

ROSETTA STONE INC
Form 10-K
March 14, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2015
Commission file number: 1-34283

Rosetta Stone Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State of incorporation)

1919 North Lynn St., 7th Fl.
Arlington, Virginia
(Address of principal executive offices)

043837082
(I.R.S. Employer
Identification No.)

22209
(Zip Code)

Registrant's telephone number, including area code:
703-387-5800

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class

Common Stock, par value \$0.00005 per share

Securities Registered Pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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 any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

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The aggregate market value of the common stock held by non-affiliates of the registrant was approximately \$136.5 million as of June 30, 2015 (based on the last sale price of such stock as quoted on the New York Stock Exchange). All executive officers and directors of the registrant and all persons filing a Schedule 13D with the Securities and Exchange Commission in respect of registrant's common stock have been deemed, solely for the purpose of the foregoing calculation, to be "affiliates" of the registrant.

As of March 8, 2016, there were 21,882,727 shares of common stock outstanding.

Documents incorporated by reference: Portions of the definitive Proxy Statement to be delivered to stockholders in connection with the 2016 Annual Meeting of Stockholders to be held on May 19, 2016 are incorporated by reference into Part III.

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PART I

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, including the documents incorporated by reference, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve risks and uncertainties and provide current expectations of future events based on certain assumptions. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts and often include words such as "believes," "expects," "anticipates," "estimates," "intends," "plans," "seeks" or words of similar meaning, or future-looking or conditional verbs, such as "will," "should," "could," "may," "might," "aims," "intends," or "projects" or similar words and phrases. The absence of these words or similar expressions does not mean that a statement is not forward-looking. These statements may relate to: our revised business strategy; guidance or projections related to bookings, Adjusted EBITDA, and other measures of future economic performance; the contributions and performance of our businesses including acquired businesses and international operations; projections for future capital expenditures; and other guidance, projections, plans, objectives, and related estimates and assumptions. A forward-looking statement is neither a prediction nor a guarantee of future events or circumstances, and the Company's actual results may differ significantly from the events or circumstances discussed in the forward-looking statement. Management believes that these forward-looking statements are reasonable as and when made. However, caution should be taken not to place undue reliance on any such forward-looking statements because such statements are based on beliefs and assumptions made by, and information currently available to, management and speak only as of the date when made. We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In addition, forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our present guidance, expectations or projections. These risks and uncertainties include, but are not limited to, those described below in this Annual Report on Form 10-K in Part I, Item 1A: "Risk Factors" and Part II, Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations," those described elsewhere in this Annual Report on Form 10-K, and those described from time to time in our future reports filed with the Securities and Exchange Commission.

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Item 1. Business

Overview

Rosetta Stone Inc. ("Rosetta Stone," "the Company," "we" or "us") is dedicated to changing people's lives through the power of language and literacy education. Our innovative, personalized language and reading programs drive positive learning outcomes in thousands of schools, businesses, government organizations and for millions of individuals around the world. Our cloud-based programs allow users to learn online or on-the-go via tablet or smartphone, whether in a classroom, corporate setting, or personal learning environment. Rosetta Stone is also a leader in the literacy education space, helping millions of students build fundamental reading skills. Additionally, our Fit Brains business offers personalized brain training programs that are both exciting and challenging.

Rosetta Stone Inc. was incorporated in Delaware in 2005. Founded in 1992, Rosetta Stone pioneered the use of interactive software to accelerate language learning and is widely recognized today as the industry leader in providing effective language programs. Today we offer courses in 30 languages across a broad range of formats, including web-based software subscriptions, digital downloads, mobile applications, and perpetual CD packages. Rosetta Stone has continued to invest in language learning and expanded beyond language learning and deeper into education-technology with its acquisitions of Livemocha Inc. ("Livemocha") and Lexia Learning Systems Inc, ("Lexia") in 2013 and Vivity Labs, Inc. ("Vivity") and Tell Me More S.A. ("Tell Me More") in January 2014. These acquisitions have enabled us to meet the changing needs of learners around the world.

As our Company has evolved, we believe that our language and literacy Enterprise & Education segment is our largest opportunity for long-term value creation. The customers in these marketplaces have demands that recur each year, creating a more predictable revenue opportunity. This demand profile also fits well with our suite of products, the well-known Rosetta Stone brand and the demonstrated efficacy of our literacy tools. We also believe the demand for e-learning based literacy solutions in the US and English language-learning around the globe is growing.

