

INVESTMENT LETTER
ROSETTA STONE, INC. (NYSE: RST)

August 24, 2009

It was one of those bright, brutally hot mornings in late July in Tulsa when the sun is bearing down on you and all you can think of is getting into a building with air-conditioning. In Tulsa if a business wishes to keep its doors open (a confusing metaphor I admit when discussing the imperative nature of air-conditioning in Oklahoma) it must often turn its air conditioning on as early as March, and sometimes, even turn the a/c on as early as February.

I was driving toward my favorite Mexican restaurant in Tulsa, [El Rio Verde](#) at 38 North Trenton Avenue. I parked, walked a few steps toward the restaurant, opened the door, and greeted the owner and the staff, all of whom I know. “¿Cómo estás?” I began and we exchanged hellos. I wanted to continue the conversation and to talk about the heat, but my Spanish is primitive, and that evaluation may be kind. So, a few minutes later, consuming a pork, lettuce and tomato burrito, I reminded myself to do something about my Spanish speaking ability. With the press of business, however, I forgot about my self-promise and my Spanish remained primitive or euphemistically, basic.

Then, about three weeks later, on a Saturday morning in August, I was at [Borders](#), at 2740 East 21st Street, wandering around the store, entranced with the possibilities of learning provided by the wondrous selection of books, yet confused by the wide range of offerings. So I decided to take a break to seek some rest from the powerful, entrancing stimuli produced by the alluring graphics. It was as if I could not handle all the excitement and that I needed a quiet place to regain my composure. So I headed to the café in the store. After I had purchased an overpriced but delicious cup of chai latte I found the magazine rack, picked up a copy of [The Economist](#), walked to the cash register to pay for the magazine and then settled into one of the comfortable couches in the café.

I was in one of my pseudo-intellectual moods and as I read [The Economist](#), I glanced around every few minutes to be sure that everyone in the café knew that I comprehended everything I was reading. I was making soft yes sounds every few minutes as I turned the pages. I was turning the pages fast, not paying much attention to either the articles or the advertisements until I came to the advertisement shown below.



Perhaps the young farmer, I imagined, had developed an interest in the Italian supermodel after he had read a press release from her agents indicating that she would be making a brief stop in the city nearest to his town. The young farmer had followed the career of the Italian supermodel, always wanting to meet her. Now that he knew she would be visiting a nearby city, he wondered how he could meet her, and how he could impress her. He was excited but as a disciplined young man, he knew that in real life, first impressions are what count and he did not want, with an incomplete or incorrect knowledge of Italian, to disappoint the beautiful Italian supermodel. He had only a few weeks to bring his Italian up to snuff, and he had heard that the Dynamic Immersion courses in foreign language learning offered by **Rosetta Stone**¹ would do the job.

As I took another sip of the delicious beverage, I recalled that I had heard a lot about **Rosetta Stone**, remembering that the company had gone public in April of 2009 with the offering prospectus boasting that the company's mission was to change the method that people used to learn languages. The company proclaimed that its approach to learning languages was revolutionary, and disruptive.

What was this method, I asked myself? I made a note to go online on Monday and find the company's initial public offering prospectus. This is what I found:

Our teaching method, which we call Dynamic Immersion, is designed to leverage the innate, natural language learning ability that children use to learn their native language. Our courses are based on our proprietary technologies and pedagogical content, and utilize a sophisticated sequencing of images, text and sounds to teach a new language without translation or grammar explanation. (*Rosetta Stone, Inc. initial public offering prospectus, April 15, 2009, page one*)

Sometimes you need an extra dose of caffeine to get through an initial public offering prospectus and **Rosetta Stone's** was no exception. To get through the legalese and the pretentious language can be quite a challenge, just as getting through one of my letters can be quite an undertaking.

The company's income statement showed that it spent a good portion of its revenue every year on research and development and I assumed that a good deal of this money went to the creation and refinement of 'proprietary technologies'. So it was important for me to know what 'proprietary technologies' meant.

¹ **Rosetta Stone** is proprietary language-learning software produced by Rosetta Stone, Ltd. Its title and its logo are an allusion to the Rosetta Stone, an artifact inscribed in multiple languages that helped Jean-François Champollion to decipher Egyptian hieroglyphics by comparing the inscriptions of the Coptic language, a version of spoken ancient Egyptian, and Greek, alongside the hieroglyphs.

The Rosetta Stone software utilizes a combination of images, text, and sound, with difficulty levels increasing as the student progresses, in order to teach various vocabulary terms and grammatical functions intuitively, without drills or translation. They call this the "Dynamic Immersion method". The goal is to teach languages the way first languages are learned. (*Wikipedia, 2009*)

To read the full Investment Letter, please email us at contact@ferimc.com or call (918) 743-5959. You could also fill out your contact information at <http://www.ferimc.com/contact.html>, we will contact you as soon as possible.