**THIRD QUARTER 2012 INVESTOR WEBCAST**

**November 7, 2012**

Prepared Remarks

**Steve Somers, Investor Relations**: Good afternoon and let me welcome you to Rosetta Stone's third quarter 2012 earnings call. I am Steve Somers, Vice President of Investor Relations and I am joined today by Steve Swad, Rosetta Stone's President and CEO, and Tom Pierno, CFO, to discuss the operations and financial results for the third quarter and our outlook.

In addition to our commentary, we have made our 3Q12 Earnings Results press release, supplemental financial information, and a slide deck supporting this webcast available on our IR website at investors.rosettastone.com. Please review them to find important additional information.

[Safe Harbor]

There are or will be forward-looking statements in our press release, slides and conversation today. We offer these statements under the Safe Harbor provided by U.S. law. Of course, risks and uncertainties attach to any forward-looking statement. A detailed discussion of such risks and uncertainties is contained in our Form 10-K for the fiscal year ended December 31, 2011 filed with the SEC in March 2012, which is available in the Investor Relations section of our website. We ask that you review those risk factors before making any investment decision. Please note these forward-looking statements reflect our opinions only as of the date of this presentation and we undertake no obligation to provide or publicly release the results of any revision to the forward-looking statements in light of new information or future events.

We also use non-GAAP numbers in our presentation. The definitions of those numbers, and their reconciliation to GAAP numbers, are available in today's press release on our website and as filed with the SEC today on Form 8-K.

Now here's Steve.

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**Steve Swad, Chief Executive Officer:**

Thanks Steve and welcome everyone.

[Third Quarter Overview]

We had a good third quarter with bookings up 9% year-over-year with double-digit growth in our consumer business and single-digit growth in our institutional business. We did a better job managing our expenses and we also made progress shifting the business online, growing Online Learners to 57,000, up 115% since the beginning of the year and up 167% versus this time last year. In addition, our Institutional business is over 80% online. We also operated more efficiently and lowered expenses, including reducing our kiosk expenses and lowering our international media spend which allowed us to deliver Adjusted EBITDA of $1.8 million, more than double the $1.8 million loss a year ago. This is now the fourth consecutive quarter of positive Adjusted EBITDA contribution and we showed margin of 2.8%, near the high-end of the 1-3% guidance that I outlined for the year. Year to date, our Adjusted EBITDA is up $17.8 million from last year's loss through the first 9 months.

In the quarter, we made good progress on our technology platform which will allow us to begin to introduce new language learning products in the near future. And our cash balance continues to increase, giving us the flexibility to explore acquisitions that will help strengthen our position and accelerate our strategy.

So overall, we believe the business is getting stronger and we are better positioned for the future; we are managing expenses more tightly and we are making important investments that should help us return to improved growth rates. My expectation is that this progress will continue with growth coming from leveraging our powerful brand, expanding our distribution and innovating our platform. I will take you through some of our efforts in each of these areas and then Tom will dive deeper into the financial results.

Just as I was pleased with the financial performance in the quarter, I am also pleased by the progress and momentum that helped drive results this quarter and the efforts that will drive future results.

In terms of going to market, in the US, we continued to put resources behind our DTC channel, which helped drive North American consumer bookings growth to nearly 20% year-over-year. During the quarter, we ran a very successful back-to-school promotion and also leveraged new sales avenues through Facebook and Groupon. Not only were these campaigns successful sales drivers, but represent new distribution channels that are allowing us to reach more consumers. This point is especially clear when considering that over 70% of claims from our Facebook campaign came from mobile devices. In addition, our new "Live Life Fluently" creative, which we launched in late June, appears to be well-received, the positive impact of which we started to see in 3Q. This combined with our promotional campaigns also boosted results in the retail channel, where sell-through, or sales to end-consumers, was up strong double digits year-over-year.

On the product front, let me highlight that during the quarter we released a refresh of our flagship TOTALe product. This refresh touches all three of our strategic priorities and is an important example of how we are improving engagement and increasing our relevance. It improves the social aspects of our product with more pronounced chat functionality, upgraded gaming and an enhanced ability to connect with other learners for gaming or practice. Since this refresh we have seen a doubling of activities in the social portions of our product. Not only do we think this will lead to a better customer experience, but that it creates a more state-of-art perception of the brand, improves engagement of our community and makes it easier for us to leverage the viral nature of social media for distribution.

On the cost side of things, we saw the benefits of our reduced kiosk and retail footprint again this quarter, while also benefiting from lower box costs and improved efficiency in coaching. The combination of the growth in booked sales combined with our more streamlined operations helped lower sales & marketing to 52% of bookings, down 8 points from last year and down 4 points from last quarter.

