

# FINAL TRANSCRIPT

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## **RAX - Rackspace Hosting, Inc. at Pacific Crest Securities Technology Leadership Forum**

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## CORPORATE PARTICIPANTS

### **John Engates**

*Rackspace Hosting, Inc. - CTO*

## PRESENTATION

### **John Engates** - *Rackspace Hosting, Inc. - CTO*

(audio in progress) the leader in hosting. I think we're going to take that further and become the specialist in hosted computing. I think there's a lot of confusion to day about what the difference between hosting and cloud and infrastructure as a service is. I think we are the sort of leader in the traditional hosting space but I think that going on a changing a little bit because of cloud computing. We intend to be the leader there as well at some point.

We want to think the difference between us and everybody else is who really want to create a great experience for our customers. We have always been strong on customer service. We call it fanatical support, so when you see fanatical experience, we want people to enjoy the experience of doing business with us.

I think that's a little different than sort of the vending machine approach to cloud computing that I think has so far been out there in the marketplace. And the last thing about us I think, we want to bring a complete suite of services, a hybrid approach to infrastructure as a service to our customers.

A lot of the services that you see out there today are point services that need to be combined with other services and that is hard to do at a distance. We think we can bring them together.

As a Company, traditional business of managed hosting represents about 96 -- last year 96% of our business. This year it is 93%. So that means the cloud is growing. The cloud is 7% and we will talk more about what is in that 7%. But again, that is a very fast growing portion of our business.

First-quarter revenue this year, \$145 million. I have to tell you, I'm not the finance guy. I'm the CTO, so I'm a little not as good on the numbers but if you have any specific numbers maybe I can answer them.

So on demand computing, what does that mean? I think there's a shift going on, a change in the way that people consume IT. Traditionally it has been either outsource it to one of the big guys or do it all yourself.

I think companies are waking up to a third alternative which is buying computing as a service. The market demand is growing. I think because of that paradigm shift, because of the economy, because of a lot of factors, people are starting to really take a look at it.

Cloud computing is the buzzword of the day and there are a lot of people that are attaching their name to it. But we think we are very significant player in the cloud computing space. I'll show you a little bit more about that in a minute.

And again, that full suite of services. Cloud all by itself is very difficult for companies to consume. It's not an all or nothing kind of proposition with cloud. You have to take it slow and you have to find applications that work in the cloud and I think the idea of having dedicated physical infrastructure, private cloud, public cloud, software as a service, all of those combined really make a difference.

So, this is sort of the diagram that sort of explains what I talked about where companies are starting to see new wave. Traditionally everything has been either internal or done with an outsourcer. That includes all of the strategic and core stuff and all the non-core stuff -- the managing servers, managing data centers, all of that aspect of IT.



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I think what is changing is that people are starting to see a way to keep control of the upper layers of the stack and offload some of the underlying layers. One of the big complaints that people have about outsourced IT is they feel like they lose control.

They don't have -- they've really sort of handed over the keys to everything to someone else and that feels helpless, they feel helpless when they're in that position. With on-demand computing, they have [route] access.

They have people that they can turn to on their own staff who can actually diagnose problems and troubleshoot and it allows them to go faster. I think a lot of the big complaints that people have is it's hard to do anything quickly when you have to wait six weeks for infrastructure to be delivered.

So this on-demand computing paradigm, it is in many ways a better paradigm than what we have seen before. It's easier because of the automation that cloud computing provides, because of the productization, the ability for us to deliver something off of a menu rather than true custom one-off IT. It's easier and faster. It's plug and play. It's on-demand.

Many of our services are exposed through an application programming interface, an API. And so customers actually can launch services through their own tools, through their own systems and that makes it a lot easier on them. It's more valuable for companies to be able to do it this way.

Value in the sense of a lot of the technical headaches, a lot of the burden of managing, patching their infrastructure; monitoring their data centers. All of that can be offloaded. It's oftentimes a better fit.

Sometimes we've heard from companies that in the outsourcing model, their one-size-fits-all server doesn't always fit. So with a cloud computing or infrastructure on demand, you can mix and match and you can add services when you need them and change them over time.

The last aspect is the economies. Economies of scale kick in at the scale that Rackspace works at. The size of our data centers, the size of our operations teams, the fact that we can get better utilization on the equipment that we deploy. With cloud computing, we can approach closer to 90% utilization versus the 5 or 10% that most servers sit at most of the time.

