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Value Investor CONFIDENTIAL

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FEATURES

INVESTMENTS FEATURED

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Private Equity Approach To Deep Value Investing?

Jim Roumell proves that an intense focus on misunderstood businesses can provide safety and outsized returns over time.

James (Jim) Roumell founded Roumell Asset Management in 1998. Jim and his team take an interesting in-depth private-equity approach to value investing by seeking to deploy capital on a highly opportunistic basis while viewing cash as an important portfolio tool in order to generate strong real rates of return over time.

Since inception, Roumell Asset Management has achieved returns of 8.51% vs S&P returns of 5.20%. It's important to note that these returns were achieved with an average cash position of 24% during that period --- quite impressive.

Currently, Jim is finding value in the small cap marketplace. The three companies featured are all exceptionally well capitalized, where cash represents at least 30-40% of their market cap. All have next generation positive businesses with secular tail winds, which are being masked by what seems to be temporary legacy issues.

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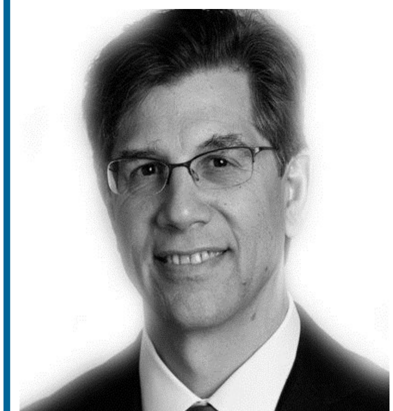
INVESTOR CONFIDENTIAL



Roumell Asset Management
RoumellAsset.com

Philosophy: Focused on finding value though out-of-favor, overlooked or misunderstood securities.

Investor Confidential: Roumell Asset Management

Jim Roumell explains how he focuses on deep value while avoiding businesses in secular decline, how he uses continuous feedback to keep his edge and grow as a person (and investor), how he was influenced by Marty Whitman, and why he sees upside in SeaChange International, Rosetta Stone, and Sizmek, Inc.

I'm really interested to learn about your philosophy and approach to value investing. Before we get to that, perhaps we could touch on some of your history. How did it start?

Jim Roumell: It started for me, in a really meaningful way, when I wrote research in the mid-90s and I got to know Gerry Pinkerton, a wholesaler for Third Avenue Management (Marty Whitman's firm). I became friends with Gerry over time and one day he saw that I analyzed individual ideas, which I would just send out to our clients episodically. He told me, "You should send one of these write-ups to Marty" and I said, "How do I get it to him?" These were the fax days, not the email days. To this day, Marty doesn't really write e-mails. So I wrote up a 3-4 page analysis on one of my favorite ideas, and faxed it to Marty's personal fax number. The very next day I got a call from Marty Whitman. I was in an executive suite and I'll never forget it because in a way it was where it started.

When I picked up the phone he said, "this is Marty Whitman, got your idea, I read it, and it's great. I want to buy a million shares. We'll pay you $0.25 per share." At this point, I was a broker that was tethered to Raymond James Financial. I said to him, "It was an honor to present an idea that you so quickly want to buy." And he said "It's a great idea, but like most great ideas, it's a pretty simple one." That interaction with Marty gave me a tremendous amount of confidence that I could do this for a living. Presenting an idea that he so quickly responded to and "got" was incredible. As a result, we try to keep it simple. What we do well, in a disciplined way, is value things according to their worth today. We want a discount to today's value with less emphasis on tomorrow's presumed value. Of course, we want to own businesses that we believe are rising in value or at least holding their own.

I believe we can be very disciplined about getting a substantial discount to the valuation of a business. If the price goes against me, I always feel comfortable buying securities 30-40% lower of where I initially bought them because I am confident about the initial asset valuation. We are able to have this fortitude because of the amount of due diligence we conduct on the underlying business.

Marty gave me the confidence and also underscored an important concept: *it ought to be really simple*. It shouldn't be very complicated. Basically, you should be able to put down an idea on a sheet of paper. At this point, I fell in love with security analysis and I was reading everything I could get my hands on in the early '90s. Shortly after, I presented some other ideas that Marty bought. And in '98, I formed Roumell Asset Management. By that time, I'd become friends with Marty. And when I started Roumell Asset Management, he was kind enough to lend his name as an 'advisor' to Roumell Asset Management, which gave us cache in the industry.

How has your view of investing evolved (if at all)?

JR: In terms of evolution, I would say this — I think it's probably well known by now that early stage deep value investors can fall in love with

Jim Roumell

On The Importance of Feedback

If you talk with Jim for two minutes, you'll understand that he's a man of high integrity and character. I was further impressed when he told me he had been visiting a therapist for years. He says, "I found it to be an extremely positive, life changing experience. And it's been extremely helpful to my business because going back to the character issue (in terms of money management) — at the end of the day, you're confronting yourself."