As a result, we are emphasizing the development of products and solutions for Corporate and K-12 learners who need to speak and read English. This focus extends to the Consumer segment, where we continue to make product investments serving the needs of passionate language learners who are motivated, results focused and willing to pay for a quality language-learning experience.

To position the organization for success, we are focused on the following four priorities:

1. Grow literacy sales by providing fully aligned digital instruction and assessment tools for K-12, building a direct distribution sales force to replace our historical reseller model, and continuing to develop our implementation services business;

2. Position our Enterprise & Education language business for profitable growth by focusing on our best geographies and customer segments and successfully delivering a new language-learning suite for Corporate customers that offers a simple, more modern, metrics-driven suite of tools that are results-oriented and easily integrated with leading corporate language-learning systems;

3. Maximize the profitability of our Consumer language business by providing an attractive value proposition and a streamlined, mobile-oriented product portfolio focused on consumers' demand, while optimizing our marketing spend appropriately; and

4. Right-size the entire cost base of the Company, including optimizing our media spend and other marketing costs in Consumer sales and marketing; right-sizing our Enterprise & Education segment to target those geographies and customer segments where we have the greatest opportunity; and reducing our general and administrative costs.

In pursuing these priorities, we will (i) allocate capital to the areas of our business that we believe have the greatest growth potential, including our literacy-learning business, (ii) focus our businesses on their best customers, including Corporate and K-12 learners primarily in North America and Northern Europe in our Enterprise & Education language business and passionate learners in the United States and select non-US geographies in our Consumer language business, and (iii) optimize the sales and marketing costs for these businesses and the costs of our business overall.

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Business Segments

Our business is organized into two operating segments: Enterprise & Education and Consumer. The Enterprise & Education segment derives revenues from sales to educational institutions, corporations, and government agencies worldwide. The Consumer segment derives revenue from sales to individuals and retail partners worldwide. For additional information regarding our segments, see Note 17 of Item 8, Financial Statements and Supplementary Data. Prior periods are presented consistently with our current operating segments and definition of segment contribution.

Products and Services

Enterprise & Education:

Rosetta Stone offers a series of technology-based interactive language-learning solutions for schools, businesses and other organizations and reading and literacy solutions for schools. Rosetta Stone also offers administrator tools for performance monitoring and custom solutions to ensure that organizations achieve desired outcomes. Through our professional services, we provide expert implementation and training services to drive critical business solutions.

Language-Learning Solutions: Rosetta Stone provides web-based language-learning solutions that are primarily available online. Our core language-learning suite offers courses and practice applications in multiple languages, each leveraging our proprietary immersion methodology and innovative technology features. Available in 24 languages and designed for beginner to intermediate language learners, Rosetta Stone Foundations builds fundamental language skills using our proprietary context-based, immersion methodology and innovative technology features. Rosetta Stone Advantage is available for all proficiency levels in 9 of the 24 languages and focuses on improving everyday and business language skills. Our Advanced English for Business solution serves multinational companies seeking to build their employees' English language proficiency so they are able to communicate and operate in a global business environment. Specifically designed for use with our language-learning solutions, our Global Enterprise & Education customers may also purchase our audio practice products and live tutoring sessions to enhance the learning experience.

Literacy Solutions: Our Lexia Learning suite of subscription-based English literacy-learning and assessment solutions provide explicit, systematic, personalized fundamental reading instruction for students of all abilities. These literacy solutions deliver norm-referenced performance data and analysis without interrupting the flow of instruction to administer a test, providing personalized learning experiences that integrate well with teachers in classrooms. This research-proven technology based approach accelerates reading skills development, predicts students' year-end performance and provides teachers data-driven action plans to help differentiate instruction. Lexia Reading Core5 is available for all abilities from pre-K through grade 5. Our reading intervention program, Lexia Strategies, is designed for remedial students in grades 6 and above. Lexia RAPID Assessment is a computer-adaptive screener and diagnostic tool for grades K-12 that identifies and monitors reading and language skills to provide actionable data for instructional planning. Lexia's solutions deliver norm-referenced performance data and analysis to enable teachers to monitor and modify their instruction to address specific student needs. These literacy solutions are provided under web-based subscriptions.

Administrator Tools: Our Enterprise & Education learning programs come with a set of administrator tools to measure and track learner progress. Administrators can use these tools to access real-time dynamic reports and identify each learner's strengths and weaknesses.