It frees up capital for our customers. I think especially in the rough economy that we have had, we've seen a lot of companies start to explore cloud computing and our other hosting services because they don't have to buy the equipment.

The equipment is on Rackspace's books. We buy it, we deploy it, we manage the lifecycle and we dispose of it when it's done and that means that you're really just paying for a service and that service can change and flex over time. That's very critical when you have business cycles that are unpredictable or a future that is sort of a little bit hazy.

Let's see. So the categories of which our services fall under, I've alluded to this. But we have dedicated infrastructure on the far left-hand side there, dedicated servers for your custom applications.

This is our core business. This is this what we have been doing for 10 years. So this is where companies run their big websites, big ERP systems, their support systems, all of their back-office. What's starting to happen now though is people are starting to look for alternatives for things like the blogs and the test (inaudible) websites and the brand sites, the departmental websites that maybe are not quite as mission-critical but still have to have a place to live.

Those are starting to live in the cloud. And the cloud comes in a few different flavors -- infrastructure as a service and platform as a service. We deliver both of those as offerings under our cloud servers and files and sites products.

And then the last category, software as a service, this is the most well-known. We offer e-mail as a service here and we also offer a backup service that backs up your machines into the cloud. So all of this coming together, I think this suite of services that meets the needs of all of the workloads that IT companies have, is really the power of what Rackspace is bringing.



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In terms of our progress and our leadership, we are known as the number one hosting provider on the dedicated and private cloud space. In terms of our leadership in the other categories, we think we are certainly number two in terms of infrastructure as a service.

Probably close -- the number one guy is probably Amazon, but we're a close second. We saw an article that came out the other day. They did a study on how many websites were hosted on the various clouds and we were a close second to Amazon EC2 platform. So if you have heard of that, that's where we play on cloud servers.

And then platform as a service, we think we are number one there as well. Google App Engine really released some stats that they host about 80,000 applications on Google App Engine. We are at 130,000 apps on our cloud sites platform.

And then in terms of e-mail or business e-mail as a service, these are paid e-mail boxes. A lot of the guys that you hear about that are throwing out big numbers, they give away a lot of free e-mail. We don't give away any free services or business-class e-mail and this is exchange as a service or what webmail (inaudible) type service. We're at 1.2 million users and we think we are probably second only to Google if they would announce the numbers. But they really don't.

So we think we are number one in terms of paid e-mail. So with the business model; on-demand hosting, the suite, we think it's going to appeal to a broad audience. We think it's a general-purpose technology that has wide appeal because everybody needs computers. Everybody needs Web servers, everybody needs app servers and databases. So there really is no specific market or vertical.

No specific customer makes up more than 2% of our revenue. We are a company that has a lot of customers across a lot of different product sets. We have customers globally. So we are around the world.

I think that all adds up to a strong business that continues to grow. Fanatical support, I talked a little bit about our focus on customer service. We call it fanatical support. We've been calling it that for 10 years.

It's what we are. It's in our DNA. You sort of can't separate Rackspace from this customer service mindset. The fact that our business is subscription-based means you have to continue to renew those subscriptions and fanatical support is one of the pillars that stands on.

The fact that we are also delivering a world-class technology service means that you have to have really sharp people and you have to have continuity in your offering and your operations. And fanatical support is sort of built on on top of a culture of great customer service and support.

Our cloud business is in hyper growth mode right now. I think it's growing much faster than our traditional businesses primarily because of the ease of sort of subscribing to it. A lot of these services are available via credit card.

You can go sign up with a credit card in a few minutes. You can be up and running on the cloud. You can actually launch a lot of these services via iPhone applications. They are all exposed via API type services. So it's really easy for people to go and grow on that platform.

And then this last bullet talks about our loyalty model. I mentioned that we really have to make our customers happy over time. The fact that we are focused on having a disciplined approach to this, we're not spending money the sort of ways you have heard about the big guys do. We have to make sure that we spend the money where it counts and we think that is in investments in the people, the data centers and the infrastructure.

Fanatical support, we do believe in this. We think it provides us an advantage in terms of reducing churn in our business. We have probably record sort of industry-leading churn numbers in terms of our business.



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We also create a lot of promoters of our business with this model. People like to talk about services that they enjoy using. People love to talk about Apple. People love to talk about a lot of their favorite brands.

Fanatical support drives that level of loyalty and it drives an army of promoters for Rackspace. If you follow Twitter and you follow what's being said, you can see just how our customers love us.