"You're confronting your fears, your greed, your impatience, your competitiveness, your fatigue, your desperation, your hopes and dreams — it's a drama. And I think that *Wheaties is not the breakfast of champions, I think feedback is the breakfast of champions.* And the therapy is about feedback about your character. I believe that segues to the investment process very well because people, myself included, have a hard time taking feedback. We have a hard time owning up to the mistakes we make or understanding the pattern of mistakes. One of the hardest things for people to do is to confront themselves. But it's one of the best things a person can do to differentiate themselves."

I, for one, will not be eating Wheaties for breakfast anymore — I'm on a strict feedback diet.

the balance sheet and forget a real crappy business will burn through a balance sheet. In terms of evolution, instead of just buying a strong balance sheet and hoping for something good to happen, *I really stick to strong balance sheets but I want to make sure I have a business that's not in secular decline.*

There can be a distinction here with a company that has a legacy business in secular decline compared to another business component within the same business that has an emerging, next generation business. These next generation business are not always accelerating as quickly as you want. In many cases, there can be some type of legacy business declining, while another type of emerging business is growing. This can be masked by the preoccupation of the legacy business in most cases. But to be clear — what has not changed — we are in search of cheap securities, not great businesses. If I can own a great business, at a great price, terrific. We've done this recently with our largest holding in the last two years being Apple Computers. It's a rare instance where we were able to acquire a great business at a great price. However, normally we are not buying great businesses. We are buying well-capitalized, very cheap securities. That's one of the things I learned from Marty.

Do you have any Daily Rituals that help you reach peak performance?

JR: One daily ritual that I've done for years is one of the first things I do within an hour of waking up — I do 50 push-ups. I typically wake up around 6:30 and I've done that for years. At this point, I try to get some quiet time. I read literature that gives me some inspiration. It could be something from the bible, a favorite author, or doing a little meditation and reflecting. I think it's important to have that quiet time to try to calm my mind. I also enjoy walking my dog for a mile in the morning. I find that I've come to really appreciate it. Once I come into the office, I typically have calls set up. I talk with a lot of industry people. Investment edge comes in one in three flavors: 1) you have *superior information,* 2) your *analyzing the situation in a superior fashion* albeit with the same information that is available to everybody, or 3) you have a *behavioral edge.* With a behavioral edge you don't have an information edge or an analytic edge, but you're willing to act against the herd and you're emotionally constructed to do that. I believe this was underscored with our position in Apple a couple of years ago where we bought our first shares at $76. Then bought it again at $64. We added further to our position at $56. That was just a behavioral edge. We didn't know more than the market. And we certainly didn't "out-analyze" anyone, but we were willing to be against the grain in a company where we didn't think gross margins were going from 38% down to 28% (where Nokia bottomed out).

ON INVESTMENT PHILOSOPHY:

Most often, we are not buying great businesses. We are buying well-capitalized, very cheap securities. And that's one of the things I learned from Marty…. We are in search of cheap securities, not great businesses.

If you think about it, in most of the small-cap and the micro-cap land that we live in, our investment edge is typically going to be informational. We gain an informational edge through knowing industry experts, talking to clients, and talking to competitors. For example, I'm going to a cable internet TV convention in Chicago in a couple of weeks. I'll be able to meet customers of our largest holding, *SeaChange (SEAC),* and get a sense of how they like the company and their new products. It's amazing to me, but I rarely meet people from the buy or sell side at these industry trade shows and conferences. You've got a lot of industry people who can be great sources of contacts for years. Other than research, there's a lot of time setting up calls with industry contacts and trying to get an idea of what's going on behind the curtain.

Ted, my partner, spends a lot of time looking at numbers. He'll dig in on the income and cash flow statements going back the past several years. He's trying to figure out what's happened with a particular business over time from a numbers point of view. Whereas, I try to try to figure out where the puck's going next year. Numbers tell you where this story is coming from, but we're looking at securities that are out-of-favor, overlooked, or misunderstood. In order to answer why it's out-of-favor or why it's overlooked or why it's misunderstood — it really involves developing an informational advantage and talking to industry people who really understand the business.

What's a little known secret about yourself that many people don't know?

JR: I'll give you an answer that you probably haven't heard before — I've been visiting a therapist for years. I found it to be an extremely positive, life changing experience. It's been extremely helpful to my business, because going back to the character issue (in terms of money management) — at the end of the day, you're confronting yourself. You're confronting your fears, your greed, your impatience, your competitiveness, your fatigue, your desperation, your hopes and dreams — it's a drama. I think that *Wheaties is not the breakfast of champions, I think feedback is the breakfast of champions.* And the therapy is about feedback about your character. I believe that segues to the investment process very well because people, myself included, have a hard time taking feedback. We have a hard time owning up to the mistakes we make today and the pattern of mistakes we've made in the past. One of the toughest things for people to do is to confront themselves. But it's one of the best things a person can do to differentiate themselves.

Who are the people that inspire you the most? And why?

JR: I have to say Marty because he taught me this: "Value a business independent of the market and stock volatility." Think about how much noise leaves the room when you only focus on that one sentence. Don't try to figure out what Janet Yellen is going to do next. Don't try to figure out GDP growth next year. It's ok to have a view of it, but you end up with the average of the average opinion.

