LETTER TO STOCKHOLDERS

Dear Fellow Rackspace Investor,

One of my colleagues loves to fly-fish for tarpon in the shallow waters around the Florida Keys. On a good day, he sees maybe a dozen of these torpedo-sized fish and manages to hook one or two. But on his latest trip, something extraordinary happened. He and his guide staked out their skiff on a sandy flat, and as they gazed toward the horizon, they saw what looked like a dark, undulating river moving toward them. It was a huge school of tarpon, numbering in the thousands and stretching for more than a mile. As the fish passed his boat, my colleague was able to hook one after another, limited only by how well he could execute accurate casts.

I tell you this story because I think it illustrates our situation at Rackspace®. We've worked hard to position ourselves alongside a swelling river of business demand for hosted cloud computing. We believe the world is in the early phases of a long-term shift in the way businesses do their computing and that demand will double and redouble in the coming years. This type of major market shift is a crucible, where some companies emerge as winners generating extraordinary returns for years to come, and others see their businesses severely disrupted.

In this letter, I'd like to discuss how we at Rackspace see the transformation that is sweeping our industry and our plans to build a company that is great enough and big enough to capitalize on this shift. I'll also share with you what we've accomplished in the past year and our plans for the year ahead.

What's the nature of this revolution in computing? To put it simply, the market is moving away from a do-it-yourself world where businesses spend billions a year on IT *inputs* (servers, software, IT specialists) and manage them in their own data centers or server closets. The market is moving toward a world where companies buy high-quality IT *outcomes* from companies like Rackspace.

Today we serve more than 172,000 customers in 120 countries. These customers didn't have to make big, up-front investments in servers or software, nor did they need to hire IT experts to run their web presence. Instead, they simply phoned Rackspace or visited our website and provisioned IT resources with a click of their mouse. What used to take them weeks or months is now accomplished in minutes, allowing them to realize a cost savings for computing that is faster and more agile than what they were running in-house. When customers purchase in this manner they are literally tapping into Rackspace data centers and infrastructure — our cloud. With this access, customers can provision the equivalent of a supercomputer from their smart phone. Buying computing and storage as a service over the Internet is at the heart of our industry — cloud hosting. This is a new and exciting world for IT that has the promise to improve all of our lives.

Ours is a crowded and competitive industry, and our opportunity at Rackspace is to carve out a differentiated position so we end up one of the winners. Rackspace is a disruptor in the shift to cloud computing. You see, our competitors want to continue to grow fat by selling traditional IT hardware or proprietary cloud technologies that lock customers into a platform and make it difficult for customers to migrate. We believe that customers want the freedom to choose the provider, price, and service level that best fits their needs. In that world, providers have to compete on technology outcomes instead of technology lock-in.

A. Lanham Napier
Chief Executive Officer
Rackspace Hosting

At Rackspace, we're focused on building the ***service leader*** in cloud computing. That leadership is created not by trapping customers, but by serving them so well that we generate a loyalty advantage in the marketplace. Our business economics are based on customer loyalty, and to boost that loyalty, we are constantly investing in our employees, known as "Rackers," and in our technology.

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Have we outperformed our competitors in the market up to this point? We believe we have. Our customers are loyal and they refer their friends to us. Our reputation for **Fanatical Support®** is our calling card. Businesses keep doing more business with us because we've earned their trust. They know they're going to have a great experience with us. We're an ally who increases the service levels in their IT department — and we can save them money along the way.

How have we won this loyalty? Our strategy is pretty simple. If we take good care of our Rackers they will take care of our customers, and the loyalty and engagement of both customers and Rackers will make our stockholders happy in the long run.

We're working to build a big company. But we believe we must start by building a great one. We figure that if we invest in building a great workplace, hiring great talent, and providing Rackers and customers with great technology, big will be a natural byproduct.