Our Institutional business also had a good quarter growing bookings by 4% which reflected the continued strength in our Corporate and International verticals as we signed several new and renewal contracts in the quarter. This business has demonstrated slow, but steady improvements with bookings growth improving through the year increasing from 2% in 1Q to over 4% in 3Q. Not yet great growth, but heading in the right direction.

As it relates to our strategic priorities, let me comment on the specific progress we made in each of the three areas of Brand, Platform and Distribution.

With respect to Leveraging the Brand, we continue to refine our online strategy and are poised to roll-out different Tiers or product bundles in our Consumer business. I expect these tiered offerings will better promote our new online products and give our customers greater choice to select the product that best suits their learning style and their budget. This will likely include a range of options that goes from course-only to a full suite that includes course and private studio sessions. With these offerings we will expand our product offering along a wider span of prices.

These offerings should help us further grow our base of 57k Online Learners even more so since most of this count only represents the test offerings that we have conducted over the past year or so and has not been supported with meaningful marketing spend. As we go into 4Q and 2013 and begin to put our marketing muscle behind the online offerings, we think there exists significant opportunity to further penetrate the market and speak to those customers that prefer an on-line duration-based service.

In addition to our online efforts, we are leveraging the brand through new ads that target the US Hispanic market and consumers in Asia. In Japan, we launched ReFLEX, which can expand our brand. I've mentioned in the past that we are developing a kids-specific product and we are targeting a first half 2013 launch, which we think will address untapped demand and introduce kids to our brand at an earlier age as well as reaching their parents in a new way.

With respect to Innovating the Platform, we have launched functionality so that our product works on the Nook and are working on one for the Kindle Fire. We are also testing functionality on our website that gives customers the option to purchase our product directly as a digital download. In addition, we also released new cloud-based functionality in TOTALe that recommends next steps in our program based on how a learner is progressing, such as recommending a new lesson, a class with one of our coaches, or a game to practice your skills. Currently, this is driven by some basic artificial intelligence, but, early next year, we expect to launch a more sophisticated version of this AI so that the delivery of content is customized to the learners' needs. This customized learning approach will enable advanced learners to quickly move through or skip certain content pages or slow down and repeat content for learners having trouble. We believe this capability will particularly help in both the Consumer and K-12 channels.

On the Distribution front, we made some progress, but are working on additional initiatives. In the quarter, we carried out a successful Groupon offering and expanded sales via Facebook as I mentioned earlier, while also increasing our mobile engagement. We signed a few small deals with some airlines and credit card companies, and think there are many more avenues for us to increase our presence. In

Korea, we are testing Proctor Home Learning, which is where tutors host classes for kids and will be using Rosetta Stone as the primary curriculum.

So, from my perspective, we are executing on all three of our strategic priorities. We are taking actions that leverage the brand. By that I mean, taking actions that will help grow the company into the brand, like developing new products, as well as looking to acquire products that we can sell with our brand and through our worldwide distribution channels. We are investing in our platform to enable key capabilities, such as artificial intelligence, to power the smart delivery of content, to enable mobility so our products travel with you on tablets and smart phones, and to develop community, so you practice and communicate socially with others while you learn. And lastly, we are growing distribution globally by moving into new channels and working with new partners to increase our presence.

Before turning it over to Tom, let me say that I am pleased that we settled our trademark infringement lawsuit against Google last week. Google has agreed to meaningfully collaborate with us to combat online ads for counterfeit goods and prevent the misuse and abuse of our trademarks on the Internet. I believe that this settlement is a significant victory for consumer protection, and it goes a long way toward advancing our goal to strengthen the Rosetta Stone brand and trademarks around the world.

Now let me turn the call over to Tom, who will review our financials in detail.

**Tom Pierno, CFO:**

[Review of results]

Thanks Steve and good afternoon to everyone joining us as well. Overall, I was pleased with the financial performance of the company in the third quarter and our progress in general through the first nine months of the year. Despite having some hurdles to overcome in terms of fewer points of kiosk presence and the non-renewal of military contracts in the prior year, total revenues in the quarter grew slightly to $64.3MM. Adjusted EBITDA increased $3.6MM from last year, going from negative $1.8 million to a positive $1.8MM, evidence that the cost-cutting and efficiency efforts that we implemented are starting to take hold, building on the momentum that started in the second quarter.