If Marty were here he would tell you candidly that he doesn't know whether oil's bottomed out or not. These are things that you can't know. Your time spent understanding the underlying business is much more valuable. This is something you can know that's important. For example, we have a new position in a software company that is beginning to outsource. They're a cloud software company but they outsource the professional services portion of the business. I was able to talk to one of our industry contacts. It's a really good relationship and I'm learning about the engagements that they're getting and some of the differentiating aspects of this software, what it can and can't do, and how it competes with other software platforms that they represent — that's valuable, it's specific and it's time well spent. Reading the 10th article about someone's view about oil or whether China's growing this year at 7% or 7.5% — it's interesting, but inherently unknowable. And I think it takes away valuable time from what you should be doing like calling up a competitor, calling up a client, calling up someone in the ecosystem that can tell you something specific and valuable about the company you're investing in.

We have a software consultant that interviews just the Chief Technology Officer of the company. And we get a view of the code. We can get a deep understanding of how strong the code is and how easily it can be knocked off.

ON VALUATION & FOCUS:

Don't try to figure out overall GDP growth. You can have a view of it, but you basically end up with the average of the average opinion...*Value a business independent of the market and stock volatility.*

Marty is clearly my inspiration in terms of buying cheap securities, sticking with strong balance sheets, and valuing the business. The other person I would mention is David Pellegrini. He's been my therapist for many years. I would say he helped to solidify how important it is to live with integrity — that simple!

What is your philosophy and process to investing?

JR: We are looking for a well-capitalized business with a favorable future, which is currently challenged. When we invest in a business, usually there are some challenges that need to be resolved, but we see a favorable future. We don't want to be in a situation — whether it's a piece of debt coming due or a particular event has to happen in a certain period of time — where we don't have time on our side. We also try to steer clear of real declining businesses because if the company doesn't get taken out by a competitor, you have a firecracker that's waiting to go off.

Is screening a part of your idea-generation process?

JR: I've never screened for ideas. I'd say one of my strengths is talking to people and creating relationships. Hopefully I take good care of them and deal with them with integrity. I've been able to build a good ecosystem of contacts and industry people. This allows me to get ideas from them though scuttlebutt. For example, I'll be meeting with one of our industry contacts in a few weeks. He's involved in a big undertaking right now and I will ask him, "who else is participating here?" And sometimes the answer may be it's a crowded space. But again, I'm always afraid of what I don't know. I generally want to be in situations where I have someone who knows the industry and can tell me where the landmines are specifically for this company — maybe it's a contract that might be coming up that might be vulnerable.

Are there aspects to your research process that you would consider unique?

JR: Yes, I think the degree to which I attend conferences, and do scuttlebutt, and source contacts. Essentially, *we take a private equity approach to public securities.* I try to ask myself, "Would I take this business private in a heartbeat?" You can buy securities without meeting anyone at the other side of the table. When we bought Apple, obviously we never met Steve Jobs. But if you were in such a situation where $100-$200 million represented 5% or 10% of your net worth and you are going take a business private — of course you're going to sit down with the people that you're buying the business from. You'll also want to understand the management team that is going to stay and manage the customers, and you'd probably go see what their competitors and clients are saying about them.

It's a little bit old-fashioned. I understand that we're in a world now where we get fewer and fewer investors who leave the office and they're doing everything through the Internet. I think what we do that's unique — we still get out of the office a lot.

Do you have interest or expertise in a particular industry that you would call your "circle of competence"? Or are you more of a generalist in search of value or market inefficiencies?

JR: I definitely consider us generalists. With that said, we've been very successful over the years with "beaten-up" technology companies. We wrote our second or third quarter letter of 2014 that was titled *"Beaten-Up Technology Companies."* We talked about the attributes of this investment thesis — well-capitalized, staying power, and some type of legacy business in decline which is inhibiting the appreciation of a emerging business. That's essentially the idea behind our top investments right now. Typically, there's also a strategic take-out possibility. This is something we look at as well.

We have some good contacts in energy. I've been going to Dallas once or twice a year for many years. I know people in the oil patch that help me out in terms of E&P companies such as, "What are you paying for a rig now?" We've obviously been much more active in our contact with them given the drop in security prices in the Oil & Gas industry. We only have total energy exposure of 12% right now, and most of it is in distressed debt — typically trading at fifty cents on the dollar that we think is money good.

How do you determine your buy and sell decisions?

JR: We want something that we really understand. One of the real factors before buying something is we ask a question: "If this drops on us 20-25% — is there any hesitancy to buy?" And the answer has to be no. For example, we bought IBM at 10x earnings, around $138 per share. IBM could easily drop to 8x earnings, which would be $125 per share. We're well aware that you could have 20% multiple reduction. And of course it could get cheaper than that, but realistically, I think it could go to 8x where it would likely bottom out. We're pretty confident that we'll buy after a 20% drop. We won't buy before that — it has to drop at least a 20% from our initial purchase before we would start adding to our position.