Professional Services: Professional services provide our customers with access to experienced training, implementation and support resources. Our team partners work directly with customers to plan, deploy, and promote the program for each organization, incorporate learning goals into implementation models, prepare and motivate learners, and integrate the Rosetta Stone products into technical infrastructure.

Custom Solutions: Rosetta Stone offers tailored solutions to help organizations maximize the success of their learning programs. Our current custom solutions include curriculum development, global collaboration programs that combine language education with business culture training, and language courses for mission-critical government programs.

Consumer:

Rosetta Stone also offers a broad portfolio of technology-based learning products for personal use to the global consumer. Powered by our widely recognized brand, and building on our 23-year heritage in language-learning, our interactive learning solutions include a portfolio of language-learning, brain fitness, and kids' literacy and learning

solutions.

Many of our Rosetta Stone consumer products and services are available in flexible and convenient formats for tablets and smartphones. Our mobile apps enable learners to continue their lessons on the go and extend the learning experience away from a computer. Progress automatically syncs to meet our customers' lifestyles. These apps may be available for download through the Apple App Store, Google Play, Amazon Appstore for Android, and the Windows Store.

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Rosetta Stone Language-Learning Solutions: Rosetta Stone provides intuitive, easy-to-use learning programs that are available under a web-based software subscription and in perpetual formats including digital download and CD. Our language-learning suite offers courses and practice applications in multiple languages, each leveraging our proprietary immersion methodology and innovative technology features. Beginner to intermediate language-learning products are available in 30 languages to build fundamental language skills. Advanced language-learning products are available in 9 of the 30 languages and focus on improving everyday and business language skills. We also offer online services to enhance and augment our learners' capabilities. Our Online Tutoring is an online service that provides conversational coaching sessions with native speakers to practice skills and experience direct interactive dialogue. Our Online Games and Activities are online services that provide a world-wide community for users around the world with games, online chat, and other features to improve language skills. Many of our perpetual language-learning offerings include access to Online Tutoring. Almost all of our language-learning offerings for consumers include access to Online Games and Activities. Our current suite of mobile language-learning apps includes companions to our computer-based language-learning solutions.

Rosetta Stone Fit Brains: Rosetta Stone Fit Brains solutions are designed to enhance memory, mood, concentration, thinking and problem-solving skills using brain training exercises that are exciting and challenging. Our Fit Brains system targets all six major brain areas including memory, concentration, speed, visual, language, and problem solving. Our brain fitness solutions include a web-based subscription and several brain training apps that feature more than 40 scientifically designed brain training games. Included in a Rosetta Stone Fit Brains subscription are performance tracking tools to view training progress and compare performance with others of the same age and gender.

Rosetta Stone Kids: Rosetta Stone Kids mobile apps provide technology-based learning solutions for children that focus on early childhood language and literacy. Rosetta Stone Kids Reading app was launched in 2014 aimed to teach children aged 3-7 how to read using engaging self-paced interactive games and activities that introduce and reinforce core reading skills. Rosetta Stone Kids Reading uses award-winning, research-proven technology focused on phonological awareness, phonics, vocabulary, fluency, and comprehension. Rosetta Stone Kids Reading includes dozens of games and stories, plus hundreds of fun activities. Fit Brains for Kids Sparky's Adventures offers a first-of-its-kind cognitive approach to child learning and brain development that provides a fun and healthy collection of brain games for children aged 2-8. In 2013 we launched Rosetta Stone Kids Lingo Letter Sounds and Rosetta Stone Kids Lingo Word Builder apps for children aged 3-6 that provide blended learning solutions to introduce kids to both basic literacy skills and a foreign language.

Software Developments:

Our offering portfolio is a result of significant investment in software development. Our software development efforts include the design and build of software solutions across a variety of devices, pedagogy and curriculum development, and the creation of learning content. Our development team builds new solutions and enhances or maintains existing solutions. We have specific expertise in speech recognition technology, iterative and customer-focused software development, instructional design, and language acquisition.

Our research and development expenses were \$29.9 million, \$33.2 million, and \$34.0 million for the years ended December 31, 2015, 2014 and 2013, respectively.

We continue to evaluate changes to our solutions to strengthen our brand and improve the relevance of our offering portfolio. We are focused on completing the alignment of our three language platforms and moving towards the consolidation of our legacy platforms to offer our customers a single solution that provides streamlined access and simplified pricing for the full suite of English and world language learning content, along with assessment, placement, ongoing reporting and demonstration of results, all of which address important customer needs to focus and demonstrate payback.

