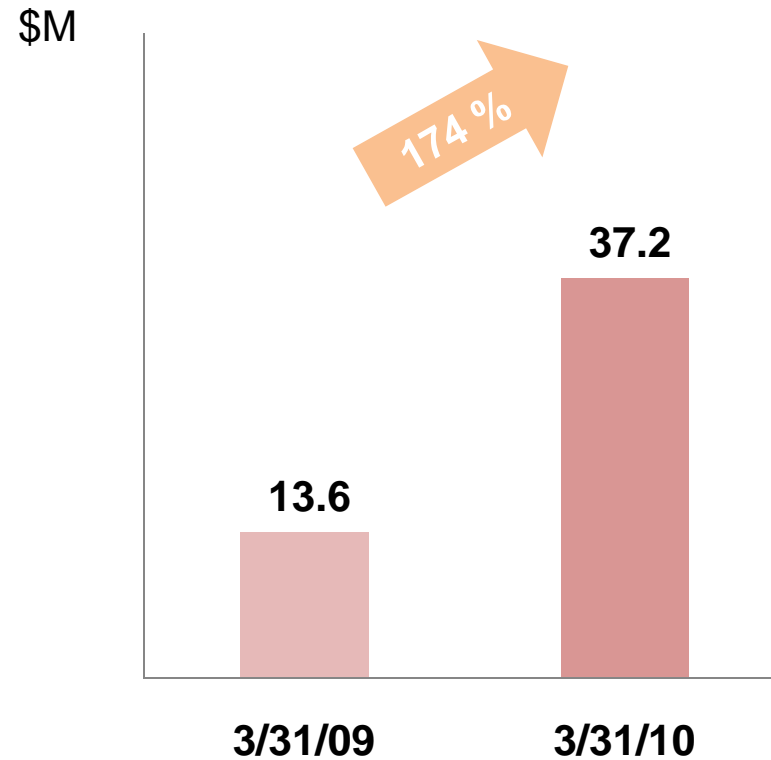
(3) Operating EBITDA excludes \$0.9 million of stock based compensation and \$3.2 million of litigation expenses