ON BUY & SELL DECISIONS

One of the real factors before buying something is we ask a question: "If this drops on us 20-25% — is there any hesitancy to buy?" ***And the answer has to be no.***

We make this decision to buy because we basically see it as a timing issue. With IBM it's about the timeframe of when the legacy business bottoms and the software cloud services business ascends. You're basically in the valley, both price and operations. If you understand that concept, then you're never buying at the bottom of the valley. You're just living in the valley during an accumulation period. We're not trying to pick the bottom in the stock price. That's the reason we come up with these thresholds as to when we would add to a position. In order to meet that criterion, you have to basically answer, "What's our downside?" The times where we have really screwed up we haven't been appreciative of focusing on our downside. As a result, we stay away from leverage generally. In a number of instances they worked out. However, there are also situations that haven't worked out for us and they are often balance sheet related.

I don't want to hold fully valued securities. This is one departure I have from Marty. Marty was a very low turnover investor. He'd always say, "Why sell? Now you have to go find another idea." I'm built a little bit different. My philosophy is, why hold something that you wouldn't actively seek to buy with new money? Why buy something that's $.95 on the dollar. In a market like today, where things are just going up (for liquidity or other reasons), it can be difficult to maintain your discipline. Someone once asked, "How did you make all your money?" And the person replied, "I sold early." If you sell early, there are times when you feel stupid, but over time it's worked very well. What's interesting about our return figures, which isn't reflected in the numbers — we've had an average cash holding for 16 years of 24% with our 8.51% return.

We typically enter a position at a discount of 30-50% of our intrinsic value calculation. And this depends on the riskiness of the situation.

How do you think about managing risk?

JR: We think about company-specific risks. We really don't think much about market risk. Let me be clear though — we do pay attention to overall market valuation. As you know from reading The Intelligent Investor, so did Benjamin Graham. It's interesting that people often associate Graham with just company specific analysis. Clearly that was the bulk of his thinking, but he took the temperature of the overall market too. Why wouldn't you? So on a Market-Cap/GDP basis, we're at about 130% which is the highest we've seen since the tech bubble bursting in 2000. To be clear, that only tells you the general market dynamics. I am as excited as ever about buying a little software company right now that's trading at $2 per share. And I'm not at all dissuaded from buying it because the Market-Cap/GDP ratio is above 130%.

For example, in a market like this, the market can come in quickly. Even a company like IBM can drop to $125 before you can blink your eyes. We are okay with this because we will average down and our average cost will be reduced. Right now we are set up to take advantage of high conviction ideas because of our cash position.

Over the years we've done a lot of self-assessment and I give a lot of credit to my partner, Ted Crawford, who came from Columbia Business School. Before he came here, he worked for a Tiger Cub, learned under Julian Robertson and was an analyst and partner at Maple Leaf Partners. He's been on board for almost 4 years. One of the things he really forced us to do is look at every single equity purchase we've made in the past 16 years and look at patterns. And I thought to myself, "Do we really have to?" It took us probably a year. We even had some interns come in to crunch some numbers. *Remember the importance of feedback being the breakfast of champions.* We divided the data points into "high conviction" ideas and our "standard" ideas. We measured a high conviction idea, as one where the initial amount allocated to that idea is 5% or more.

One of the things Ted discovered was our high conviction ideas had a hit rate of 85% versus an overall hit rate of 66%, and the annualized returns of those high conviction ideas were 25% versus 19% (hit rate meaning the investment made money — it could be 1% or more). Next, we looked at the whole portfolio and just annualized the returns of each trade (about 225).

We thought where we short-changed our clients in some middle years is we didn't leverage our high conviction ideas in the way we should have. Because we're so labor-intensive, we really have to leverage our ideas. We can only do that much work on so many names. That's a long way of saying we have 4 positions that are 8-10% each in our fund today. We have one of the statistically cheapest portfolios we've ever had. And it's very focused.

ON A FOCUSED PORTFOLIO

...because we're so labor-intensive, we really have to leverage our ideas because we can only do that much work on so many names. That's a long way of saying we have 4 positions that are 8-10% and we like that.

Can you describe your broader investment thesis on SeaChange (SEAC)?

JR: This is our biggest position. We own about 6% of the company and it's about 10% of our fund. SeaChange is the market leader in back-office software enabling cable companies to deliver high margin VOD content; roughly 50% North American market share and 60% European market share. Their legacy product declines appear to be bottoming out and are only 10% of product revenue now. We see the potential for built-in organic growth resulting from over 50 next-generation software design wins. This represents 80 million subscribers over the past three years including the world's largest cable company, Liberty Global. The revenues from these design wins are in process of converting from lower margin professional service revenue to higher margin recurring software revenue and have a long (ten year estimated) life-cycle given high switching costs. There's also potential with over-the-top (OTT) software opportunities with the flexibility of its software underscored by its recent first pure OTT design win from the British Broadcasting Corp. (BBC). In addition, it's exceptionally well-capitalized (cash represents roughly 50% of market cap, no debt) and it's estimated at cash-flow break-even. The new CEO, Jay Samit, provides vision, energy and a long list of media/tech accomplishments. Also, we wouldn't be surprised to see this company as a potential buyout target.

With SEAC at more than 50% off its highs in 2013. How are you looking at valuation at current levels?