Distribution Channels

Enterprise & Education:

Our Enterprise & Education language-learning distribution channel is focused on targeted sales activity primarily through a direct sales force in five markets: K-12 schools, colleges and universities, federal government agencies, not-for-profit organizations, and corporations. Our Enterprise & Education language-learning customers include the

following:

Educational Institutions. These customers include primary and secondary schools and colleges and universities.
U.S. Federal Government Agencies and Not-for-Profit Organizations. These customers include government agencies and organizations developing workforces that serve non-native speaking populations, offering literacy programs, and preparing members for overseas missions.

Corporations. We promote interest in this market with onsite visits, trade show and seminar attendance, speaking engagements, and direct mailings.

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Third-party Resellers. We utilize third-party resellers to provide our language-learning solutions to businesses, schools, and public-sector organizations in emerging markets predominantly outside the U.S.

Our Enterprise & Education literacy distribution channel utilizes a direct sales force as well as relationships with third-party resellers focused on the sale of Lexia solutions to K-12 schools.

Consumer:

Our Consumer distribution channel comprises a mix of our call centers, websites, third party e-commerce websites, consignment distributors, select retail resellers, and daily deal partners. We believe these channels complement each other, as consumers who have seen our direct-to-consumer advertising may purchase at our retailers, and vice versa. **Direct to consumer.** Sales generated through either our call centers and on our e-commerce website at www.rosettastone.com.

Indirect to consumer. Sales generated through arrangements with third-party e-commerce websites such as the Apple App Store, and consignment distributors such as Wynit Distribution and Software Packaging Associates.

Retailers. Our retailers enable us to provide additional points of contact to educate consumers about our solutions, expand our presence beyond our own websites, and further strengthen and enhance our brand image. Our retail relationships include Amazon.com, Barnes & Noble, Target, Best Buy, Books-a-Million, Sam's Club, Staples, and others in and outside of the U.S. We also partner with daily deal resellers.

Home School. We promote interest in the language-learning market through advertising in publications focused on home schooling, attending local trade shows, seminars and direct mailings.

Sourcing and Fulfillment

Consistent with the Software-as-a-Service ("SaaS") model in our Enterprise & Education segment, our strategy in the Consumer segment is to shift the sales mix away from CD-based product sales toward a cloud-based software subscription in order to reduce costs associated with physical packaging and distribution.

Our physical inventory utilizes a flexible, diversified and low-cost manufacturing base. We use third-party contract manufacturers and suppliers to obtain substantially all of our product and packaging components and to manufacture finished products. We believe that we have good relationships with our manufacturers and suppliers and that there are alternative sources in the event that one or more of these manufacturers or suppliers is not available. We continually review our manufacturing and supply needs against the capacity of our contract manufacturers and suppliers with a view to ensuring that we are able to meet our production goals, reduce costs and operate more efficiently.

Competition

Rosetta Stone competes in several categories within the technology-based learning industry, including consumer, enterprise and educational language learning, literacy, and brain fitness.

The language-learning market is highly fragmented globally and consists of a variety of instructional and learning modes: classroom instruction utilizing the traditional approach of memorization, grammar and translation; immersion-based classroom instruction; self-study books, audio recordings and software that rely primarily on grammar and translation; and free online and mobile offerings that provide content and opportunities to practice writing and speaking. Within consumer-focused language learning, our competitors include Berlitz (Benesse Holdings), Pimsleur (Simon & Schuster, part of CBS Corporation), Living Language (Penguin Random House, a joint venture of Pearson and Bertelsmann), McGraw-Hill Education, Duolingo, Inc., Fluenz, Busuu Ltd., Babbel (operated by Lesson Nine GmbH) and many other small and regionally-focused participants. In the enterprise and education-focused language market, we compete with EF Englishtown, Global English (Pearson), Wall Street English (Pearson), inlingua, Imagine Learning, Transparent Language, as well as many private language schools and other classroom-based courses.

In the literacy category, we compete primarily in the K-12 digital reading space in the U.S. with Scholastic, Inc., Imagine Learning, Achieve3000, Scientific Learning, Odyssey (Compass Learning), Waterford Early Reading (Pearson), Renaissance, and Istation.

In the brain fitness category, the category is new and highly fragmented. We compete with Lumosity, Elevate and Posit Science as well as many online and digital app providers.