Even though consolidated revenues were basically flat year-over-year, there is evidence that the business has some momentum and is getting stronger as bookings in the quarter were up 9% and $7.8MM higher than reported revenues. This reflects both the higher amount of contracts booked in our institutional business as well as the increased bookings from paid subscribers, or what we call Online Learners, in the consumer business. Overall, consumer revenues were up 2%, but the nearly $3MM comp hurdle from kiosk closures to the top line masks the growth in our DTC business. Our US Consumer business increased 5% versus last year on the strength of our DTC channel which increased 18%, even though we operated 60 fewer kiosks, on average, compared to a year ago, which contributed to over $2MM to last year's top line. If we adjust for this reduction in our kiosk footprint, we would have shown double-digit revenue growth for the quarter.

In our International Consumer business, results were still down 8% in the quarter, but the rate of decrease has slowed to below double-digits for the first time in the last 12 months. The biggest reason for the year-over-year decline was due to our switch to an online-only model in Germany earlier this year. Despite this, we are encouraged by the growing acceptance and momentum for this product in Germany. In Asia, our top line results were actually up year-over-year nearly 20% as we saw a sharp pick-up in our home shopping channel, which along with modest gains in our DTC channel, lifted results. While we still have more work to do, International Consumer showed signs of improvement.

On the Institutional side, revenues were down 6% to $14.5MM but was still impacted by the $1.3MM drag related to the absence of the military contracts. Excluding those contracts, which dropped in July of last year, growth would have been positive 2%. I think it is useful to note here that our Institutional business is over 80% online subscription and service revenues, which gets reflected in our deferred revenue balance.

Before commenting further on the financials for the quarter, I'd like to call your attention to some new and revised metrics that we are disclosing for the first time today on our supplemental financial table. As we mentioned on our second quarter call, in recent quarters, our reported average revenue per unit or ARPU and unit counts have reflected the increasing amount of monthly online subscribers in our unit count as more of our business has, and is, shifting online and the lower monthly ARPU associated with them. Starting with this quarter we are expanding our disclosure to provide two sets of volume and pricing metrics for our Consumer segment. The first set will be Product Units, which are box units and downloadable products, and their corresponding ARPU and the second set is ending paid Online Learners and what their monthly ARPU is for the quarter. In effect, the Product Unit metric relates to a one-time sale while the Online Learner metric reflects a service sale. We think that as Rosetta Stone transitions to a more digital business model, this will become an increasingly important way to track and assess the business.

This disaggregation has the effect of removing the impact of lower ARPU and higher units attributable to Online Learners from our historical reported consumer unit count. Please note that we have provided this new and revised information back to the first quarter of 2010.

With that said, let me discuss some of these metrics for the quarter, which you can also see in graphical form in our accompanying slide presentation. Product Units increased 9% this quarter to 146k units compared with 134k units a year ago, while Product Unit ARPU was down 9% to $313 from $346 a year ago, and down slightly from $319 in the second quarter. While revenue from Product Units was flat with last year, we saw strong growth in Online Learners. We ended the quarter with over 57k Online Learners, which was up over 115% from the 26k that we started the year at and 167% at this time last year. The growth in Online Learners has been driven by several factors. The first is the broad transition that we are carrying out to move to a more digital model. That has resulted in us introducing online-only products, like ReFLEX in Korea, and TOTALe in Germany which are incrementally adding Online Learners. The biggest driver, however, has been the ongoing test offerings of online services in the US, as well as customers who have paid to extend or renew the online service that is included as part of a TOTALe box product bundle. Monthly Online Learner ARPU was $24 in the third quarter, down from $39 a year ago and $27 in the second quarter. The reason for the decrease in ARPU is due entirely to the increasing number of 12-month subscriptions which have been tested in the $20-$30/month range over the past year. I think it is important to note here as well, that unlike a telco or media company, our service is a fixed-duration one, and our early experience is that most Online Learners purchase and use the service and then depart at the end of their term. Because of this dynamic, we do not think that it is appropriate at this time to think of this base in terms of churn. With that said, given the high proportion of 12-month contracts in our base, an Online Learner has a lifetime revenue value of roughly $300, which approximates that of our Product Unit ARPU. Because we primarily collect payment up front and recognize revenues from Online Subscribers over the term of their contract, the growth of Online Learners is partially reflected in increases to the cash and deferred revenue balances on our balance sheet.

Moving on, gross profit increased $200k to $53.1MM and gross margin increased to 83% from 82%. Not only was this an improvement versus last year, but was an increase from 81% in the second quarter. The margin gains were driven by lower hard-product and coaching costs as we benefited from the shift to online as well as scale and efficiencies in our coaching operations, where per session costs were down 25% year-over-year; this despite having delivered over 60% more sessions this quarter. We believe there may be additional gross margin enhancement opportunities related to coaching as we go to market with our tiered product offerings.