JR: EV/ Revenue is currently 0.85x with a price/ book value of 1.30. Just to put this in perspective, Cisco Systems acquired NDS, a SEAC competitor, in 2012 for 5x revenue. In '13, SEAC displaced NDS at Liberty Global, Europe's largest cable operator. The company is free cash flow (FCF) break even, has $95 million in cash, and has no debt.

What are the opportunities for a strategic buy-out of SEAC?

JR: We believe SEAC is a unique property that will remain of interest to any one of the following companies looking to build its software presence: Cisco (CSCO), Arris (ARRS), TIVO (TIVO), and Rovi (ROVI). In late 2013 rumors that TIVO and Rovi were bidding for the company sent shares to $15. In late 2011, driven by Starboard, SEAC was marketed and we believe an ARRS offer for roughly $9.50/share was turned down. At the time, Adrenaline/Nucleus had under 5 customers. Subsequently, SEAC won a patent infringement case initiated by ARRS in

October, 2012 which was affirmed on appeal in October, 2013. Cisco acquired NDS in March, 2012 for $5 billion, roughly 5x revenue. Cisco acquired single-point solution provider BNI Video (estimated revenue of $10 million) in late 2011 for $99 million.

Why is the company trading at such low levels? Is there a divergence between perception and reality?

JR: We believe investors are fixated on the preoccupation with declining sales of legacy products and concerns over long sales cycle on next generation products. Our viewpoint is that their next generation cable products are best in class and will be coveted by strategic acquirers. The lengthened sales cycle will ultimately turn out to be noise because the sales, once achieved, are very sticky.

Isn't Cable a dying business?

JR: Cable companies are clearly in a battle but they need bullets to fight and SEAC has some bullets. SEAC's Adrenaline/Nucleus platform allows for multi-screen viewing (content from any device) and drives down cable company cap-ex as it completely dumbs down the cable box. With the Adrenaline/Nucleus package households only need one box that can receive future cable operating upgrades without the need for a new box. The box manufacturers are in trouble, and are therefore potentially strategic buyers of SeaChange. Moreover, small and mid-sized cable companies can use the Adrenaline/Nucleus cloud product. Cable is not going away and VOD is still a major revenue stream. According to Ron Sanders, president of home entertainment for Time Warner Inc.'s Warner Brothers, "The VOD market is so big and important…It's critical that we get it growing again," WSJ, January 7, 2015. Mr. Sanders noted that simpler user interfaces and more options to rent and watch movies on portable devices are among the changes that could lift VOD.

What are the biggest risks you see in your investment in SeaChange?

JR: Cable industry is under going significant change and viewing habits are shifting. It's hard to know how it all shakes out at the end of the day. SNL Kagan noted 2013 was the first year of cable subscription decline, albeit very modest. OTT is beginning to take off with recent announcements from HBO, ESPN and CBS to provide a pure OTT option underscoring the speed of change in the industry. This also presents an opportunity for SeaChange, which can leverage its cable leadership history with Adrenaline/Nucleus software while positioning itself to capitalize on secular growth trends in OTT. SEAC must reduce the customization factor of its software offerings and strengthen its off-the-shelf attributes to drive down professional service revenue and increase margins. The company has indicated a strong commitment to maintaining a cash balance above $50 million. Nonetheless, poor acquisitions could destroy value.

INVESTMENT SPOTLIGHT

SeaChange International		**Price**	**$6.71**
(NAS:SEAC)		52-Week Range	**$5.30—$9.73**
Description: Engaged in the delivery of multi-screen television.		Dividend Yield	N/A
		Market Cap	223.44M
Basic Valuation:		**Largest Owners:**	**% Owned**
P/FCF:	N/A	Oak Ridge Investment	9.02%
P/TBV:	1.80	Royce & Associates	8.49%
Trailing P/E:	N/A	Pinnacle Associates	6.92%

SEAC PRICE HISTORY

INVESTMENT SUMMARY

Jim says EV/ Revenue is currently 0.85x with a price/ book value of 1.30. Just to put this in perspective, Cisco Systems acquired NDS, a SEAC competitor, in 2012 for 5x revenue. In '13, SEAC displaced NDS at Liberty Global, Europe's largest cable operator. The company is free cash flow (FCF) positive, has $95 million in cash, and has no debt.

Sources: Company reports (10Ks, 10Qs), other public information

Tell us about your position in Rosetta Stone. Can you describe your broader investment thesis?

JR: We believe Rosetta Stone has a differentiated language learning product for serious language learners. Rosetta's value proposition is for serious language learners. And many of the serious language learners are found on the enterprise and education level, not on the individual consumer side (for the most part). There is a serious consumer language learner, but I'm not that concerned about the individual consumer level. We have a very good contact (Remember our ecosystem and having an informational edge). One of our contacts indicates that corporations like Microsoft or Cisco want their global work forces to understand English and they want their people who are going to Egypt, for a 3-year assignment, to be able to speak Egyptian. This person tells us that the serious language learning group (corporations and schools) values the service and support that Rosetta provides.