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Seasonality

Our business is affected by variations in seasonal trends. Within our Enterprise & Education segment, revenue in our education, government, and corporate sales channels are seasonally stronger in the second half of the calendar year due to purchasing and budgeting cycles. Our Consumer revenue is affected by seasonal trends associated with the holiday shopping season. In particular, we generate a significant portion of our Consumer sales in the fourth quarter during the period beginning on Black Friday through the end of the calendar year. We sell to a significant number of our Consumer retailers and distributors and Enterprise & Education customers on a purchase order basis and we receive orders when these customers need products and services. As a result, their orders are typically not evenly distributed throughout the year and generally are highest in the third and fourth quarters. Our Enterprise & Education segment and our Consumer segment are affected by different sales-to-cash patterns. Historically, in the first half of the year we have been a net user of cash and in the second half of the year we have been a net generator of cash since Consumer sales typically turn to cash more quickly than Enterprise & Education sales, which have longer collection cycles.

Intellectual Property

Our intellectual property is critical to our success. We rely on a combination of measures to protect our intellectual property, including patents, trade secrets, trademarks, trade dress, copyrights and non-disclosure and other contractual arrangements.

We have ten U.S. patents, fourteen foreign patents and several U.S. and foreign patent applications pending that cover various aspects of our language-learning and literacy technologies.

We have registered a variety of trademarks, including our primary or house marks, Rosetta Stone, The Blue Stone Logo, Livemocha, Lexia Learning, Lexia and Fit Brains. These trademarks are the subject of either registrations or pending applications in the U.S., as well as numerous countries worldwide where we do business. We have been issued trademark registrations for our yellow color from the U.S. Patent and Trademark Office. We intend to continue to strategically register, both domestically and internationally, trademarks we use today and those we develop in the future. We believe that the distinctive marks that we use in connection with our solutions are important in building our brand image and distinguishing our offerings from those of our competitors. These marks are among our most valuable assets.

In addition to our distinctive marks, we own numerous registered and unregistered copyrights, and trade dress rights, to our products and packaging. We intend to continue to strategically register copyrights in our various products. We also place significant value on our trade dress, which is the overall image and appearance of our products, as we believe that our trade dress helps to distinguish our products in the marketplace from our competitors.

Since 2006, we have held a perpetual, irrevocable and worldwide license from the University of Colorado allowing us to use speech recognition technology for language-learning solutions. Since 2014, we have also held a commercial license from the Florida State University Research Foundation allowing us to use certain computer software and technology in our literacy offerings. These types of arrangements are often subject to royalty or license fees.

We diligently protect our intellectual property through the use of patents, trademarks and copyrights and through enforcement efforts in litigation. We routinely monitor for potential infringement in the countries where we do business. In addition, our employees, contractors and other parties with access to our confidential information are required to sign agreements that prohibit the unauthorized disclosure of our proprietary rights, information and technology.

Employees

As of December 31, 2015, we had 1,148 total employees, consisting of 855 full-time and 293 part-time employees. We have employees in France, Spain and Italy who are represented by a collective bargaining agreement. We believe that we have good relations with our employees. In the first quarter of 2015, we implemented a program to reduce costs as part of an alignment of resources around our Enterprise & Education segment, including the reduction of non-Enterprise & Education headcount by approximately 15%. On March 14, 2016, we announced that we intend to exit our direct sales presence in almost all of our non-U.S. and non-northern European geographies related to the distribution of our Enterprise & Education language offerings. If our intentions are realized, these actions will reduce headcount by approximately 17% of our full-time workforce. For more information about these employee reductions,

see Notes 13 and 21 of Item 8, Financial Statements and Supplementary Data contained in this Annual Report on Form 10-K.

Financial Information by Segment and Geographic Area

For a discussion of financial information by segment and geographic area, see Note 17 of Item 8, Financial Statements and Supplementary Data contained in this Annual Report on Form 10-K.

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Available Information

This Annual Report on Form 10-K, along with our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"), are available free of charge through our website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission ("SEC"). Our website address is www.rosettastone.com. The SEC maintains a website that contains reports, proxy statements and other information regarding issuers that file electronically with the SEC. These materials may be obtained electronically by accessing the SEC's website at www.sec.gov.

Item 1A. Risk Factors

The following description of risk factors includes any material changes to, and supersedes the description of, risk factors associated with our business previously disclosed in our Quarterly Report on Form 10-Q filed on November 4, 2015 with the SEC for the period ended September 30, 2015. An investment in our common stock involves a substantial risk of loss. Investors should carefully consider these risk factors, together with all of the other information included herewith, before deciding to purchase shares of our common stock. If any of the following risks actually occur, our business, financial condition, or results of operations could be materially adversely affected. In such case, the market price of our common stock could decline and all or part of an investment may be lost.