# Strong cash flow generation

## TTM Operating Cash Flow



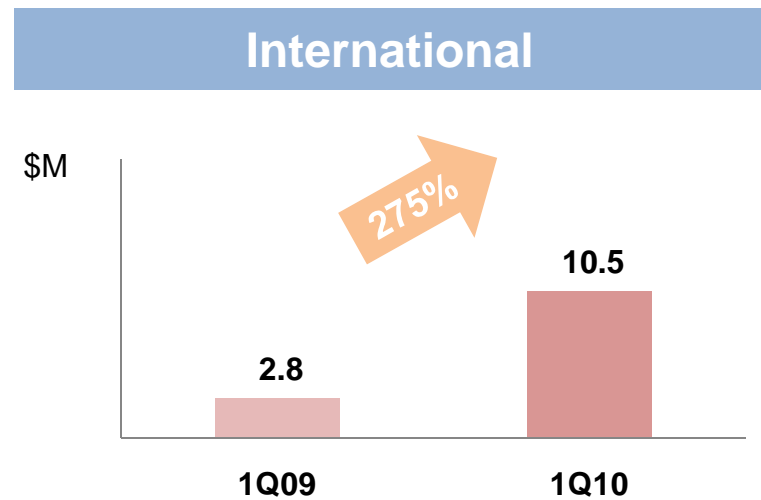
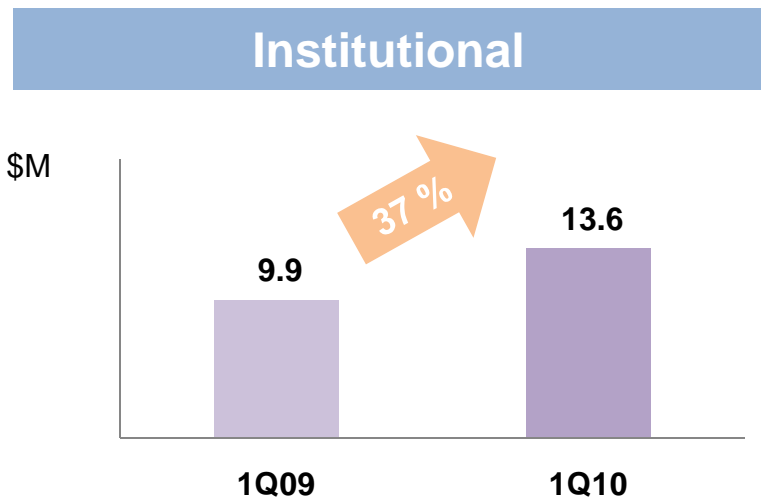
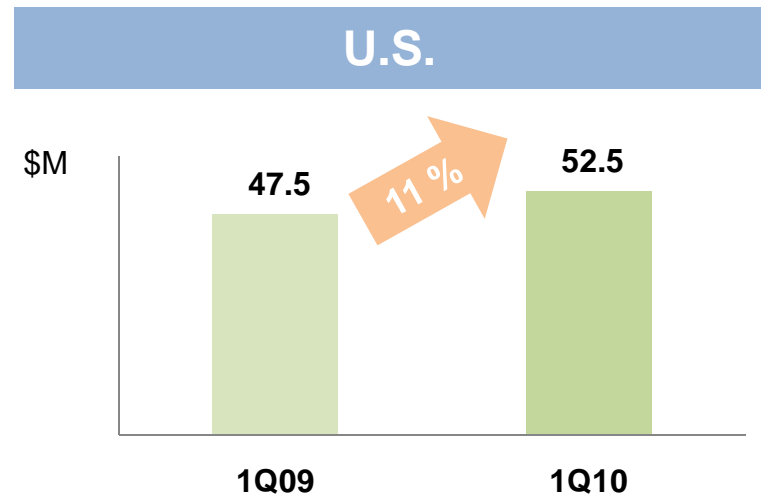
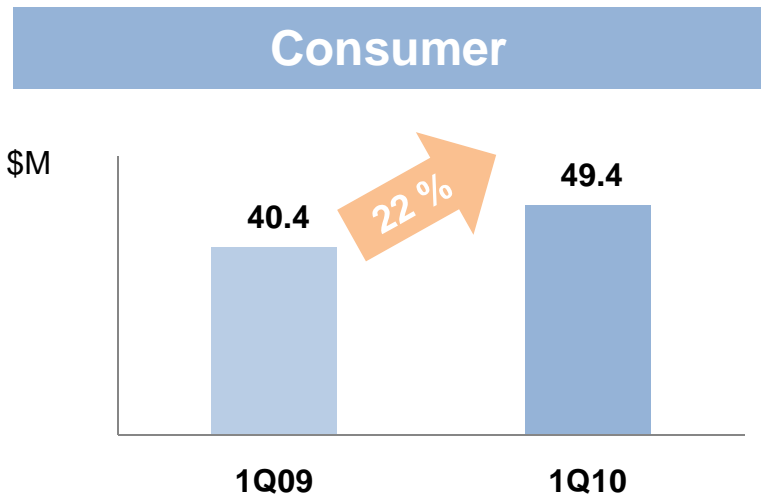
## TTM Free Cash Flow



"TTM" is trailing twelve months

"Free cash flow" is operating cash flow minus capital expenditures.