And then all of that rests on having engaged employees. We had to create a culture that could support all of this. We built it by really focusing on the types of people we hire.

The roles that we hire have to be a good fit for the employees. We actually recently won the Fortune Magazine's 100 Best Places to Work in America two years in a row actually and then in the UK as well. We have a big operation in the UK and we certainly focus on it there as well. But all of what we do really rests on top of that customer service experience and that's driven by great people.

The other thing that we do a little differently than most companies is we build a team of people that support our customers versus just a random person in a big call center. A lot of people use the textbook approach to call centers and they have the tier one, tier two, tier three and they try to route you the lowest guy first and then route you up the stack.

We've tried to turn that on its head and build a model where people can talk to the same people on a regular basis, they build a relationship. They feel like they're dealing with a small company even though we're 2600 people. They only know a handful of people and those are the front-line employees.

I thought I had another slide but I guess that was in a different presentation. I think what that leaves us is some time to talk about anything you want to talk about, any questions you have, any thought you have on your business or anything I haven't covered here.

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## QUESTIONS AND ANSWERS

### Unidentified Audience Member

[Inaudible question - microphone inaccessible]

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### John Engates - Rackspace Hosting, Inc. - CTO

Okay, what's the difference? Well so let me go back to the slide that I showed you here that talks a little bit about the different businesses that we are in. If you look at this slide, the dedicated or custom is probably the most closely related to traditional hosting.

Savvis has played there for a long time, Terremark has played there for a long time. This is most closely related to what Amazon is doing with EC2 and S3. So we have both.

That's one thing that's different about us than the traditional hosting companies and it's different about us than Amazon. Neither of those guys have a public cloud and a hosting business with private cloud.

When you hear the term 'private cloud,' private cloud is being pushed by people like EMC and VMWare and Cisco as the alternative for big companies, big enterprise type companies. And usually that means VMWare-based infrastructure.



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So in our dedicated infrastructure, we have something -- I thought I had a slide that actually showed the term private cloud. Here it is. So dedicated and private cloud falls under our sort of core business.

So there we have a product that probably pretty closely resembles what Terremark is trying to do with their VMWare offering, what Savvis is trying to do with theirs. Those guys -- the hosting world has not really invested in building a lot of their own technology.

They've waited for VMWare to come out with their V Cloud or whatever the alternative is. All this stuff in the middle, the Amazon style cloud, we have had to build it ourselves. We have invested a lot of hours in software development, we have our own IP.

We've acquired companies to help us build this. And so that is the big difference between us and a lot of the hosting crowd. It puts us more squarely in a position against the big guys, the Amazons, Microsoft, Microsoft Azure, Google, whatever they are doing; it puts us in sort of that category within our public cloud space but we still have a large foot in the traditional hosting space and that is where we compete with the likes of Savvis and Terremark, IBM, whoever else you can think of. Does that help? Does anybody else have any thoughts?

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#### Unidentified Audience Member

You had some service disruptions (multiple speakers) what caused them and what have you put in place to stop them?

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#### John Engates - Rackspace Hosting, Inc. - CTO

Yes, we did. We did have some service disruptions that were founded -- the problem was found basically at the data center level. This is not -- these are not service issues at the software layer or people issues.

These are just facility failures all concentrated in one data center. We have 10 data centers across the globe. This was in one data center and it was even really one phase of one data center.

So this was in Dallas. We have a big facility in Dallas that unfortunately affected a few high-profile customers.

I remember seeing Justin Timberlake twittering about it. His website was offline. So the high-profile nature is what sort of put that on the front page of some of the tech rags.

But it wasn't really any different than I think a lot of companies have in terms of failures. Everybody has failures from time to time.

We are putting in place some -- we put some new people in place to make sure that we are doing the right things there. We have -- there were some probably problems that could have been prevented if we had done the right things at the facility level. So we fixed those.

We have got -- the people have been changed out. The facility has been sort of gone over with a fine tooth comb. And we are also shifting some of those people that have had failures, they want to potentially be in different facilities.

Some of them have moved to different facilities. We have also recently announced the addition of a data center in Chicago. So a lot of our cloud is going to be moving to Chicago.

One of the things we are doing is sort of spreading the cloud amongst a lot more data centers rather than being concentrated in Dallas. Dallas was sort of our first phase for the development of cloud services and so that's where we started.

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Over time, it's going to spread to all the facilities. So what you really want to do is just make sure you don't have all your eggs in one basket. Everybody that is building clouds is trying to distribute their risk across multiple data centers and that is the beauty of cloud. It is something that can be distributed.