The competition they're typically up against is simply a consumer website where the company's just basically trying to give access to language learning but it's not supported by a service support team. For example, if Cisco buys 200 licenses from Rosetta, they get Friday tutorials online, with up to 4 in the classroom talking with a live person in Italian, French, or Chinese. The individuals in the courses will get a call after 2 weeks. If they're taking one module over the week and they didn't do much of it last week, they'll get a call, "Hey. How are you doing? You didn't complete module 3. Can we help you out?" So schools and corporations understand that those supportive services are very instrumental in actually creating real language learning. That's the investment thesis — they have something of real value to the serious language learner. Usually, the serious language learner is to be found in the corporate, government or K-12 World. This is $115 Million of EE Revenue (Enterprise and Education). Rosetta's been sold to 20,000 K-12 Schools in North America.

That business is growing. We think they're differentiated and we think that the overall value proposition of that business is being masked by the consumer business. Like most online consumer products, they're under attack from apps. It's the same thing with Weight Watchers, right? It's a very similar situation because people can now get a free app, and track their calories. It's destroying Weight Watchers value proposition. Coincidentally, Weight Watchers is doing something similar in that they are now going to corporations, and they're saying, "Look, a tremendous amount of losing weight and what has been the secret sauce of Weight Watchers is the community sense of showing up to a meeting with the whole supportive process. Where the free apps go on the consumer side for Weight Watchers, who knows? But they're going after major corporations saying, "Hey. We can come in. We can get your people healthier and get their weight in line." That's a nascent business, and it's growing.

INVESTMENT SPOTLIGHT

Rosetta Stone Inc.
(NYSE:RST)
Description: Offers interactive courses and support in 30 languages across a range of formats.

Basic Valuation:

P/B:	3.00
P/OCF:	28.30
P/S:	0.70

Price	**$8.38**
52-Week Range	$7.16—$11.97
Dividend Yield	N/A
Market Cap	$180.59M

Largest Owners:	**% Owned**
Ariel Investments	17.55%
Osmium Partners	8.35%
Nierenberg Investments	7.01%

RST PRICE HISTORY

INVESTMENT SUMMARY

Jim believes Rosetta Stone has a differentiated language learning product for serious language learners. He thinks the value of the business today is not accurately reflected by the market. He believes the company is worth well more than the $50-55 million in adjusted enterprise value — much too cheap for a company of its caliber. In addition, the company has no debt which gives the turnaround time to play out.

Sources: Company reports (10Ks, 10Qs), other public information

Interesting, so with shares trading around $8.36 per share, how are you looking at the valuation?

Here's the difference between Weight Watchers and Rosetta Stone — Weight Watchers carries $2 billion worth of debt, Rosetta carries zero. So we have time in our favor. Our average cost in Rosetta Stone is $9 per share. We started buying it at $10, and we bought it all the way down to $7.50. If you take 20 million shares at $8, it's trading at a $160 million market cap and they have $60-65 million in cash. So we have a $100 million enterprise value. We think they'll sell Fit Brains, which they bought a couple of years ago for $12 million. They've grown this platform, but It just doesn't fit into the E&E focus right now, so we think they'll get back their $10-12 million (maybe more). So now you're down to a $85 million Enterprise Value for the business. If you look at that $85 million, you can monetize an acquisition they've made 2 years ago called Lexia. Lexia is a reading software for K-12. When they bought Lexia for $20 million 2 years ago, it had $15 million of revenue. They've grown it to $25 million in annualized revenue. The idea here was basically leveraging the railroad tracks into K-12 schools in North America where Rosetta provides a cost effective alternative. When a school needs to cut back costs, what's one of the first departments to get cut? It's usually language. Now, what's the first way to save money? Each school normally has a French teacher, German teacher, and/or Spanish teacher. Now you can consolidate the language program and have one teacher that overseas all of the kids using Rosetta Stone. And given that Rosetta is already in the school system, they bought Lexia to say, "Look, we're already making the sales call. We're already here." A lot of these school systems need reading software and they're right there already. They've essentially leveraged the railroad tracks in growing that business from $15 to $25 million in revenue. We think that that business today is easily worth $30 million. Steve Swad, the former CEO of Rosetta, thinks it could get $50 million from that business today. We think $30 million seems reasonable.

So now you're down to $55 million for Rosetta's language learning platform and brand. And it's a brand that is recognized by 8 out of 10 Americans because they've spent over half a billion dollars in the past 6 years in sales and marketing. We believe, similar to Weight Watchers, that the kind of casual language learner now no longer needs Rosetta Stone. And that's okay. We think that's what the market is preoccupied with right now, but we don't give that $200 million in revenue any value.

ON FEEDBACK

Wheaties is not the breakfast of champions — I think feedback is the breakfast of champions.