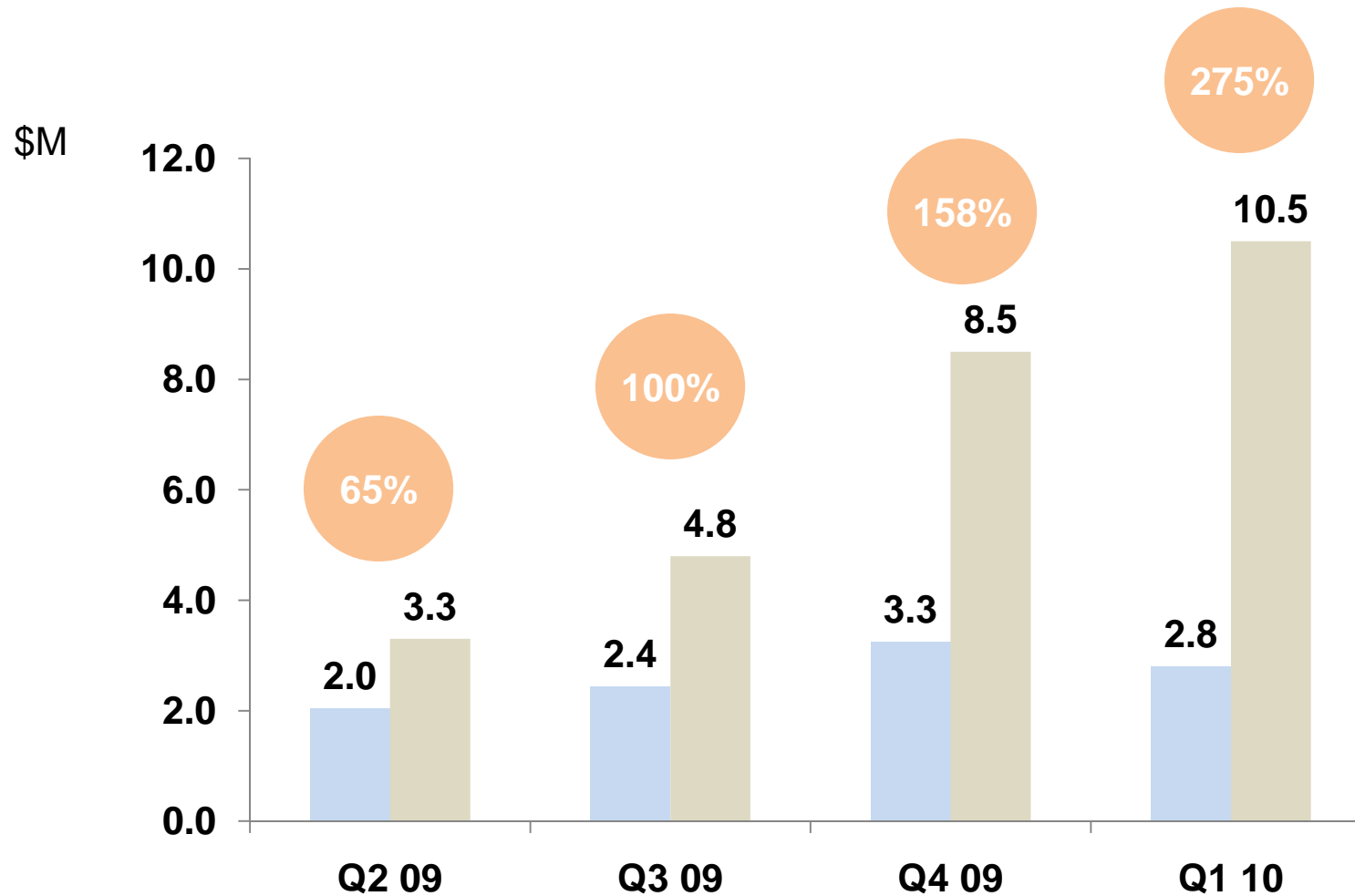
# Growth in all businesses





# International growth accelerates

Non-U.S. revenues over same quarter previous year

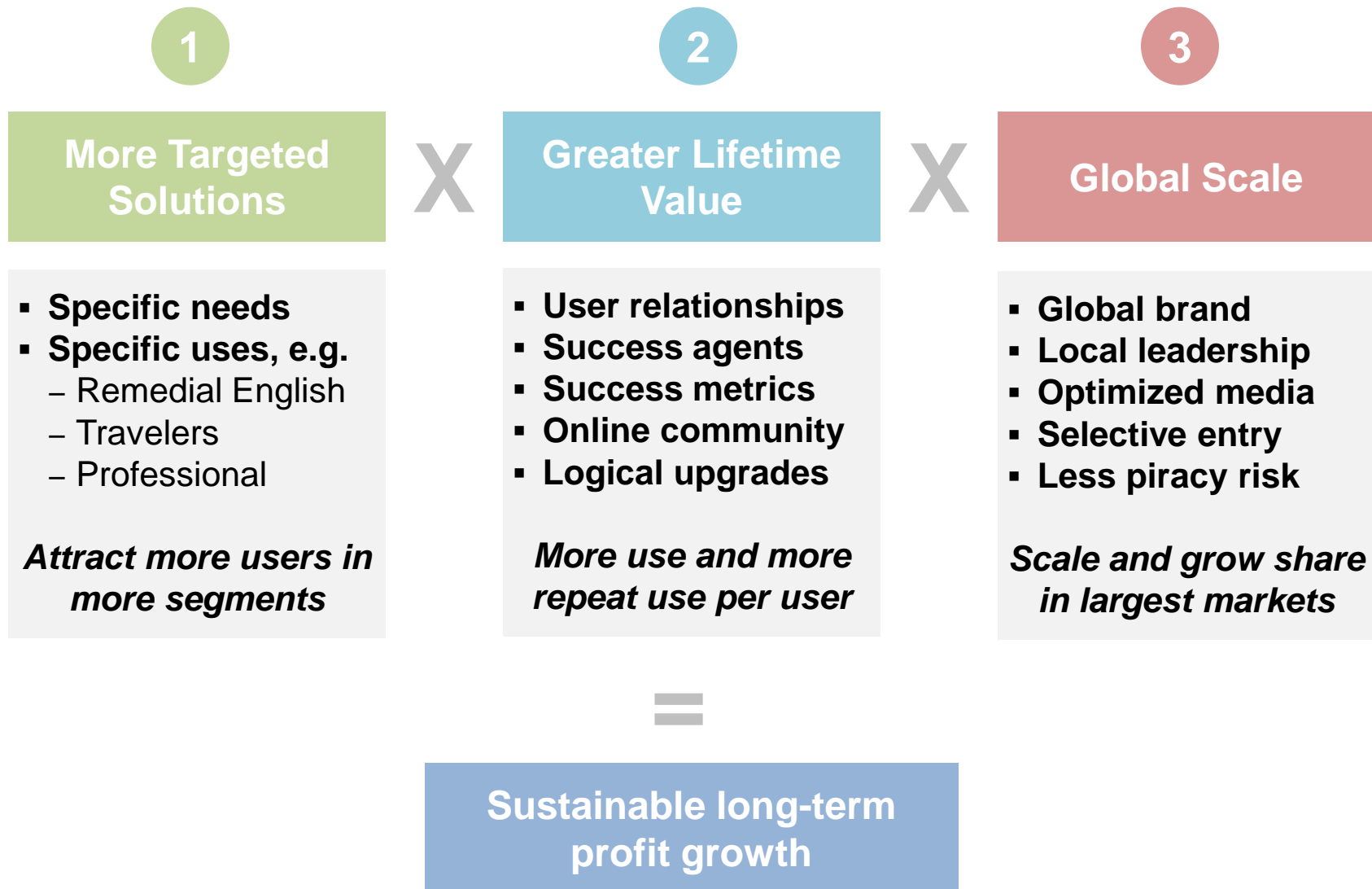


# Strong balance sheet

In \$M

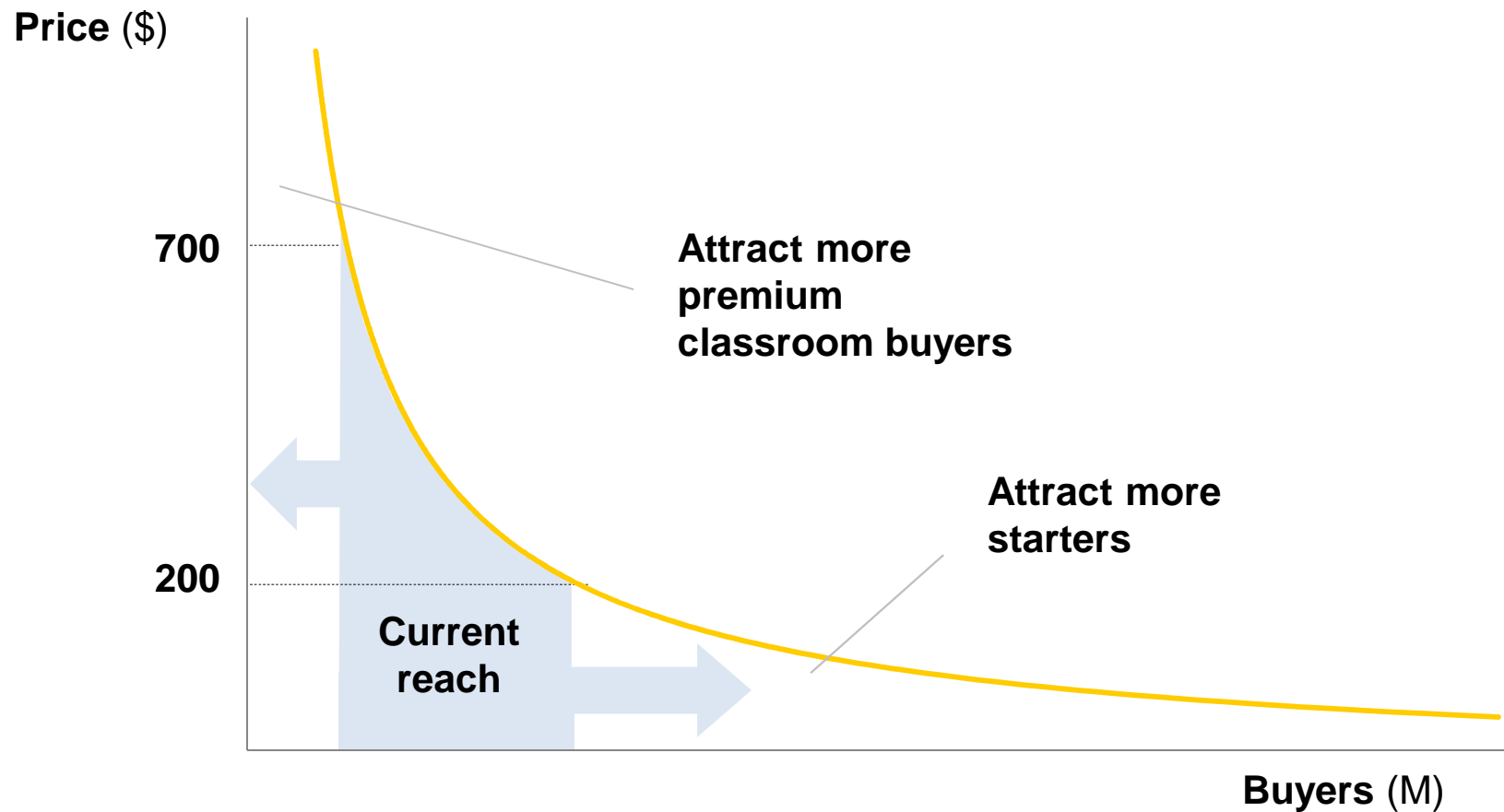
|   | 12/31/2009   | 3/31/2010    |
|---|--------------|--------------|
| Cash and cash equivalents                         | 95.2         | 98.7         |
| Accounts receivable, net                          | 37.4         | 27.7         |
| <b>Total assets</b>                               | <b>225.4</b> | <b>220.5</b> |
| Deferred revenue                                  | 26.1         | 23.9         |
| Total debt  | -            | -            |
| <b>Total liabilities</b>                          | <b>69.0</b>  | <b>58.2</b>  |
| <b>Total liabilities and stockholders' equity</b> | <b>225.4</b> | <b>220.5</b> |

# Three long-term growth drivers



# Version 4 TOTALe solution expands market reach

U.S. language learning demand curve:



Source: Nielsen 2007 Global Language Survey

# Better business model

## Version 3 Software

One-time sale

Limited after-sale contact

Course progress validation

Piracy risk

Limited control over outcomes

PC / Mac

## Version 4 TOTALe Solution

**Lifetime value**

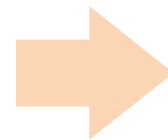
**Ongoing relationship**

**Live coach validation**

**Can't copy full experience**

**Success agents**

**PC / Mac / offline / online / mobile**



**More effective**

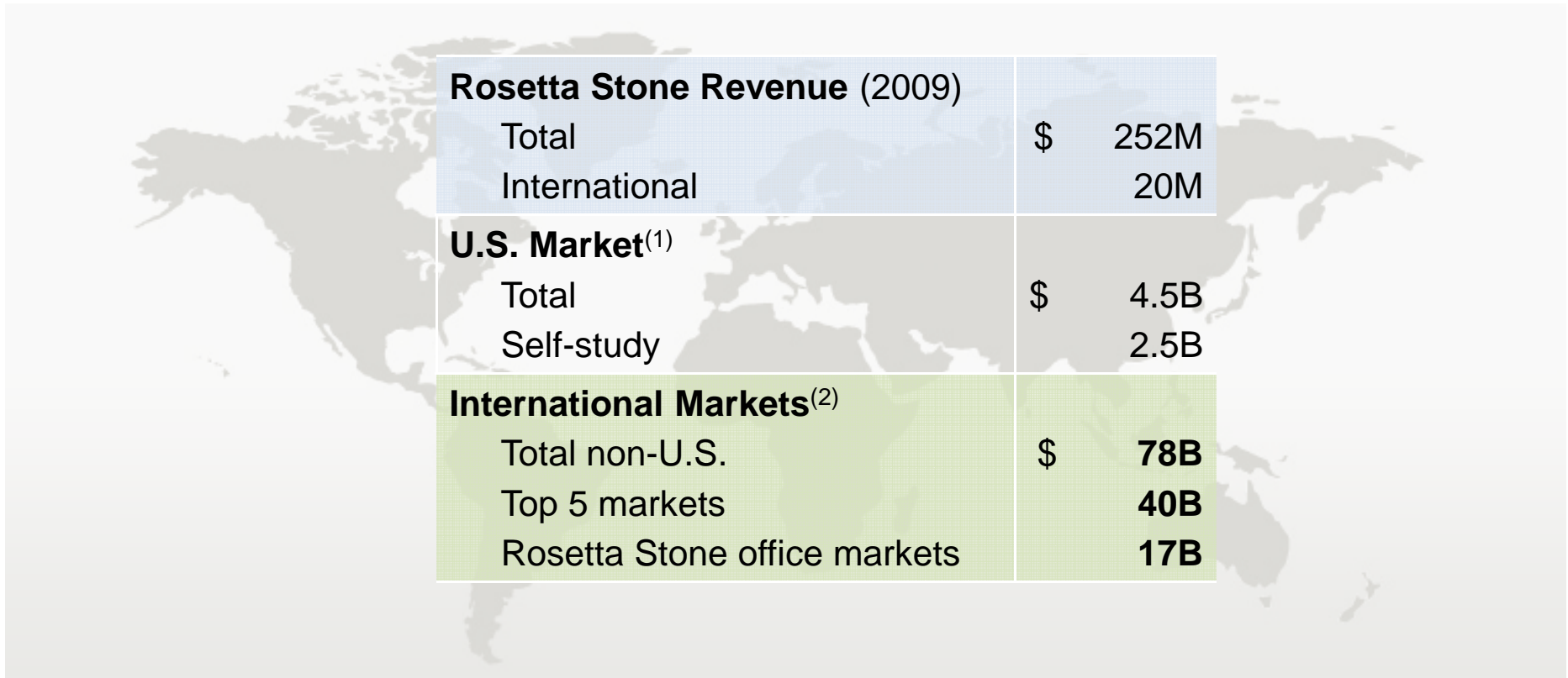
**More use**

**Greater stickiness**

**Higher value**

**Harder to emulate**

# Global market



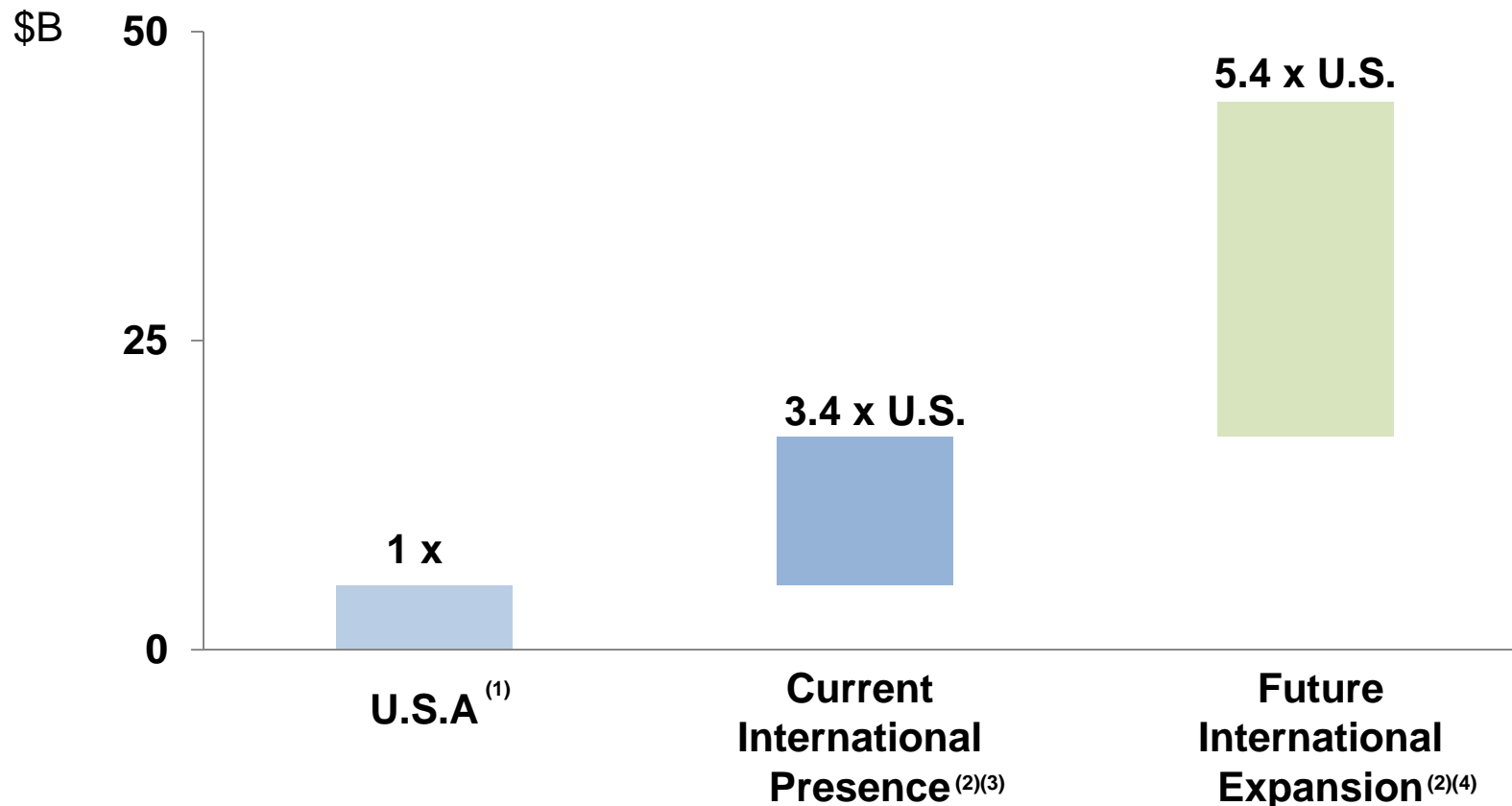
|  |         |
|--|---------|
| <b>Rosetta Stone Revenue (2009)</b>        |         |
| Total                                      | \$ 252M |
| International                              | 20M     |
| <b>U.S. Market<sup>(1)</sup></b>           |         |
| Total                                      | \$ 4.5B |
| Self-study                                 | 2.5B    |
| <b>International Markets<sup>(2)</sup></b> |         |
| Total non-U.S.                             | \$ 78B  |
| Top 5 markets                              | 40B     |
| Rosetta Stone office markets               | 17B     |