Now for the dedicated hosting customers, the physical servers that you really -- that only exist in one facility, the best you can do is just protect those with the very best technology, look for single points of failure and I think the work we've been doing is going to ferret out any last single points of failure that we have got.

Any other thoughts?

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#### Unidentified Audience Member

I have a question, John. Can you talk a little bit about maybe your customer base and how they transitioned from more of that traditional dedicated hosting into the cloud? And are there ramifications on the business be it operational, financial, anything that we should look for?

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#### John Engates - Rackspace Hosting, Inc. - CTO

That's a great question. I think that what we have seen -- one of the things that prompted us to invest in this public cloud space is the fact that we had customers on our traditional hosting business that were starting to explore Amazon's Web services. They were starting to look for ways that they could reduce the spend on traditional dedicated servers and offload some of that to cloud-based services.

The nice part about cloud is that it's pay as you go. You can use it for when you need it and you can turn it off when you don't. With traditional hosting, that's a lot harder. You have servers that are dedicated to you, they are on a contract.

So these companies are looking for ways to take pieces of their applications, pieces of their platform and move elements of it to the cloud. It's nice when you can have the offerings all in house so they don't have to go to Amazon.

So some companies are starting to reduce spend on one aspect of their infrastructure and move it somewhere else. Now that does mean potentially in the short term a little bit lower revenue for us. Because cloud servers are cheaper than dedicated servers, they're virtualized.

But at the same time, those services are more profitable for us because we get better utilization on those servers. We get to reuse those servers for a lot longer period of time. Nobody knows what specs are underneath a cloud server.

They know all about what's underneath a physical server. So when a physical server is a year old, nobody wants it any more. They want a brand-new one. They want the latest, greatest Intel processor.

So the nice part about cloud is once you get them in there, you don't have to change the infrastructure all that often. And it's actually a much better business for us. So even if the revenue goes down, the profitability actually may go up on that customer.

The other thing we see about cloud is that people tend to buy more cloud servers faster than they did physical servers. Physical servers are something that you have to go to the boss to get approval for. You have to get a PR requisition or a purchase requisition to buy a physical server.

With cloud, sometimes you do it on your credit card on the afternoon shift and you are done with them by the end of the day for your (inaudible) or whatever. And those kinds of things lead to growth that we just -- we probably haven't seen in our lifetime at Rackspace.

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But the mail business grows faster, the cloud business grows faster. But it's on a lower base, a lower base of revenue right now. But over time, we think that will grow. So that's what's happening.

People are starting to take pieces of it, but not everything. We don't think everything is going to move from physical to cloud. Primarily things like big databases, big high security type applications, things that have a heavy amount of I/O on the disc, places where you need a big SAN or things of that sort, those are going to remain in physical hosting or dedicated hosting and people are going to augment that with cloud wherever it makes sense.

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**Unidentified Audience Member**

[Inaudible question - microphone inaccessible]

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**Unidentified Company Representative**

It's not going to be overnight. This is going to be a five-year trend. Cloud is still something that is very new for a lot of companies. The fact that I go -- I went to an event in New York last week and had a panel of CTOs in a roundtable forum and the question was asked how many people are using cloud. Very few of the big guys are really using it in any big way.

So what's going to have to happen is that the technology is going to have to get better over time. It will. It's not for all things yet. It's for sort of -- it's for pockets of applications. So it's just going to take time.

When the cloud gets better, better for I/O, heavy I/O, better for different types of functions, better security, better ways to protect it -- some people are still concerned about they want a physical firewall, a dedicated physical firewall wrapped around all of their servers whether they be cloud or physical. We think we can do that with the fact that they are all in the same data center. We're going to be able to do that kind of thing.

But that is something that today is difficult in a pure cloud model. So for a long time, it's going to be a hybrid approach to this. And I don't know when -- I can't give you a date on when the shift will happen but you can see that it went on this other graph back here, went from 4% cloud last year, 7% cloud this year. I don't know if that is a trend but we do think it's going to grow. Cloud business is growing.

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**Unidentified Company Representative**

I think now is a good time to stop. John, thanks very much for being here and for presenting, thank you everyone in the audience. And I will mention at 10:00 in five minutes, we have a cloud panel. John will be on that along with Savvis and Terremark. So please join us over there. Thanks John.

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**John Engates - Rackspace Hosting, Inc. - CTO**

Thank you everybody.

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