Here's the transition they're going through: it's a well capitalized turnaround with time and a differentiated product. We don't see their business in decline in terms of transmitting learning to serious language learners. What they're doing now, and what sent the stock down recently was in the 4th quarter numbers. They really dropped pricing on the consumer side. Meaning, what was going for $200, was being offered at $160. There were corporate clients that said, "Look, why should we be paying $220 a license, when you're offering it here for $160?" As you can imagine, this hurt the 4th quarter corporate side and now they've announced they're going to stop the price buying of the consumer business because it's negatively affecting corporate. And corporate is not as price-conscious as an individual customer user. So the idea of dropping your price to drive volume in the consumer side was the wrong strategy long-term.

They need to protect the brand, and protect the value they have on the E&E side. They needed to let the consumer business fall to where it naturally falls given a price point that values the product. And the consumer business will fall to whatever that native serious language learner user is in the consumer side. And this is okay, but they need to protect the E&E side. If you look at the E&E side of the business — it has over a 75% renewal rate. In fact, the government side has over 90%. And they've been in DOD for years.

How does management play a role in your investment in Rosetta?

Ted and I sat down with the Chairman of the Board a week ago. And prior to that, we thought it was time for Steve to go. We think he's a wonderful and honest person. We believe he did some very good things, such as overseeing the company's exit from the airport kiosk business, the acquisitions of *Lexia*, and *Tell Me More*. Tell Me More is high-end language course. Traditionally, Rosetta had beginner and intermediate language learning programs. And they were a little lacking in really high-end and they bought Tell Me More, which helped fill that out 2 years ago. Steve made the acquisition. Our contact tells us it literally helped close business. For example, certain companies and municipalities have workers that must get certified every year in order to move up in ranks. They have to show language proficiency every year so these are used regularly. Rosetta needed a stronger language product to go above intermediate, so Steve made some great acquisitions. Now John Hass is running the business.

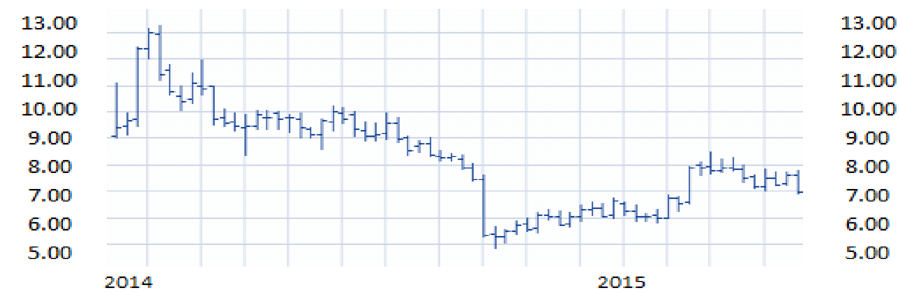
He was brought in several months ago by Osmium partners, the 10% holder of the company. We did some background checks on him and found some really, really good feedback. He was a Goldman banker for many years and he has operational experience. He really has a reputation for working very collaboratively. We think he is going to make the changes needed. They've already announced cutting back on spending on the consumer side, which shows us price discipline and we think they'll sell *Fit Brains*. We also believe they'll undergo a strategic review to know what the business could be sold for today versus what they can reasonably grow the business given the changes they want to make. We encourage them to look because knowing what one in the hand is worth today, to compare it to what two in the bush are tomorrow, is important to know. We don't know what the right answer is, but we do know (and they completely agree) you need to have the numbers in order to answer the question. Essentially, we're very excited about John being the interim CEO. The chairman is great. When he became chairman two years ago, he bought about half a million dollars of stock at $15 (which is 2x the current price). He's a terrific guy, absolutely committed to doing the right thing.

What we have now is a solid and differentiated product on the E&E side. We have a situation where top-line growth is being masked because of what's happening on the consumer side. But we think it's correctible, it's well capitalized, and we've got time. We have multiple shots on goal in this situation. There's potential to sell the business, but truthfully I'm most excited about just pricing the business right, and growing E&E because I think the demand for language learning is growing as the world gets flatter.

INVESTMENT SPOTLIGHT

Sizmek		**Price**	**$6.96**
(NAS:SZMK)		52-Week Range	$4.85—$10.20
Description: Engaged in providing online ad campaign management and distribution platform.		Dividend Yield	N/A
		Market Cap	217.73M
Basic Valuation:		**Largest Owners:**	**% Owned**
P/OCF:	15.78	Roumell Asset	5.79%
P/B:	0.90	Dimensional Fund	4.43%
P/TBV:	1.40	BlackRock Fund	4.34%

SZMK PRICE HISTORY



INVESTMENT SUMMARY

Jim sees a similar situation here compared to Rosetta. It's a $210 million market cap company with $100 million in cash. Giving us an enterprise value of about $110 million or 60% of revenue. They have $25 million in EBITDA. This is an uncommon ad-tech company that actually has EBITDA, so it trades at less than 5x EV/EBITDA. And Jim can point to at least two transactions going off at 3x revenue and 10x EBITDA. When you look at some other transactions; BrightRoll was bought in the last 6 months by Yahoo at 5x, and Conversant at 10x EBITDA and 3 times revenue.

Sources: Company reports (10Ks, 10Qs), other public information

Tell us about your investment thesis in Sizmek (SZMK)?