|                       |                       |                     |
|-----------------------|-----------------------|---------------------|
| <b>Local offices:</b> | <b>UK (2005)</b>      | <b>Japan (2007)</b> |
|                       | <b>Germany (2009)</b> | <b>Korea (2009)</b> |

(1) U.S. market size source: Company 2009 U.S. Language Survey  
 (2) International market size source: Nielsen 2007 Global Language Survey

# International represents large opportunity

## Language learning spend excluding college:



- (1) U.S. market size source: Company 2009 U.S. Language Survey
- (2) International market size source: Nielsen 2007 Global Language Survey
- (3) Includes Germany, Japan, Korea, and the United Kingdom
- (4) Includes Brazil, China, France, and Italy which represent primary markets for potential future expansion

# Financial Outlook: Q2 2010 and Full-Year 2010

|  | Q2 2010                         | Full Year 2010                  |
|--|---------------------------------|---------------------------------|
| <b>Total revenue</b>                         | <b>\$63 mil. to \$66 mil.</b>   | <b>\$286 mil. to \$299 mil.</b> |
| <b>Sales bookings<sup>1</sup></b>            | <b>\$66 mil. to \$69 mil.</b>   | <b>\$310 mil. to \$325 mil.</b> |
| <b>Non-GAAP diluted net income per share</b> | <b>\$0.05 to \$0.07</b>         | <b>\$0.90 to \$1.00</b>         |
| <b>Operating EBITDA<sup>2</sup></b>          | <b>\$6.0 mil. to \$6.8 mil.</b> | <b>\$58 mil. to \$65 mil.</b>   |
| <b>Diluted shares outstanding</b>            | <b>21.3 mil.</b>                | <b>21.5 mil.</b>                |
| <b><i>Google litigation</i></b>              | <b><i>\$1.8 mil.</i></b>        | <b><i>\$5.0 mil.</i></b>        |

1 "Sales bookings" are defined as executed sales contracts received by company that are either recorded immediately as revenue or as deferred revenue.

2 "Operating EBITDA" equals Adjusted EBITDA (excludes stock-based compensation and amortization of intangibles) plus change in deferred revenue.



# Guidance: quarterly Version 4 TOTALE impact

| Category                           | Estimated Impact   | 2010 Timing |    |    |
|------------------------------------|--|-------------|----|----|
|                                    |  | Q2          | Q3 | Q4 |
| <b>Ongoing</b>                     |  |             |    |    |
| <b>Coaches and agents</b>          | Gross margins of <b>83%</b> to <b>84%</b> upon Version 4 launch <sup>1</sup> . | ✓           | ✓  | ✓  |
| <b>Non-recurring</b>               |  |             |    |    |
| <b>V4 marketing preparation</b>    | <b>Approximately \$2.0M</b> additional costs.                                  | ✓           |    |    |
| <b>V4 launch activities</b>        | <b>Approximately \$2.5M</b> additional costs.                                  |             | ✓  | ✓  |
| <b>V3 inventory obsolescence</b>   | <b>Approximately \$3.0M</b> charge.  |             | ✓  |    |
| <b>Ongoing, no cash difference</b> |  |             |    |    |
| <b>Revenue deferment</b>           | <b>20% to 25%</b> of sales price of Rosetta Stone Version 4 TOTALE.            |             | ✓  | ✓  |

<sup>1</sup> Impact to be smaller in Q2, larger towards Q4.