The risks described below are not the only ones facing us. Our business is also subject to the risks that affect many other companies, such as general economic conditions and geopolitical events. Further, additional risks not currently known to us or that we currently believe are immaterial could have a material adverse effect on our business, financial condition, cash flows and results of operations. In addition to the other information set forth in this annual report on Form 10-K, you should carefully consider the risk factors discussed below and in other documents we file with the SEC that could materially affect our business, financial condition, cash flows or future results.

Our business could be impacted as a result of actions by activist shareholders or others.

We may be subject, from time to time, to legal and business challenges in the operation of our company due to proxy contests, shareholder proposals, media campaigns and other such actions instituted by activist shareholders or others. Responding to such actions could be costly and time-consuming, disrupt our operations, may not align with our business strategies and could divert the attention of our Board of Directors and senior management from the pursuit of current business strategies. Perceived uncertainties as to our future direction as a result of shareholder activism or potential changes to the composition of the Board of Directors may lead to the perception of a change in the direction of the business or other instability that may make it more difficult to attract and retain qualified personnel and business partners, and could have a materially adverse effect on the Company's stock price.

We might not be successful in executing our strategy of focusing on the Enterprise & Education segment and on more passionate language learners in the Consumer segment, and our company reorganization and realignment might not produce the desired results.

We are continuing to undertake a strategic reorganization and realignment of our business to maximize profitable growth in our Enterprise & Education segment by serving the needs of corporate and K-12 language learners, and prioritizing those who wish to speak and read English. In addition, we are now focusing on the needs of more passionate language learners in our Consumer segment, rather than addressing the needs of the mass marketplace. If we do not successfully execute our strategy, our revenue and profitability could decline. Our recent strategy changes include actions to reduce headcount, exit unprofitable geographies, and other cost reductions. These cost reduction efforts could harm our business and results of operations by distracting management and employees, causing difficulty in hiring, motivating, and retaining talented and skilled personnel, and creating uncertainty among our customers and vendors that could lead to delays or unexpected costs. Also, our ability to achieve anticipated cost savings and other benefits from these efforts is subject to many estimates and assumptions, which are subject to significant economic, competitive and other uncertainties, some of which are beyond our control. If these estimates and assumptions are incorrect, or if other unforeseen events occur, our business and financial results could be adversely affected.

Our actual operating results may differ significantly from our guidance.

Historically, our practice has been to release guidance regarding our future performance that represents management's estimates as of the date of release. This guidance, which includes forward-looking statements, is based on projections

prepared by management. These projections are not prepared with a view toward compliance with published guidelines of the American Institute of Certified Public Accountants, and neither our registered public accountants nor any other independent expert or

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outside party confirms or examines the projections and, accordingly, no such person expresses any opinion or any other form of assurance with respect thereto.

Projections are based upon a number of assumptions and estimates that, while presented with numerical specificity, are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and are based upon specific assumptions with respect to future business decisions, some of which will change. We generally state possible outcomes as high and low ranges or a single point estimates, but actual results could differ materially. The principal reason that we release guidance is to provide a basis for management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by any such persons.

Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions in the guidance furnished by us will not materialize or will vary significantly from actual results. Accordingly, our guidance is only an estimate of what management believes is realizable as of the date of release. Actual results may vary from our guidance and the variations may be material. In light of the foregoing, investors are urged not to rely upon, or otherwise consider, our guidance in making an investment decision in respect of our common stock.

Any failure to successfully implement our strategy or the occurrence of any of the events or circumstances set forth in these "Risk Factors" and elsewhere in this annual report on Form 10-K could result in the actual operating results being different from our guidance, and such differences may be adverse and material.

Intense competition in our industry may hinder our ability to attract and retain customers and generate revenue, and may diminish our margins.

The business environment in which we operate is rapidly evolving, highly fragmented and intensely competitive, and we expect competition to persist and intensify. Increased competition could adversely affect operating results by causing lower demand for our products and services, reduced revenue, more product returns, price reductions or concessions, reduced gross margins, and loss of customers.