Similar to last quarter, and consistent with our initiative to more effectively manage our sales and marketing spend, we were able to lower sales and marketing expenses 7% to $37.1MM versus a year ago. This figure was 57.7% of revenues, a 430 basis point improvement versus 3Q11 and flat with last quarter, reflecting efficiencies achieved despite a more competitive advertising market given the Olympics and the start of the political election season in the U.S. R&D expenses for the quarter were up 4% to $5.2MM vs. $5.0MM, but up less than 1% year-to-date compared with the first nine months of last year. G&A expenses were $14.5MM, up 2.5% versus last year, but include approximately $1MM of costs related to our lawsuit against Google. Excluding these costs, run-rate G&A is down year-over-year. I'd like to point out that fourth quarter results will include additional legal costs related to the Google litigation incurred prior to the recent settlement of the case.

Adjusted EBITDA for the quarter came in at $1.8MM up 200% compared with negative $1.8MM a year ago. This reflects a margin of 2.8% and a 563 basis point improvement from last year. Through the first nine months of the year, we have delivered $4.7MM of Adjusted EBITDA with our seasonally biggest quarter still to come. To put this progress into perspective, this is a $17.8MM positive swing at this point in the year compared to last year, and reflects the measured and balanced approach that we are taking to turn the business around and set us on a course to achieve our long-term financial targets.

Our reported net loss this quarter was negative $33.4MM or negative $1.58 per share, which includes the impact of a $25.6MM non-cash charge to establish a valuation allowance against our deferred tax assets, the vast majority of which was in the US. Excluding the impact of this non-cash valuation allowance as well as the legal costs related to the Google lawsuit, adjusted net loss would have been $1.7MM with a adjusted net loss per share of $0.08. U.S. GAAP requires companies to assess quarterly whether a valuation allowance is required by evaluating certain criteria, including whether the company had a cumulative three-year historical pre-tax GAAP loss. We had disclosed in prior filings that Rosetta Stone might cross into this position before the end of 2012 and in fact we did in the third quarter primarily because high positive income quarters in 2009 have dropped out of the calculation, weighting it more towards the high negative income periods in late 2010 through early 2011. As a result, we were required to establish this valuation allowance. This does not diminish our ability to utilize these deferred tax assets in future periods by demonstrating a trend of positive earnings and they expire in no less than 20 years. I want to emphasize that this does not reflect a change in the Company's view of its near or long-term financial outlook, as the valuation allowance is significantly the result of past performance. In fact, we are increasing our Adjusted EBITDA guidance for 2012, reflecting the company’s improved performance, which I will discuss shortly.

[Balance Sheet and Cash Flow Review]

Turning to our financial position, the company’s improved operating performance helped boost total cash, cash equivalents and short-term investments by $5.7MM to

$126.1MM up from $120.4MM at the end of the second quarter and up from $111.3MM a year ago. This represents almost $6.00 of cash per share and is the highest cash level ever reported by the company. Taken together with the fact that we have no debt, the balance sheet remains very healthy. Deferred revenue in the quarter increased sequentially by $7.8MM to $57.8MM from the previous quarter, reflecting the underlying sales strength in our Institutional business as well as the growing number of Consumer Online Learners. I think it is also important to point out here that while we have generated Adjusted EBITDA of almost $5MM for the first nine months of the year, we have also created additional value that currently resides on the balance sheet in our deferred revenue balance, which is up $6MM year to date, bringing the effective 9 month contribution to $11MM.

Capex in the quarter was $0.9 million and we generated $4.5 million of free cash flow compared with negative $4.5 million in 3Q of last year. For the first nine months of the year, free cash flow was $8.6 million versus negative $11.9 million for the comparable period last year, largely reflecting the improved operating results.

[Guidance]

When we first announced guidance for the full year 2012 in May, we set a range for Adjusted EBITDA of $5-8 million. After the second quarter, we increased the bottom end to $6MM for a range of $6 to $8MM. We believe the improvements in the business over the last couple of quarters and the relative outperformance gives us confidence to further lift the range by $2MM for a new Adjusted EBITDA range of $8 to $10MM. Consistent with prior commentary, this guidance range does not include any of the legal expenses related to our lawsuit against Google, which we add back for guidance purposes. With the greater emphasis on growing our digital-based business, we are planning to take some actions in the fourth quarter to accelerate our online consumer business. We think this is the right thing to do for the company and will improve our future outlook, but could have the effect of boosting bookings and growing our deferred revenue and cash balances, but moderating revenue growth in the short term. As a result, even as we are raising our expectations for Adjusted EBITDA, we are more likely to come in more towards the low end of our $270-285MM revenue guidance range. For the year, we also continue to expect adjusted net loss to be between $4 and $6 million with an adjusted loss per share of $0.20 to $0.30 excluding the impact of the valuation allowance and legal costs related to our lawsuit against Google.

With that, operator, we are ready to take questions.