Let's talk about how we define greatness, because it ties directly into our loyalty focus. We define greatness based on our Net Promoter® Scores, which measure how customers and Rackers feel about our company. Our business starts with Rackers. These passionate people are our secret sauce. They create the new cloud technologies for our open-source cloud platform, and they serve up Fanatical Support to customers. Most incumbent technology companies aren't passionate about customer outcomes. These incumbents compete based on technologies that hold their customers captive. As the market shifts to cloud computing and open standards, we can differentiate by competing on the IT outcomes that we deliver and not by trying to lock in customers. This is why our commitment to Fanatical Support and OpenStack™ has been received so warmly by the marketplace.

Fanatical Support has two components: people and technology. It starts with our culture and the talented Rackers who drive our company. We're proud of being included in some of the most prestigious lists of best companies to work for in the U.S. and the U.K., because a supportive culture enables Rackers to do great work. Culture eats strategy for lunch — and culture is impossible to copy. Our culture is a competitive advantage for us. It makes it easier for us to recruit amid today's fierce competition for technology talent, and keeps engagement and retention levels high among our Rackers. In a loyalty-driven economic model, loyalty starts in the employee base.

The second component of Fanatical Support is technology. It includes the internal tools we've built to help Rackers serve customers, as well as the technologies that we're adding through OpenStack, for open-source computing and storage at web scale. These technologies are driving innovation for our customers and the overall marketplace. We will continue to make investments in our technology capability so our platform delivers Fanatical Support. These technologies are a competitive advantage for us. You can't buy these tools off the shelf. You have to have the expertise and knowledge to design, build and operate them.

The more we invest for the long term to drive customer loyalty, the more we may negatively impact our short-term results. Yet we will continue to make those investments, and believe they will pay off over time.

Last year, I outlined our financial goals for 2011, which included faster growth, maintaining our margin profile, and investing in areas that would enhance our position as the service leader in cloud computing. We were successful in all three areas and closed out 2011 with the strongest quarter we had posted since the Great Recession. We accelerated our revenue growth for the second year in a row, while improving margins and return on capital.

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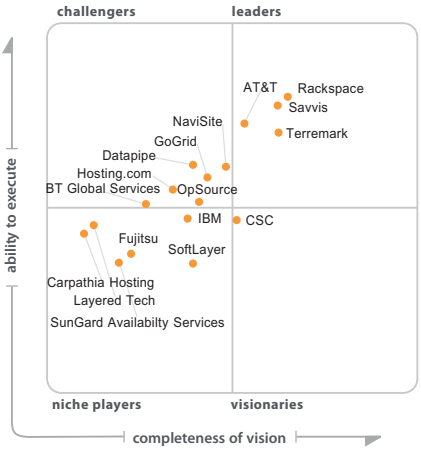
Let me share a bit more detail on our 2011 investments and outcomes:

HIGHLIGHTS

- **REVENUE** growth accelerated to 31%, up from 24% in 2010, and 18% in 2009. We surpassed $1 billion in revenue for the first time in our history.
- **MARGINS** based on adjusted EBITDA rose to 33.9%, up from 33.6% last year.
- **RETURN ON CAPITAL** grew to 14.7%, up from 11.6% in 2010, even as we continued to make strategic investments in data centers, new products and new technologies to support our vision.
- **SERVERS** under management grew by 20.9% to 79,805.
- Our **CUSTOMER COUNT** rose to 172,510, from 130,291 at the end of 2010.
- Our **PRODUCT PORTFOLIO**, already among the industry's most comprehensive, expanded to include Rackspace Cloud Private Edition for enterprise, the Rackspace Cloud Builders OpenStack deployment services, and enhancements to our popular RackConnect™ offering, which seamlessly links a customer's dedicated and public cloud resources.
- Over the past year, global commercial backers of **OPENSTACK** have tripled to 149, including AT&T and Hewlett Packard. OpenStack also held two successful Design Summits with participants from six continents, and released two new software upgrades.
- **LARGE ENTERPRISES** signed on with Rackspace in record numbers. We now deliver our services to more than 60% of the global giants in the Fortune 100. New enterprise customers include Accenture, Ebay/X.commerce, PayPal, Red Bull, Sony, and Steve Madden.
- **EMAIL ACCOUNTS** grew by 29% to more than 2.7 million, bolstering our position as one of the world's largest hosts of paid business email accounts.
- Our **INDUSTRY LEADERSHIP** was reaffirmed as Rackspace was positioned in the leaders quadrant for Gartner, Inc.'s *Magic Quadrant for Managed Hosting.*[1]
- **FORTUNE MAGAZINE** named Rackspace one of America's 100 Best Companies to Work For — the fourth time we've won that honor in the past five years. In the United Kingdom, Rackspace was recognized for the seventh straight year as one of the Financial Times Great Places to Work, which also earned Rackspace entry into the Best Workplaces Hall of Fame.
- We opened a new office in **SAN FRANCISCO** to bolster our software-development capabilities — a key area where we need to improve in 2012.
- Although we rank far below the biggest companies in San Antonio, our Rackers punched above their weight in **COMMUNITY INVOLVEMENT**. In 2011 we fielded the city's largest corporate team of Big Brothers and Big Sisters, and led the largest Thanksgiving food drive that San Antonio has ever seen, delivering more than 1,000 dinners to families in need.