Many of our current and potential domestic and international competitors have substantially greater financial, technical, sales, marketing and other resources than we do, as well as greater name recognition in some locations, as well as in some cases, lower costs. Some competitors offer more differentiated products (for example, online learning as well as physical classrooms and textbooks) that may allow them to more flexibly meet changing customer preferences. The resources of our competitors also may enable them to respond more rapidly to new or emerging technologies and changes in customer requirements and preferences and to offer lower prices than ours or to offer free language-learning software or online services. We may not be able to compete successfully against current or future competitors.

There are a number of free online language-learning opportunities to learn grammar, pronunciation, vocabulary (including specialties in areas such as medicine and business), reading, and conversation by means of podcasts and MP3s, mobile applications, audio courses and lessons, videos, games, stories, news, digital textbooks, and through other means. We estimate that there are thousands of free mobile applications on language-learning; free products are provided in at least 50 languages by private companies, universities, and government agencies. Low barriers to entry allow start-up companies with lower costs and less pressure for profitability to compete with us. Competitors funded by venture capital, that may be focused more on user acquisition rather than profitability, enable our competitors to offer products at significantly lower prices or for free. As free online translation services improve and become more widely available and used, people may generally become less interested in language-learning. Although we also offer free products such as mobile apps, if we cannot successfully attract users of these free products and convert a sufficient portion of these free users into paying customers, our business could be adversely affected. If free products become more engaging and competitive or gain widespread acceptance by the public, demand for our products could decline or we may have to lower our prices, which could adversely impact our revenue and other results.

Historically a substantial portion of our revenue has been generated from our Consumer business. If we fail to accurately anticipate consumer demand and trends in consumer preferences, our brands, sales and customer relationships may be harmed.

Demand for our consumer focused language-learning, literacy and brain fitness software products and related services is subject to rapidly changing consumer demand and trends in consumer preferences. Therefore, our success depends

upon our ability to:

- identify, anticipate, understand and respond to these trends in a timely manner;
- introduce appealing new products and performance features on a timely basis;
- provide appealing solutions that engage our customers;

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- adapt and offer our products and services using rapidly evolving, widely varying and complex technologies;
- anticipate and meet consumer demand for additional languages, learning levels and new platforms for delivery;
- effectively position and market our products and services;
- identify and secure cost-effective means of marketing our products to reach the appropriate consumers;
- identify cost-effective sales distribution channels and other sales outlets where interested consumers will buy our products;
- anticipate and respond to consumer price sensitivity and pricing changes of competitive products;
- and

• identify and successfully implement ways of building brand loyalty and reputation.

We anticipate having to make investments in new products in the future and we may incur significant expenses without achieving the anticipated benefits of our investment or preserving our brand and reputation. Investments in new products and technology are speculative, the development cycle for products may exceed planned estimates and commercial success depends on many factors, including innovativeness, developer support, and effective distribution and marketing. Customers might not perceive our latest offerings as providing significant new value and may reduce their purchases of our offerings, unfavorably impacting revenue. We might not achieve significant revenue from new product and service investments for a number of years, if at all. We also might not be able to develop new solutions or enhancements in time to capture business opportunities or achieve sustainable acceptance in new or existing places. Furthermore, consumers may defer purchases of our solutions in anticipation of new products or new versions from us or our competitors. A decline in consumer demand for our solutions, or any failure on our part to satisfy such changing consumer preferences, could harm our business and profitability.

If the recognition by schools and other organizations of the value of technology-based education does not continue to grow, our ability to generate revenue from organizations could be impaired.

Our success depends in part upon the continued adoption by organizations and potential customers of technology-based education initiatives. Some academics and educators oppose online education in principle and have expressed concerns regarding the perceived loss of control over the education process that could result from offering courses online. If the acceptance of technology-based education does not continue to grow, our ability to continue to grow our Enterprise & Education business could be impaired.

We depend on discretionary consumer spending in the Consumer segment of our business. Adverse trends in general economic conditions, including retail and online shopping patterns or consumer confidence, as well as other external consumer dynamics may compromise our ability to generate revenue.

The success of our business depends to a significant extent upon discretionary consumer spending, which is subject to a number of factors, including general economic conditions, consumer confidence, employment levels, business conditions, interest rates, availability of credit, inflation, and taxation. Adverse trends in any of these economic indicators may cause consumer spending to decline further, which could hurt our sales and profitability.

Because a significant portion of our Consumer sales are made to or through retailers and distributors, none of which has any obligation to sell our products, the failure or inability of these parties to sell our products effectively could hurt our revenue and profitability.