This is a similar concept to Rosetta. What we have here is a $210 million market cap company, $100 million in cash. Essentially, *we have an enterprise value of about $110 million (or 60% of revenue) with $25 million of EBITDA. This is an uncommon ad-tech company that actually has EBITDA and it trades at less than 5x EV/EBITDA.* I can point to two transactions; *BrightRoll* was bought in the last 6 months by *Yahoo* at 5x, and *Conversant* at 10x EBITDA and 3 times revenue. We originally owned *DG Generation*. DG Generation owned online ad distribution and is a TV ad distribution business. It had 75% of that market by digitally sending ads to TV stations and radio companies. They sold that business about a year and a half ago, to Extreme Reach for $525 million, paid off debt and sent us $3 a share as a special dividend. So they completely deleveraged the balance sheet and paid us $3. This left us with the spun-off Sizmek and we stuck with it because we now have a pure online ad distribution business that we think is differentiated. Since that time we've gotten to know Neil Nguyen, the CEO, very well over the past 3 years. Neil spoke at our conference last year. And the founder of Sizmek, Scott Ginsberg (who really founded DG Generation) spoke in our conference 3 years ago. After the company sold DG Generation, it effectively went up to $16 per share because we've already had $3 distribution. We sold a third of our stock. As it came back down, we were big buyers at $5 in the fall. So we have an average cost at $7.25 in the fund.

Give us a breakdown of the legacy business versus that of the hidden next generation business?

JR: First, let's go over what Sizmek actually does. Sizmek manages ad campaigns for agencies. They typically partner with agencies to distribute ad campaigns and they get paid per click. But, like many of these businesses, they are converting to a sales model where you'll pay a one-stop shop fee and get all sorts of different services. This business has about $185 million in revenue. And right now they're the only independent ad distributor that isn't connected to either Facebook or Google. Google's ad distribution is DoubleClick and they dominate this space.

Sizmek is considered the #2, but a very distant #2. They did one and a half impressions last year. DoubleClick probably did 10 times that number. However, that's okay because when I talked with Publicis and its other clients, they tell me there's an opportunity to not use Google. There's enough of a market for people who don't want to be controlled by Google because they feel it's like the fox guarding the hen house. Essentially, Google's distributing your ads, but they also own property. Obviously they want to send you to their properties because they can increase the hit rate on those properties which increases the price of that real estate. Sizmek's differentiation is that it's completely independent and it's end-to-end. It delivers the ad, provides analytics, and measurability. We've interviewed Sizmek executives a number of times. So we check in with them once or twice a year, sometimes three. We're very on top of where the platform is, its strength, and how much code is in it. We've spoken to customers and we've spoken to a company that would love to buy Sizmek. I'm not very concerned about the business. I feel very confident that if the company wanted to sell itself tomorrow, it would get at least 8-10 times EBITDA — it's trading at less than 5x right now.

Now, what's legacy and what's next generation? The stock went down in the 3rd quarter last year in October from a preannouncement. They announced revenues at 7% below what the street was expecting. So it was $38 million for the quarter, the Street was expecting $41 million. It was still 3% year over year growth, but the stock went down 35%. It was just about a net-net at this time. One of the legacy businesses that was a big part of Sizmek was advertising that's called *Rich Media*. *Rich Media* is an interactive banner ad. Basically, you have banner ads, video, mobile, and *Rich* in broad categories. And *Rich* is basically when you go to a site and something starts going across your screen or confetti starts falling — that's *Rich Media*. They were the dominant distributor of Rich Media, and they had over 50% of that market. The problem is it's an ad tool that has been in decline and has been declining year over year at around 35%. What's interesting now is it's now down to 25% of Sizmek's business. What has happened in the last two quarters, (stock moved from $5 to $8) is their non-Rich Media business has grown 25% year over year. What wasn't even appreciated last October, was now the focus of the Street. If you remember, the market was fixated on top line issues. The top line was only going to be up 3% year over year but again, it was 7% off from expectation. We've known that *Rich* was declining — but video and mobile was dramatically increasing, as well as a lot of their analytics. One of the big areas of focus in the digital ad space that people are concerned with is, are your clicks authentic? You want verification and measurability. We've gotten to know the CEO very well. We believe he has a lot of integrity. We've known him for about 4 years now and he's always been straight. We're very comfortable with him. He knows what he's doing, he has a clear technology vision for the company, and he's positioning himself in a differentiated way.

ON SIZMEK

I feel very confident that if the company wanted to sell itself tomorrow, it would get at least 8-10 times EV/EBITDA — it's trading at less than 5x right now.

It's only been a publicly traded online ad company for 1 year, so I think it's covered by one or two people. If you look at many of its peers like *Rocket Fuel* — these companies have no margins. Rocket Fuel is down 70% over the last several months, which is growing like a weed. Neil tells me year after year, "We could grow a lot more. We just won't make any money." And he's continued to have EBITDA. He manages for margin. The Street saw media decline and responded by selling those stocks across the board without an appreciation for their next generation products and capabilities. As *Rich* gets smaller and smaller, now you start to see what this company looks like. As the non-Rich continues to grow at the levels it's growing, it overtakes that argument. VIC

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