We had a good year in 2011. But every day, I see Rackers striving to lift us from good to great.

Gartner, Inc.'s Magic Quadrant for Managed Hosting[2]



As of March 2012

[1] Gartner, Inc., Magic Quadrant for Managed Hosting, Lydia Leong, Ted Chamberlain, March 2012

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[2] This graphic was published by Gartner, Inc. as part of a larger research document and should be evaluated in the context of the entire document. The Gartner document is available upon request from Rackspace Hosting.

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That's what inspires me as I look toward 2012.

THE YEAR AHEAD — CHANGE, CHALLENGES AND EXECUTION

The year 2012 will be exceptionally important for Rackspace. We plan to invest in our portfolio of products and our service levels, while making capital-efficiency improvements to our business model. We will invest more time in recruiting and screening of new Rackers to ensure that we add not only the talent and leadership that we need, but also the right human beings — ones with servants' hearts, who are driven to deliver on our promise of Fanatical Support to customers.

The coming year will demand greater execution on complex and critical tasks. The migration of our Cloud Servers™ business to OpenStack remained in beta at the end of 2011 and serves as an example of the type of work we need to accomplish better and faster. Developing open technologies at web scale is one of our three strategic goals, along with delivering Fanatical Support, and providing a seamless portfolio of cloud hosting services across dedicated hardware and public cloud resources.

OpenStack technology will underpin many of the new cloud products we plan to introduce this year, such as Cloud Block Storage and Cloud Databases. In addition, OpenStack will serve as the infrastructure underpinning many of the new service levels we plan to introduce on top of our public cloud platform.

We must also deliver an online experience for customers that rivals the one they get when they receive Fanatical Support in person or over the phone. This is a formidable challenge that involves integrating control panels across our portfolio and giving customers more insight into, and control of, their cloud computing resources. As the world shifts to cloud computing, we need to bolster our systems, products, and service capabilities to help our customers make this transition. The product development work we are doing is all about delivering Fanatical Support across a portfolio of cloud services that enable large, high-performance workloads.

We believe that successful execution of this plan in 2012 will further our position as the service leader in cloud computing, and enable us to take advantage of a once-in-a-lifetime shift in the way that the world buys its computing. I also believe that Rackspace is in the initial stages of this journey.

I'm a history buff, and I enjoy looking back to other moments when inventors and entrepreneurs changed the world with new technologies like the electric grid, the telephone, and the personal computer. These moments changed the quality of life for millions, across generations. And that's what the shift to cloud computing will do. Imagine what it will mean for the efficiency and growth of the U.S. economy when it can do more and better computing at lower prices. Just as the iPhone spawned a whole new industry of app developers, so will cloud computing make possible businesses that cannot be imagined today.

We Rackers are excited to be among the leaders of this revolution — and we hope you feel the same way as a stockholder in Rackspace. We are positioning ourselves beside one of the deepest and most productive currents in the history of business. So if you see a sign on my chair that says "Gone Fishing," understand that means I'm hard at work.

Sincerely,

A. Lanham Napier
Chief Executive Officer
Rackspace Hosting