We rely on retailers and distributors, together with our direct sales force, to sell our products. Our sales to retailers and distributors are concentrated on a key group that is comprised of a mix of websites, such as Amazon.com and the Apple App Store; select retail resellers such as Barnes & Noble, Best Buy, Target, Books-a-Million, Staples, and Sam's Club; and consignment distributors such as Wynit Distribution and Software Packaging Associates. Sales to or through our retailers and distributors accounted for approximately 10% of our revenue for the year ended December 31, 2015, compared to 13% for the year ended December 31, 2014.

We have no control over the amount of products that these retailers and distributors purchase from us or sell on our behalf, we do not have long-term contracts with any of them, and they have no obligation to offer or sell our products or to give us any particular shelf space or product placement within their stores. Thus, there is no guarantee that this source of revenue will continue at the same level as it has in the past or that these retailers and distributors will not promote competitors' products over our products or enter into exclusive relationships with our competitors. Any material adverse change in the principal commercial terms, material decrease in the volume of sales generated by our

larger retailers or distributors or major disruption or termination of a relationship with these retailers and distributors could result in a significant decline in our revenue and profitability. Furthermore, product display locations and promotional activities that retailers undertake can affect the sales of

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our products. The fact that we also sell our products directly could cause retailers or distributors to reduce their efforts to promote our products or stop selling our products altogether.

Many traditional physical retailers are experiencing diminished foot traffic and sales. For our retail business, even though online sales have increased in popularity and are growing in importance, we continue to depend on sales that take place in physical stores and shopping malls. Reduced customer foot traffic in these stores and malls is likely to reduce their sales of our products. In addition, if one or more of these retailers or distributors are unable to meet their obligations with respect to accounts payable to us, we could be forced to write off accounts receivable with such accounts. Any bankruptcy, liquidation, insolvency or other failure of any of these retailers or distributors could result in significant financial loss and cause us to lose revenue in future periods.

Price changes and other concessions could reduce our revenue.

We continue to test and offer changes to the pricing of our products. If we reduce our prices in an effort to increase our sales, this could have an adverse impact on our revenue to the extent that unit sales do not increase in a sufficient amount to compensate for the lower pricing. Reducing our pricing to individual consumers could also cause us to have to lower pricing to our Enterprise & Education customers. Any increase in the taxation of online sales could have the effect of a price increase to consumers and could cause us to have to lower our prices or could cause sales to decline. It is uncertain whether we will need to continue to lower prices to effectively compete and what the other short-term and long-term impacts could be.

We also may provide our retailers and distributors with price protection on existing inventories, which would entitle these retailers and distributors to credit against amounts owed with respect to unsold packaged product under certain conditions. These price protection reserves could be material in future periods.

In the U.S. and Canada, we offer consumers who purchase our packaged software and audio practice products directly from us a 30-day, unconditional, full money-back refund. We also permit some of our retailers and distributors to return packaged products, subject to certain limitations. We establish revenue reserves for packaged product returns based on historical experience, estimated channel inventory levels, the timing of new product introductions and other factors. If packaged product returns exceed our reserve estimates, the excess would offset reported revenue, which could hurt our reported financial results.

Our future growth and profitability will depend in large part upon the effectiveness and efficiency of our marketing. Our future growth and profitability will depend in large part upon the effectiveness and efficiency of our marketing, including our ability to:

- appropriately and efficiently allocate our marketing for multiple products;
- accurately identify, target and reach our audience of potential customers with our marketing messages;
- select the right marketplace, media and specific media vehicle in which to advertise;
- identify the most effective and efficient level of spending in each marketplace, media and specific media vehicle;
- determine the appropriate creative message and media mix for advertising, marketing and promotional expenditures;
- effectively manage marketing costs, including creative and media expenses, in order to maintain acceptable customer acquisition costs;
- differentiate our products as compared to other products;
- create greater awareness of our new products like kids' literacy and brain fitness, and of our brands and learning solutions;
- drive traffic to our e-commerce website, call centers, distribution channels and retail partners; and
- convert customer inquiries into actual orders.

Our planned marketing may not result in increased revenue or generate sufficient levels of product and brand name awareness, and we may not be able to increase our net sales at the same rate as we increase our advertising expenditures.

Some of our radio, television, print, and online advertising has been through the purchase of "remnant" advertising segments. These segments are random time slots and publication dates that have remained unsold and are offered at discounts to advertisers who are willing to be flexible with respect to time slots. There is a limited supply of this type of advertising and the availability of such advertising may decline or the cost of such advertising may increase. In addition, if we increase our

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